

NETSOL TECHNOLOGIES INC  
Form 10-Q  
November 08, 2011  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 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 September 30, 2011

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-22773

NETSOL TECHNOLOGIES, INC.  
(Exact name of small business issuer as specified in its charter)

NEVADA  
(State or other Jurisdiction of  
Incorporation or Organization)

95-4627685  
(I.R.S. Employer NO.)

23901 Calabasas Road, Suite 2072,  
Calabasas, CA 91302  
Address of principal executive offices)  
(Zip Code)

(818) 222-9195 / (818) 222-9197  
(Issuer's telephone/facsimile numbers,  
including area code)

Indicate by check mark whether the issuer: (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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  Small 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

The issuer had 56,503,855 shares of its \$.001 par value Common Stock and no shares of Series A 7% Cumulative Convertible Preferred Stock issued and outstanding as of November 7, 2011.

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NETSOL TECHNOLOGIES, INC.  
INDEX

| <u>PART I. FINANCIAL INFORMATION</u>   | Page No.  |
|--|-----------|
| <u>Item 1. Financial Statements (Unaudited)</u>  |           |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2011 and as of June 30, 2011</u>                            | <u>2</u>  |
| <u>Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 2011 and 2010</u>            | <u>3</u>  |
| <u>Condensed Comparative Consolidated Statements of Cash Flow for the Three Months Ended September 30, 2011 and 2010</u> | <u>4</u>  |
| <u>Notes to the Condensed Consolidated Financial Statements</u>  | <u>6</u>  |
| <u>Item 2. Management's Discussion and Analysis or Plan of Operation</u>   | <u>23</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>  | <u>37</u> |
| <u>Item 4. Controls and Procedures</u>   | <u>37</u> |
| <br>   |           |
| <u>PART II. OTHER INFORMATION</u>  |           |
| <u>Item 1. Legal Proceedings</u>   | <u>38</u> |
| <u>Item 1A. Risk Factors</u>   | <u>38</u> |
| <u>Item 2. Unregistered Sales of Equity and Use of Proceeds</u>  | <u>39</u> |
| <u>Item 3. Defaults Upon Senior Securities</u>   | <u>39</u> |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>   | <u>39</u> |
| <u>Item 5. Other Information</u>   | <u>39</u> |
| <u>Item 6. Exhibits</u>  | <u>39</u> |

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

| ASSETS  | As of September<br>30,<br>2011 | As of June 30,<br>2011 |
|---|--------------------------------|------------------------|
| Current assets:   |                                |                        |
| Cash and cash equivalents   | \$ 3,123,686                   | \$ 4,172,802           |
| Restricted Cash   | 2,700,000                      | 5,700,000              |
| Accounts receivable, net  | 13,864,226                     | 15,062,503             |
| Revenues in excess of billings  | 7,038,291                      | 7,601,230              |
| Other current assets  | 2,081,864                      | 2,053,904              |
| Total current assets  | 28,808,066                     | 34,590,439             |
| Property and equipment, net   | 16,469,748                     | 16,014,461             |
| Intangibles:  |                                |                        |
| Product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, net   | 26,364,728                     | 25,437,479             |
| Customer lists, net   | 147,067                        | 164,715                |
| Goodwill  | 9,439,285                      | 9,439,285              |
| Total intangibles   | 35,951,080                     | 35,041,480             |
| Total assets  | \$ 81,228,895                  | \$ 85,646,380          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                |                        |
| Current liabilities:  |                                |                        |
| Accounts payable and accrued expenses   | \$ 4,069,230                   | \$ 4,730,027           |
| Current portion of loans and obligations under capitalized leases   | 4,092,747                      | 7,062,535              |
| Other payables - acquisitions   | 103,226                        | 103,226                |
| Unearned revenues   | 2,475,387                      | 2,653,460              |
| Convertible notes payable , current portion   | -                              | 2,745,524              |
| Loans payable, bank   | 2,269,632                      | 2,319,378              |
| Common stock to be issued   | 206,625                        | 400,700                |
| Total current liabilities   | 13,216,848                     | 20,014,850             |
| Obligations under capitalized leases, less current maturities   | 257,711                        | 285,472                |
| Convertible notes payable less current maturities   | 3,587,464                      | -                      |
| Long term loans; less current maturities  | 425,556                        | 434,884                |
| Total liabilities   | 17,487,579                     | 20,735,206             |
| Commitments and contingencies   |                                |                        |
| Stockholders' equity:   |                                |                        |
| Common stock, \$.001 par value; 95,000,000 shares authorized; 56,076,355 & 55,531,855 issued and outstanding as of September 30, 2011 and June 30, 2011 | 56,077                         | 55,532                 |
| Additional paid-in-capital  | 98,844,487                     | 97,886,492             |
| Treasury stock  | (396,008 )                     | (396,008 )             |
| Accumulated deficit   | (35,589,651 )                  | (34,130,944 )          |
| Stock subscription receivable   | (2,031,210 )                   | (2,198,460 )           |
| Other comprehensive loss  | (9,362,762 )                   | (8,805,922 )           |
| Total NetSol shareholders' equity   | 51,520,932                     | 52,410,690             |
| Non-controlling interest  | 12,220,383                     | 12,500,484             |

|  |               |               |
|--|---------------|---------------|
| Total stockholders' equity                 | 63,741,315    | 64,911,174    |
| Total liabilities and stockholders' equity | \$ 81,228,895 | \$ 85,646,380 |

See accompanying notes to these unaudited condensed consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

|   | For the Three Months<br>Ended September 30, |              |
|---|---|--------------|
|   | 2011  | 2010         |
| Net Revenues:   |   |              |
| License fees  | \$ 1,075,850                                | \$ 3,477,793 |
| Maintenance fees  | 2,037,206                                   | 1,669,919    |
| Services  | 3,115,652                                   | 3,255,360    |
| Total revenues  | 6,228,708                                   | 8,403,071    |
| Cost of revenues:   |   |              |
| Salaries and consultants                                    | 2,383,411                                   | 1,986,888    |
| Travel  | 285,673                                     | 231,612      |
| Repairs and maintenance                                     | 74,194                                      | 57,058       |
| Insurance   | 35,868                                      | 30,992       |
| Depreciation and amortization                               | 789,105                                     | 630,941      |
| Other   | 516,409                                     | 243,138      |
| Total cost of revenues                                      | 4,084,660                                   | 3,180,629    |
| Gross profit  | 2,144,048                                   | 5,222,442    |
| Operating expenses:   |   |              |
| Selling and marketing                                       | 700,281                                     | 483,970      |
| Depreciation and amortization                               | 191,674                                     | 266,443      |
| Bad debt expense  | 192,250                                     | 254,632      |
| Salaries and wages  | 806,564                                     | 920,264      |
| Professional services, including non-cash compensation      | 186,749                                     | 139,085      |
| General and administrative                                  | 892,972                                     | 1,132,519    |
| Total operating expenses                                    | 2,970,490                                   | 3,196,913    |
| Income (loss) from operations                               | (826,442 )                                  | 2,025,530    |
| Other income and (expenses)                                 |   |              |
| Loss on sale of assets                                      | (1,641 )                                    | (14,794 )    |
| Interest expense  | (251,430 )                                  | (315,644 )   |
| Interest income   | 32,805                                      | 84,461       |
| Gain (loss) on foreign currency exchange transactions       | (120,906 )                                  | 1,073,894    |
| Share of net loss from equity investment                    | (100,000 )                                  | (70,438 )    |
| Beneficial conversion feature                               | (21,583 )                                   | (177,411 )   |
| Other expense   | (7,718 )                                    | (55,554 )    |
| Total other income (expenses)                               | (470,474 )                                  | 524,515      |
| Net income (loss) before income taxes                       | (1,296,916 )                                | 2,550,045    |
| Income taxes  | (24,534 )                                   | (8,556 )     |
| Net income (loss) after tax                                 | (1,321,450 )                                | 2,541,489    |
| Non-controlling interest                                    | (137,258 )                                  | (974,508 )   |
| Net income (loss) attributable to NetSol                    | (1,458,708 )                                | 1,566,980    |
| Other comprehensive loss:                                   |   |              |
| Translation adjustment                                      | (974,199 )                                  | (475,902 )   |
| Comprehensive income (loss)                                 | (2,432,907 )                                | 1,091,078    |
| Comprehensive loss attributable to non controlling interest | (417,360 )                                  | (206,888 )   |
| Comprehensive income (loss) attributable to NetSol          | \$ (2,015,547 )                             | \$ 1,297,966 |

Net income (loss) per share:

|   |            |            |
|---|------------|------------|
| Basic   | \$ (0.03 ) | \$ 0.04    |
| Diluted                                       | \$ (0.03 ) | \$ 0.04    |
| Weighted average number of shares outstanding |            |            |
| Basic   | 55,883,268 | 39,544,096 |
| Diluted                                       | 55,883,268 | 43,251,519 |

Amounts attributable to NetSol common shareholders

|                   |                 |              |
|-------------------|-----------------|--------------|
| Net income (loss) | \$ (1,458,708 ) | \$ 1,566,980 |
|-------------------|-----------------|--------------|

See accompanying notes to these unaudited condensed consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW  
(UNAUDITED)

|  | For the Three Months<br>Ended September 30, |             |
|--|---|-------------|
|  | 2011  | 2010        |
| Cash flows from operating activities:  |   |             |
| Net (loss) income  | \$(1,321,451)                               | \$2,541,489 |
| Adjustments to reconcile net income<br>to net cash provided by operating activities: |   |             |
| Depreciation and amortization  | 980,778                                     | 897,383     |
| Provision for bad debts  | 192,250                                     | 254,632     |
| Share of net loss from investment under equity method                                | 100,000                                     | 70,438      |
| Loss on sale of assets   | 1,641                                       | 14,794      |
| Stock issued for interest on notes payable   | -   | 14,419      |
| Stock issued for services  | 118,300                                     | 383,950     |
| Fair market value of warrants and stock options granted                              | 59,852                                      | 53,594      |
| Beneficial conversion feature  | 21,583                                      | 177,411     |
| Changes in operating assets and liabilities:   |   |             |
| Increase/ decrease in accounts receivable  | 1,658,236                                   | (2,708,406) |
| Increase/ decrease in other current assets   | 169,558                                     | (1,453,577) |
| Increase/ decrease in accounts payable and accrued expenses                          | (1,096,849)                                 | (359,946)   |
| Net cash provided by (used in) operating activities                                  | 883,900                                     | (113,820)   |
| Cash flows from investing activities:  |   |             |
| Purchases of property and equipment  | (1,427,884)                                 | (682,676)   |
| Sales of property and equipment  | 2,591                                       | 4,550       |
| Purchase of non-controlling interest in subsidiary                                   | -   | (180,000)   |
| Short-term investments held for sale   | -   | (254,632)   |
| Investment under equity method   | (100,000)                                   | -           |
| Increase in intangible assets  | (1,768,681)                                 | (1,574,143) |
| Net cash used in investing activities  | (3,293,974)                                 | (2,686,900) |
| Cash flows from financing activities:  |   |             |
| Proceeds from sale of common stock   | -   | 2,021,139   |
| Proceeds from the exercise of stock options and warrants                             | 140,000                                     | 186,875     |
| Proceeds from convertible notes payable  | 4,000,000                                   | -           |
| Payments on convertible notes payable  | (2,758,330)                                 | -           |
| Restricted cash  | 3,000,000                                   | -           |
| Bank overdraft   | 40,201                                      | 90,944      |
| Proceeds from bank loans   | 1,731,634                                   | 1,064,554   |
| Payments on bank loans   | 141,852                                     | (45,427)    |
| Payments on capital lease obligations & loans - net                                  | (4,885,224)                                 | (2,365,852) |
| Net cash provided by financing activities  | 1,410,133                                   | 952,233     |
| Effect of exchange rate changes in cash  | (49,174)                                    | (72,246)    |
| Net increase in cash and cash equivalents  | (1,049,115)                                 | (1,920,733) |
| Cash and cash equivalents, beginning of year   | 4,172,802                                   | 4,075,546   |
| Cash and cash equivalents, end of year   | \$3,123,686                                 | \$2,154,813 |

See accompanying notes to the unaudited condensed consolidated financial statements.





NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW (CONTINUED)  
 (UNAUDITED)

|  | For the Three Months<br>Ended September 30, |             |
|--|---|-------------|
|  | 2011  | 2010        |
| SUPPLEMENTAL DISCLOSURES:                        |   |             |
| Cash paid during the period for:                 |   |             |
| Interest   | \$464,156                                   | \$429,289   |
| Taxes  | \$(6,810 )                                  | \$659       |
| NON-CASH INVESTING AND FINANCING ACTIVITIES:     |   |             |
| Stock issued for the conversion of Notes Payable | \$-   | \$1,900,598 |

See accompanying notes to the unaudited condensed consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The Company designs, develops, markets, and exports proprietary software products to customers in the automobile finance and leasing, banking, healthcare, and financial services industries worldwide. The Company also provides system integration, consulting, IT products and services in exchange for fees from customers.

The consolidated condensed interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these consolidated condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended June 30, 2010. The Company follows the same accounting policies in preparation of interim reports. Results of operations for the interim periods are not indicative of annual results.

The accompanying consolidated financial statements include the accounts of NetSol Technologies, Inc. and subsidiaries (collectively, the "Company") as follows:

Wholly-owned Subsidiaries

NetSol Technologies North America, Inc. ("NTNA")

NetSol Technologies Limited ("NetSol UK")

NetSol Connect (Private), Ltd. ("Connect")

NetSol-Abraxas Australia Pty Ltd. ("Abraxas")

NetSol Technologies Europe Limited ("NTE")

NTPK (Thailand) Co. Limited ("NTPK Thailand")

Vrooz, Inc. ("Vrooz")

Majority-owned Subsidiaries

NetSol Technologies, Ltd. ("NetSol PK")

NetSol Innovation (Private) Limited ("NetSol Innovation")

For comparative purposes, prior year's consolidated financial statements have been reclassified to conform to report classifications of the current year.

NOTE 2 – ACCOUNTING POLICIES

Use of Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ

from those estimates.

Accounting for Convertible Debt with Warrants:

The Company accounts for proceeds from convertible debt instruments issued together with warrants by allocating such proceeds between debt and equity components based on their relative fair values, along with a corresponding debt discount. Debt discounts are amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense.

Page | 6

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NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS:

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for us in fiscal 2013 and earlier adoption is permitted. We are currently evaluating the impact of our pending adoption of ASU 2011-08 on our consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220)—Presentation of Comprehensive Income (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for us in our first quarter of fiscal 2013 and should be applied retrospectively. We are currently evaluating the impact of our pending adoption of ASU 2011-05 on our consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820)—Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements (as defined in Note 3 below). ASU 2011-04 is effective for us in our fourth quarter of fiscal 2012 and should be applied prospectively. We are currently evaluating the impact of our pending adoption of ASU 2011-04 on our consolidated financial statements.

NOTE 4 – EARNINGS/ (LOSS) PER SHARE:

Basic earnings per share are computed based on the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options, warrants, and stock awards.

The components of basic and diluted earnings per share were as follows:

| For the three months ended September 30, 2011 | Net Loss      | Shares     | Per Share |
|---|---------------|------------|-----------|
| Basic loss per share:                         | \$(1,458,708) | 55,883,268 | \$(0.03 ) |
| Dividend to preferred shareholders            | -             |            |           |
| Net income available to common shareholders   |               |            |           |
| Effect of dilutive securities *               |               |            |           |
| Stock options                                 |               |            |           |
| Warrants                                      |               |            |           |

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|   |               |            |           |
|---|---------------|------------|-----------|
| Diluted loss per share                        | \$(1,458,708) | 55,883,268 | \$(0.03 ) |
| For the three months ended September 30, 2010 |               |            |           |
|   | Net Income    | Shares     | Per Share |
| Basic income per share:                       | \$1,566,980   | 39,544,096 | \$0.04    |
| Dividend to preferred shareholders            | -             |            | \$-       |
| Net income available to common shareholders   |               |            |           |
| Effect of dilutive securities                 |               |            |           |
| Stock options                                 |               | 1,159,964  |           |
| Warrants                                      |               | 2,547,459  |           |
| Diluted income per share                      | \$1,566,980   | 43,251,519 | \$0.04    |

\*As there is a loss, these securities are anti-dilutive. The basic and diluted loss per share is the same for the three months ended September 30, 2011

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – OTHER COMPREHENSIVE INCOME & FOREIGN CURRENCY:

The accounts of NetSol UK and NTE use the British Pound; NetSol PK, Connect, and NetSol Innovation use Pakistan Rupees; NTPK Thailand uses Thai Baht and Abraxas uses the Australian dollar as the functional currencies. NetSol Technologies, Inc., and subsidiaries, NTNA and Vroozzi, Inc., use the U.S. dollar as the functional currency. Assets and liabilities are translated at the exchange rate on the balance sheet date, and operating results are translated at the average exchange rate throughout the period. Accumulated translation losses of \$9,362,762 and \$8,805,922 as of September 30, 2011 and June 30, 2011, respectively, are classified as an item of accumulated other comprehensive loss in the stockholders' equity section of the consolidated balance sheet. During the three months ended September 30, 2011 and 2010, comprehensive loss in the consolidated statements of operations included translation loss of \$556,839 and \$269,014 respectively.

NOTE 6 - OTHER CURRENT ASSETS

Other current assets consisted of the following:

|                         | As of September<br>30<br>2011 | As of June 30<br>2011 |
|-------------------------|-------------------------------|-----------------------|
| Prepaid Expenses        | \$ 213,399                    | \$ 245,194            |
| Advance Income Tax      | 686,966                       | 726,979               |
| Employee Advances       | 36,415                        | 53,404                |
| Security Deposits       | 163,124                       | 161,263               |
| Tender Money Receivable | 123,961                       | 133,166               |
| Other Receivables       | 502,535                       | 535,597               |
| Other Assets            | 355,464                       | 198,301               |
| Total                   | \$ 2,081,864                  | \$ 2,053,904          |

NOTE 7 - PROPERTY AND EQUIPMENT

Property and equipment, net, consisted of the following:

|                                | As of September<br>30<br>2011 | As of June 30<br>2011 |
|--------------------------------|-------------------------------|-----------------------|
| Office furniture and equipment | \$ 1,162,054                  | \$ 1,179,993          |
| Computer equipment             | 13,937,589                    | 13,463,560            |
| Assets under capital leases    | 2,075,151                     | 2,024,282             |
| Building                       | 2,287,618                     | 2,337,758             |
| Land                           | 2,191,991                     | 2,240,036             |
| Capital work in progress       | 3,277,018                     | 2,659,750             |
| Autos                          | 643,246                       | 794,617               |
| Improvements                   | 160,013                       | 162,896               |
| Subtotal                       | 25,734,679                    | 24,862,892            |

|                          |               |               |
|--------------------------|---------------|---------------|
| Accumulated depreciation | (9,264,932 )  | (8,848,431 )  |
|                          | \$ 16,469,748 | \$ 16,014,461 |

For the three months ended September 30, 2011 and 2010, depreciation expense totaled \$636,568 and \$369,565 respectively. Of these amounts, \$462,543 and \$256,484 respectively, are reflected as part of cost of goods sold.

The Company's capital work in progress consists of ongoing enhancements to its facilities and infrastructure as necessary to meet the Company's expected long-term growth needs. The Company recorded capitalized interest of \$77,627 and \$278,308 as of September 30, 2011 and June 30, 2011, respectively.



NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8 - INTANGIBLE ASSETS:

Intangible assets consisted of the following:

|  | Product<br>Licenses | Customer<br>Lists | Total        |
|--|---------------------|-------------------|--------------|
| Intangible assets - June 30, 2010 - cost | \$ 29,960,803       | \$ 5,804,057      | \$35,764,860 |
| Additions                                | 8,159,168           | -                 | 8,159,168    |
| Effect of translation adjustment         | 106,429             | -                 | 106,429      |
| Accumulated amortization                 | (12,788,921 )       | (5,639,341 )      | (18,428,262) |
| Net balance - June 30, 2011              | \$ 25,437,479       | \$ 164,715        | \$25,602,194 |
| Intangible assets - June 30, 2011 - cost | \$ 38,226,400       | \$ 5,804,057      | \$44,030,457 |
| Additions                                | 1,788,199           | -                 | 1,788,199    |
| Effect of translation adjustment         | (621,424 )          | -                 | (621,424 )   |
| Accumulated amortization                 | (13,028,447 )       | (5,656,990 )      | (18,685,436) |
| Net balance - September 30, 2011         | \$ 26,364,728       | \$ 147,067        | \$26,511,795 |
| Weighted average amortization period     | 8.02                | 5.00              | 7.63         |
| Amortization expense for:                |                     |                   |              |
| Three months ended September 30, 2011    | \$ 326,562          | \$ 17,648         | \$344,210    |
| Three months ended September 30, 2010    | \$ 402,353          | \$ 125,465        | \$527,818    |

## (A) Product Licenses

Product licenses include original license issue, renewals, enhancements, copyrights, trademarks, and trade names. Product licenses included unamortized software development and enhancement costs of \$20,239,681.

## (B) Customer Lists

On October 31, 2008, the Company entered into an agreement to purchase the rights to the customer list of Ciena Solutions, LLC, a California limited liability company ("Ciena"). Under the terms of the agreement, the total consideration for these rights included an initial payment of \$350,000 (plus interest of \$2,963), and deferred consideration to be paid in cash and the Company's common stock based on the operational results of Ciena, and certain other factors, over a four-year fiscal period. Each fiscal period is measured from July 1 to June 30 with fiscal period one being the period from July 1, 2008 to June 30, 2009. No other assets or liabilities were acquired by the Company as a result of this transaction.

As a result of operational losses of Ciena in the first three fiscal periods, 2009, 2010 and 2011 respectively, the annual deferred consideration installment payments were determined to be zero.

## (C) Amortization

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Amortization expense of intangible assets over the next five years is estimated to be as follows:

| Asset            | FISCAL YEAR ENDING |             |             |           |           |              | TOTAL        |
|------------------|--------------------|-------------|-------------|-----------|-----------|--------------|--------------|
|                  | 9/30/12            | 9/30/13     | 9/30/14     | 9/30/15   | 9/30/16   | Thereafter   |              |
| Product Licences | \$1,498,017        | \$1,367,778 | \$1,237,911 | \$848,608 | \$848,608 | \$20,563,806 | \$26,364,728 |
| Customer Lists   | 70,592             | 70,592      | 5,883       | -         | -         | -            | 147,067      |
|                  | \$1,568,609        | \$1,438,370 | \$1,243,794 | \$848,608 | \$848,608 | \$20,563,806 | \$26,511,795 |

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 9 – GOODWILL

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in prior period businesses combinations. Goodwill was comprised of the following amounts:

|               | As of September<br>30,<br>2011 | As of June 30,<br>2011 |
|---------------|--------------------------------|------------------------|
| Asia Pacific  | \$ 1,303,372                   | \$ 1,303,372           |
| Europe        | 3,471,813                      | 3,471,813              |
| North America | 4,664,100                      | 4,664,100              |
| Total         | \$ 9,439,285                   | \$ 9,439,285           |

There was no impairment of the goodwill for the periods ended September 30, 2011 and June 30, 2011.

## NOTE 10 – INVESTMENT UNDER EQUITY METHOD

On April 10, 2009, the Company entered into an agreement to form a joint venture with the Atheeb Trading Company, a member of the Atheeb Group (“Atheeb”). The joint venture entity, Atheeb NetSol Saudi Company Ltd., is a company organized under the laws of the Kingdom of Saudi Arabia. The venture was formed with an initial capital contribution of \$268,000 by the Company and \$266,930 by Atheeb with a profit sharing ratio of 50.1:49.9, respectively. The final formation of the company was completed on March 7, 2010. The joint venture was accounted for as an equity method investment as the Company has not established control over the affairs of Atheeb NetSol Saudi Company Ltd. due to its minority representation on the board of directors.

The Company's investment in equity for the period ended September 30, 2011 was as follows:

|  |           |
|--|-----------|
| Net book value at June 30, 2010                        | \$200,506 |
| Net loss for the year ended June 30, 2011              | (542,929) |
| NetSol's share (50.1%)                                 | (272,007) |
| Loss adjusted against investment                       | (200,506) |
| Net book value at June 30, 2011                        | \$0       |
| Investment during the period                           | 100,000   |
| Net loss for the three months ended September 30, 2011 | (134,075) |
| NetSol's share (50.1%)                                 | (67,172 ) |
| Unabsorbed losses brought forward                      | (51,731 ) |
| Total loss   | (118,903) |
| Loss adjusted against investment                       | (100,000) |
| Net book value at September 30, 2011                   | \$0       |



NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 11 - ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following:

|                       | As of September<br>30<br>2011 | As of June 30<br>2011 |
|-----------------------|-------------------------------|-----------------------|
| Accounts Payable      | \$ 1,113,114                  | \$ 1,348,453          |
| Accrued Liabilities   | 2,200,197                     | 2,364,233             |
| Accrued Payroll       | 14,289                        | 148,565               |
| Accrued Payroll Taxes | 348,987                       | 216,485               |
| Interest Payable      | 118,560                       | 380,808               |
| Deferred Revenues     | 32,066                        | 32,066                |
| Taxes Payable         | 242,017                       | 239,417               |
| Total                 | \$ 4,069,230                  | \$ 4,730,027          |

## NOTE 12 - DEBTS

## (A) LOANS AND LEASES PAYABLE

Notes payable consisted of the following:

| Name                        | As of September<br>30<br>2011 | Current<br>Maturities | Long-Term<br>Maturities |
|-----------------------------|-------------------------------|-----------------------|-------------------------|
| Habib Bank Line of Credit   | \$ 2,583,594                  | 2,583,594             | -                       |
| Bank Overdraft Facility     | 288,475                       | 288,475               | -                       |
| Term Finance Facility       | 709,260                       | 283,704               | 425,556                 |
| Subsidiary Capital Leases   | 1,194,686                     | 936,975               | 257,711                 |
| Lease abandonment liability | -                             | -                     | -                       |
|                             | \$ 4,776,014                  | \$4,092,747           | \$ 683,267              |

| Name                      | As of June 30<br>2011 | Current<br>Maturities | Long-Term<br>Maturities |
|---------------------------|-----------------------|-----------------------|-------------------------|
| D&O Insurance             | \$ 21,429             | \$21,429              | \$ -                    |
| Habib Bank Line of Credit | 5,404,608             | 5,404,608             | -                       |
| Bank Overdraft Facility   | 254,502               | 254,502               | -                       |
| Term Finance Facility     | 869,767               | 434,883               | 434,884                 |
| Subsidiary Capital Leases | 1,232,585             | 947,113               | 285,472                 |
|                           | \$ 7,782,891          | \$7,062,535           | \$ 720,356              |

The Company finances Directors' and Officers' ("D&O") liability insurance as well as Errors and Omissions ("E&O") liability insurance, for which the total balances are renewed on an annual basis and as such are recorded in current maturities. The interest rate on the insurance financing was 0.49% as of September 30, 2011 and June 30, 2011. Interest paid during the period-ended September 30, 2011 and 2010 was nominal.

In April 2008, the Company entered into an agreement with Habib American Bank to secure a line of credit to be collateralized by Certificates of Deposit held at the bank. The interest rate on this line of credit is variable and was 2% as of September 30, 2011 and June 30, 2011, respectively. Interest expense for the three months ended September 30, 2011 and 2010 was \$20,114 and \$40,123, respectively. During the quarter ended September 30, 2011, the company redeemed certificate of deposits worth \$3 million. Consequently, the line of credit was also reduced to \$2,583,594.

During the year ended June 30, 2008, the Company's subsidiary, NTE, entered into an overdraft facility with HSBC Bank plc whereby the bank would cover any overdrafts up to £200,000, approximately \$312,560. The annual interest rate is 3.25% over the bank's sterling base rate, which was 5.00% as of September 30, 2011 and June 30, 2011, respectively.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company's subsidiary, NetSol PK, entered into a term finance facility from Askari Bank to finance the construction of a new building. The total amount of the facility is Rs. 200,000,000 or approximately \$2,269,632 (secured by the first charge of Rs. 580 million over the land, building and equipment of the company). The interest rate is 2.75% above the six-month Karachi Inter Bank Offering Rate. As on June 30, 2011, the subsidiary had used Rs. 75,000,000 or approximately \$851,112 of which \$425,556 was shown as long term liabilities and the remainder of \$425,556 as current maturity. As of the three months ended September 30, 2011, the Company paid back another installment of Rs. 12,500,000 reducing the outstanding principal amount to Rs. 62,500,000 or approximately \$709,260 of which \$425,556 is shown as long term liabilities and the remainder of \$283,704 as current maturity. Interest expense for the three months ended September 30, 2011 and 2010 was \$35,091 and \$44,170, respectively which was capitalized by the company.

The Company leases various fixed assets under capital lease arrangements expiring in various years through 2015. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are depreciated over the lesser of their related lease terms or their estimated useful lives and are secured by the assets themselves. Depreciation of assets under capital leases is included in depreciation expense for the three months ended September 30, 2011 and 2010.

Following is the estimated aggregate minimum future lease payments under capital leases:

|   | As of September<br>30<br>2011 | As of June 30<br>2011 |
|---|-------------------------------|-----------------------|
| Minimum Lease Payments                      |                               |                       |
| Due FYE 9/30/11                             | \$ -                          | \$ 1,010,836          |
| Due FYE 9/30/12                             | 995,967                       | 209,260               |
| Due FYE 9/30/13                             | 208,513                       | 115,346               |
| Due FYE 9/30/14                             | 80,910                        | -                     |
| Due FYE 9/30/15                             | -                             | -                     |
| Total Minimum Lease Payments                | 1,285,389                     | 1,335,442             |
| Interest Expense relating to future periods | (90,703 )                     | (102,856 )            |
| Present Value of minimum lease payments     | 1,194,686                     | 1,232,585             |
| Less: Current portion                       | (936,975 )                    | (947,113 )            |
| Non-Current portion                         | \$ 257,711                    | \$ 285,472            |

Following is a summary of fixed assets held under capital leases:

|                                 | As of September<br>30<br>2011 | As of June 30<br>2011 |
|---------------------------------|-------------------------------|-----------------------|
| Computer Equipment and Software | \$ 552,905                    | \$ 518,911            |
| Furniture and Fixtures          | 767,579                       | 769,106               |
| Vehicles                        | 452,451                       | 434,049               |
| Building Equipment              | 302,216                       | 302,216               |
| Total                           | 2,075,151                     | 2,024,282             |
| Less: Accumulated Depreciation  | (905,411 )                    | (807,562 )            |
| Net                             | \$ 1,169,740                  | \$ 1,216,720          |

Interest expense for the three months ended September 30, 2011 and 2010 was \$18,688 and \$8,790, respectively.



NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## (B) LOANS PAYABLE- BANK

The Company's subsidiary, NetSol PK, has a loan with a bank, secured by the company's assets. This loan consisted of the following:

For the year ended September 30, 2011:

| TYPE OF<br>LOAN  | MATURITY<br>DATE | INTEREST<br>RATE | BALANCE<br>USD |
|------------------|------------------|------------------|----------------|
| Export Refinance | Every 6 months   | 11.00 %          | \$ 2,269,632   |
| Total            |                  |                  | \$ 2,269,632   |

For the year ended June 30, 2011:

| TYPE OF<br>LOAN  | MATURITY<br>DATE | INTEREST<br>RATE | BALANCE<br>USD |
|------------------|------------------|------------------|----------------|
| Export Refinance | Every 6 months   | 11.00 %          | \$ 2,319,378   |
| Total            |                  |                  | \$ 2,319,378   |

Interest expense for the three months ended September 30, 2011 and 2010 was \$19,776 and \$51,812, respectively.

## (C) OTHER PAYABLE – ACQUISITION

On June 30, 2006, the Company acquired McCue Systems, Inc. (“McCue”), a California corporation (subsequently renamed as NetSol Technologies North America, Inc.) The total purchase price was \$7,080,385, including \$3,784,635 of cash and 1,712,332 shares of the Company's common stock. Of the total purchase price, the accompanying consolidated financial statements include certain amounts payable to McCue shareholders that have not been located as of the date of this report.

As of the period-ended September 30, 2011 and June 30, 2011, the remaining cash due of \$103,226 is shown as “Other Payable – Acquisition” and the remaining stock to be issued of 46,704 shares at an average price of \$1.89 is shown in “Shares to be issued” in the accompanying consolidated financial statements. Amounts payable represent the remaining McCue shareholders that have not been located as of the date of this report.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 13 – CONVERTIBLE NOTES PAYABLE

The net outstanding balance of convertible notes as of September 30, 2011 and June 30, 2011 is as follows:

| Issue Date | Balance net of BCF |   | Current<br>Portion | Long Term | Maturity<br>Date |
|------------|--------------------|---|--------------------|-----------|------------------|
|            | @<br>9/30/11       |   |                    |           |                  |
| Sep-11     | 3,587,464          | - |                    | 3,587,464 | Sep-13           |
| Total      | 3,587,464          | - |                    | 3,587,464 |                  |

| Issue Date | Balance net of BCF |           | Current<br>Portion | Long Term | Maturity<br>Date |
|------------|--------------------|-----------|--------------------|-----------|------------------|
|            | @<br>6/30/11       |           |                    |           |                  |
| Jul-08     | 2,745,524          | 2,745,524 | -                  |           | Jul-11           |
| Total      | 2,745,524          | 2,745,524 | -                  |           |                  |

For the periods ended September 30, 2011 and June 30, 2011, total interest accrued on convertible notes was \$15,583 and \$248,250, respectively.

## (A) 2008 CONVERTIBLE DEBT

In July 2008, the Company issued \$6,000,000 of 7% convertible debt maturing in 3 years (the “2008 Notes”), with a conversion price of \$3.00 per share.

In January 2009, the 2008 Notes were amended to remove certain anti-dilution protection provisions and participation rights in future filings in exchange for a reduction in the conversion rate to \$0.78, and \$1,000,000 in cash, payable to the debt holders in 4 quarterly installments. Pursuant to the terms of the amendment, the Company recorded a beneficial conversion feature (“BCF”) in the amount of \$230,769 which is being amortized as a component of interest expense over the maturity period. The related liability of \$1,000,000 was recorded as a component of interest expense for the year-ended June 30, 2009.

In August 2009, the Company amended the 2008 Notes by reducing the conversion rate to \$0.63, and recorded an additional BCF of \$715,518, which is being amortized as a component of interest expense over the maturity period.

During the year-ended June 30, 2010, Holders of the 2008 Notes elected to convert principal and interest due thereon into a total of 2,513,112 shares of common stock. These conversions reduced the total principal of the 2008 Notes to \$4,450,000 as of June 30, 2010.

During the year ended June 30, 2011, Holders of the 2008 Note further elected to convert the principal and interest due thereon into a total of 2,744,042 shares of common stock. These conversions reduced the principal of the 2008 Note to \$2,758,330 and unamortized balance of BCF was \$12,806 as of June 30, 2011.

During the three months ended September 30, 2011 the remaining balance of 2008 Note was fully paid along with interest due thereon out of the proceeds of new 2011 Convertible Note.

(B) 2011 CONVERTIBLE DEBT

On September 13, 2011, NetSol Technologies, Inc. entered into a purchase agreement to sell convertible notes with a total principal value of \$4,000,000 and warrants to purchase shares of common stock to an investment fund managed by CIM Investment Management Limited and another accredited investor. The notes have a 2 year maturity date and are convertible into shares of common stock at the initial conversion price of \$0.895 per share. The warrants entitle the investors to acquire a total of 1,408,451 shares of common stock, have a 5 year term and have an initial exercise price of \$0.895 per share. The proceeds of Convertible note were assigned between warrants and convertible note per ASC 470-20. The company recorded \$401,648 capitalized financing cost and discount of \$19,665 on shares to be issued upon conversion of note into equity. This capitalized finance cost and discount will be amortized over the life of the note.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 - STOCKHOLDERS' EQUITY:

(A) Shares Issued for Services to Related Parties

During the periods ended September 30, 2011 and June 30, 2011, the Company issued a total of 22,500 and 442,500 shares of restricted common stock for services rendered by the officers of the company. The issuances were approved by both the compensation committee and the board of directors. These shares were valued at the fair market value of \$37,575 and \$528,900 respectively. The expense of \$37,575 was recorded in the year ended June 30, 2011.

During the periods ended September 30, 2011 and June 30, 2011, the Company issued a total of 80,000 and 90,000 shares of restricted common stock for services rendered by the independent members of the Board of Directors as part of their board compensation. The issuances were approved by both the compensation committee and the board of directors. These shares were valued at the fair market value of \$133,600 and \$135,300 respectively. The expense of \$133,600 was recorded in the year ended June 30, 2011.

During the periods ended September 30, 2011 and June 30, 2011, the Company issued a total of nil and 139,881 shares of its common stock to employees as required according to the terms of their employment agreements valued at nil and \$33,300, respectively.

(B) Share-Based Payment Transactions

During the periods ended September 30, 2011 and June 30, 2011, the Company issued a total of 12,000 and 337,857 shares of its common stock for provision of services to unrelated consultants valued at \$16,200 and \$152,543, respectively.

(C) Share Issued Against Cash Payments

During the periods ended September 30, 2011 and June 30, 2011, the Company issued a total of nil and 5,106,756 shares of its common stock against cash valued of nil and \$4,106,250, respectively.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 15 - INCENTIVE AND NON-STATUTORY STOCK OPTION PLAN

Common stock purchase options and warrants consisted of the following:

| OPTIONS:  |             | Exercise Price    | Aggregated Intrinsic Value |
|---|-------------|-------------------|----------------------------|
| Issued by the Company                           | # of shares |                   |                            |
| Outstanding and exercisable, June 30, 2010      | 7,706,917   | \$ 0.30 to \$5.00 | \$ -                       |
| Granted   | 1,471,000   | \$ 0.65 to \$1.25 |                            |
| Exercised                                       | (1,771,000) | \$ 0.65 to \$1.25 |                            |
| Expired / Cancelled                             | (487,600 )  |                   |                            |
| Outstanding and exercisable, June 30, 2011      | 6,919,317   | \$ 0.30 to \$5.00 | \$ 1,637,459               |
| Granted   | 330,000     | \$ 0.50           |                            |
| Exercised                                       | (430,000 )  | \$ 0.50 to \$1.25 |                            |
| Expired / Cancelled                             |             |                   |                            |
| Outstanding and exercisable, September 30, 2011 | 6,819,317   | \$ 0.30 to \$5.00 | \$ (113,682 )              |
| <b>WARRANTS:</b>                                |             |                   |                            |
| Outstanding and exercisable, June 30, 2010      | 4,763,319   | \$ 1.65 to \$3.70 | \$ -                       |
| Granted   |             |                   |                            |
| Exercised                                       | (3,879,028) | \$ 0.31           |                            |
| Expired   | (706,061 )  | \$ 1.68           |                            |
| Outstanding and exercisable, June 30, 2011      | 178,230     | \$ 1.65 to \$3.70 | \$ 219,119                 |
| Granted   | 1,408,451   | \$ 0.895          |                            |
| Exercised                                       |             |                   |                            |
| Expired   |             |                   |                            |
| Outstanding and exercisable, September 30, 2011 | 1,586,681   | \$ 0.31 to \$3.70 | \$ (417,907 )              |

The average life remaining on the options and warrants as of September 30, 2011 was as follows:

| Exercise Price | Number Outstanding and Exercisable | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
|----------------|------------------------------------|---|---------------------------------|
|                |                                    |   |                                 |

## OPTIONS:

## Issued by the Company

|        |               |           |      |      |
|--------|---------------|-----------|------|------|
| \$     | 0.01 - \$0.99 | 1,406,000 | 7.24 | 0.65 |
| \$     | 1.00 - \$1.99 | 1,933,317 | 3.89 | 1.89 |
| \$     | 2.00 - \$2.99 | 2,830,000 | 3.58 | 2.70 |
| \$     | 3.00 - \$5.00 | 650,000   | 2.29 | 4.38 |
| Totals |               | 6,819,317 | 4.30 | 2.21 |

## WARRANTS:

|        |               |           |      |      |
|--------|---------------|-----------|------|------|
| \$     | 0.31 - \$1.99 | 1,574,181 | 4.76 | 0.85 |
| \$     | 3.00 - \$5.00 | 12,500    | 0.03 | 3.70 |
| Totals |               | 1,586,681 | 4.72 | 0.87 |

All options and warrants granted were vested and exercisable as of September 30, 2011.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(A) INCENTIVE AND NON-STATUTORY STOCK OPTION PLAN

The Company maintains several Incentive and Non-Statutory Stock Option Plans (“Plans”) for its employees and consultants. Options granted under these Plans to an employee of the Company become exercisable over a period of no longer than ten (10) years and no less than twenty percent (20%) of the shares are exercisable annually. Options are not exercisable, in whole or in part, prior to one (1) year from the date of grant unless the Board specifically determines otherwise, as provided.

Two types of options may be granted under these Plans: (1) Incentive Stock Options (also known as Qualified Stock Options) which may only be issued to employees of the Company and whereby the exercise price of the option is not less than the fair market value of the common stock on the date it was reserved for issuance under the Plan; and (2) Non-statutory Stock Options which may be issued to either employees or consultants of the Company and whereby the exercise price of the option is less than the fair market value of the common stock on the date it was reserved for issuance under the plan. Grants of options may be made to employees and consultants without regard to any performance measures. All options issued pursuant to the Plan are nontransferable and subject to forfeiture.

OPTIONS

During the quarter ended September 30, 2010, the Company granted 750,000 options to five employees with an exercise price of \$0.65 per share and an expiration date of 1 Year, vesting quarterly. Using the Black-Scholes method to value the options, the Company recorded \$156,630 per quarter in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |        |
|-------------------------|--------|
| Risk-free interest rate | 2.01%  |
| Expected life           | 1 year |
| Expected volatility     | 90%    |

During the quarter ended September 30, 2010, the Company granted 10,000 options to one employee with an exercise price of \$0.65 per share and an expiration date of 1 Year, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$2,785 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |        |
|-------------------------|--------|
| Risk-free interest rate | 2.01%  |
| Expected life           | 1 year |
| Expected volatility     | 90%    |

During the quarter ended September 30, 2010, the Company granted 242,000 options to seven employees with an exercise price of \$0.65 per share and an expiration date of 4 months, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$43,441 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |          |
|-------------------------|----------|
| Risk-free interest rate | 1.81%    |
| Expected life           | 4 months |

Expected volatility 90%

During the quarter ended December 31, 2010, the Company granted 15,000 options to one employee with an exercise price of \$0.65 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$11,717 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk-free interest rate | 1.65%   |
| Expected life           | 1 month |
| Expected volatility     | 99%     |

Page | 17

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NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

During the quarter ended December 31, 2010, the Company granted 4,000 options to one employee with an exercise price of \$1.25 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$1,040 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk-free interest rate | 1.65%   |
| Expected life           | 1 month |
| Expected volatility     | 99%     |

During the quarter ended March 31, 2011, the Company granted 250,000 options to three employees with an exercise price of \$1.25 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$102,154 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk-free interest rate | 2.16%   |
| Expected life           | 1 month |
| Expected volatility     | 99%     |

During the quarter ended June 30, 2011, the Company granted 100,000 options to three employees with an exercise price of \$1.25 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$47,338 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk-free interest rate | 2.4%    |
| Expected life           | 1 month |
| Expected volatility     | 99%     |

During the quarter ended June 30, 2011, the Company granted 100,000 options to three employees with an exercise price of \$1.25 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$17,915 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk-free interest rate | 3.13%   |
| Expected life           | 1 month |
| Expected volatility     | 99%     |

During the quarter ended September 30, 2011, the Company granted 330,000 options to two employees with an exercise price of \$0.50 per share and an expiration date of 1 month, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded \$63,763 in compensation expense for these options in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

|                         |       |
|-------------------------|-------|
| Risk-free interest rate | 3.13% |
|-------------------------|-------|

|                     |         |
|---------------------|---------|
| Expected life       | 1 month |
| Expected volatility | 100%    |

## WARRANTS

During the quarter ended September 30, 2011, the Company entered into an agreement to issue the 2011 Convertible Note together with warrants to purchase 1,408,451 warrants of common stock at an initial exercise price of \$0.895 per share with a life of five years. The fair market value of these warrants is calculated \$446,480 by using Black Scholes value method. Using this value, the proceeds of Convertible note were assigned between warrants and convertible note per ASC 470-20. The company recorded \$401,648 capitalized financing cost which will be amortized over the life of the note.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(B) EQUITY INCENTIVE PLAN

In May 2011, the shareholders approved the 2011 Equity Incentive Plan (the "2011 Plan") which provides for the grant of equity-based awards, including options, stock appreciation rights, restricted stock awards or performance share awards or any other right or interest relating to shares or cash, to eligible participants. The aggregate number of shares reserved and available for award under the 2011 Plan is 5,000,000 (the Share Reserve). The 2011 Plan contemplates the issuance of common stock upon exercise of options or other awards granted to eligible persons under the 2011 Plan. Shares issued under the 2011 Plan may be both authorized and unissued shares or previously issued shares acquired by the Company. Upon termination or expiration of an unexercised option, stock appreciation right or other stock-based award under the 2011 Plan, in whole or in part, the number of shares of common stock subject to such award again becomes available for grant under the 2011 Plan. Any shares of restricted stock forfeited as described below will become available for grant. The maximum number of shares that may be granted to any one participant in any calendar year may not exceed 500,000 shares. All options issued pursuant to the Plan are nontransferable and subject to forfeiture.

STOCK OPTIONS

Options granted under the 2011 Plan are not generally transferable and must be exercised within 10 years, subject to earlier termination upon termination of the option holder's employment, but in no event later than the expiration of the option's term. The exercise price of each option may not be less than the fair market value of a share of the Company's common stock on the date of grant (except in connection with the assumption or substitution for another option in a manner qualifying under Section 424(a) of the Internal Revenue Code of 1986, as amended (the Code). Incentive stock options granted to any participant who owns 10% or more of the Company's outstanding common stock (a Ten Percent Shareholder) must have an exercise price equal to or exceeding 110% of the fair market value of a share of our common stock on the date of the grant and must not be exercisable for longer than five years. Options become vested and exercisable at such times or upon such events and subject to such terms, conditions, performance criteria or restrictions as specified by the Committee. The maximum term of any option granted under the 2011 Plan is ten years, provided that an incentive stock option granted to a Ten Percent Shareholder must have a term not exceeding five years.

PERFORMANCE AWARDS

Under the 2011 Plan, a participant may also be awarded a "performance award," which means that the participant may receive cash, stock or other awards contingent upon achieving performance goals established by the Committee. The Committee may also make "deferred share" awards, which entitle the participant to receive our stock in the future for services performed between the date of the award and the date the participant may receive the stock. The vesting of deferred share awards may be based on performance criteria and/or continued service with our Company. A participant who is granted a "stock appreciation right" under the Plan has the right to receive all or a percentage of the fair market value of a share of stock on the date of exercise of the stock appreciation right minus the grant price of the stock appreciation right determined by the Committee (but in no event less than the fair market value of the stock on the date of grant). Finally, the Committee may make "restricted stock" awards under the 2011 Plan, which is subject to such terms and conditions as the Committee determines and as are set forth in the award agreement related to the restricted stock. As of September 30, 2011, 19,500 shares have been issued under this plan to non-officers employees.



NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 16 – SEGMENT AND GEOGRAPHIC AREAS

The Company has identified three global regions or segments for its products and services; North America, Europe, and Asia-Pacific. Our reportable segments are business units located in different global regions. Each business unit provides similar products and services; license fees for leasing and asset-based software, related maintenance fees, and implementation and IT consulting services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies due to their particular regional location. We account for intracompany sales and expenses as if the sales or expenses were to third parties and eliminate them in the consolidation. The following table presents a summary of operating information and certain balance sheet information for the three months ended September 30:

|   | 2011           | 2010           |
|---|----------------|----------------|
| Revenues from unaffiliated customers:                       |                |                |
| North America   | \$909,069      | \$1,242,982    |
| Europe  | 916,618        | 2,089,979      |
| Asia - Pacific  | 4,403,020      | 5,070,110      |
| Consolidated  | \$6,228,708    | \$8,403,071    |
| Operating income (loss):                                    |                |                |
| Corporate headquarters                                      | \$(905,144 )   | \$(1,056,548 ) |
| North America   | 28,714         | 321,093        |
| Europe  | (128,395 )     | 1,079,667      |
| Asia - Pacific  | 178,382        | 1,681,317      |
| Consolidated  | \$(826,442 )   | \$2,025,530    |
| Net income (loss) after taxes and before minority interest: |                |                |
| Corporate headquarters                                      | \$(1,208,576 ) | \$(1,481,129 ) |
| North America   | 28,526         | 324,250        |
| Europe  | (58,419 )      | 1,016,852      |
| Asia - Pacific  | (82,980 )      | 2,681,517      |
| Consolidated  | \$(1,321,450 ) | \$2,541,489    |
| Identifiable assets:  |                |                |
| Corporate headquarters                                      | \$14,310,339   | \$17,043,137   |
| North America   | 1,856,621      | 2,278,499      |
| Europe  | 4,184,885      | 4,783,665      |
| Asia - Pacific  | 60,877,049     | 52,068,480     |
| Consolidated  | \$81,228,895   | \$76,173,781   |
| Depreciation and amortization:                              |                |                |
| Corporate headquarters                                      | \$17,705       | \$153,724      |
| North America   | 75,434         | 132,077        |
| Europe  | 121,448        | 179,440        |
| Asia - Pacific  | 766,191        | 432,141        |
| Consolidated  | \$980,778      | \$897,383      |

## Capital expenditures:

|                        |             |           |
|------------------------|-------------|-----------|
| Corporate headquarters | \$-         | \$-       |
| North America          | 1,444       | 3,405     |
| Europe                 | -           | -         |
| Asia - Pacific         | 1,426,440   | 679,271   |
| Consolidated           | \$1,427,884 | \$682,676 |

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Net revenues by our various products and services provided for the three-month period ended September 30, were as follows:

|       | 2011        | 2010        |
|-------|-------------|-------------|
|       | \$1,075,850 | \$3,477,793 |
|       | 2,037,206   | 1,669,919   |
|       | 3,115,652   | 3,255,360   |
| Total | \$6,228,708 | \$8,403,071 |

NOTE 17 – NON-CONTROLLING INTEREST IN SUBSIDIARY

The Company had non-controlling interests in several of its subsidiaries. The balance of non-controlling interest was as follows:

| SUBSIDIARY        | Non<br>Controlling<br>Interest % | Non-Controlling<br>Interest at<br>September 30,<br>2011 |
|-------------------|----------------------------------|---|
| NetSol PK         | 39.48 %                          | \$ 11,097,960   |
| NetSol-Innovation | 49.90 %                          | 1,122,423   |
| Total             |                                  | \$ 12,220,383   |

| SUBSIDIARY        | Non<br>Controlling<br>Interest % | Non-Controlling<br>Interest at<br>June 30, 2011 |
|-------------------|----------------------------------|---|
| NetSol PK         | 39.48 %                          | \$ 11,531,694                                   |
| NetSol-Innovation | 49.90 %                          | 968,790   |
| Total             |                                  | \$ 12,500,484                                   |

(A) NETSOL TECHNOLOGIES, LIMITED (“NETSOL PK”)

For the three months ended September 30, 2011 and 2010, NetSol Technologies Ltd. (“NetSol PK”) had net loss of (\$99,918) and net income of \$2,031,123. The related non-controlling interest was (\$39,448) and \$853,884, respectively.

(B) NETSOL INNOVATION (PRIVATE) LIMITED (“NETSOL INNOVATION”)

For the three months ended September 30, 2011 and 2010, NetSol Innovation (Private) Limited (“NetSol Innovation”) had net income of \$354,119 and \$241,731. The related non-controlling interest was \$176,705 and \$120,624, respectively.

NOTE 18 – INCOME TAXES

Our effective tax rates were approximately 1.89% and 0.34% for the three months ended September 30, 2011 and 2010, respectively. Our effective tax rate was lower than the U.S. federal statutory rate due to the fact that our operations are carried out in foreign jurisdictions, which are subject to lower income tax rates. Also, the Company has established a full valuation allowance as management believes it is more likely than not that these assets will not be realized in the future.



NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 - SUBSEQUENT EVENTS

On October 13, 2011, the Company issued 187,500 shares to its directors against compensation for which the expenses have already been recorded in shares to be issued as at September 30, 2011.

On October 13, 2011, the Company issued 40,000 shares to its independent directors against compensation for which the expenses have already been recorded in shares to be issued as at September 30, 2011.

On October 13, 2011, the Company issued 200,000 shares to its employee against exercise of options.

On October 20, 2011, NetSol Technologies Europe, Ltd. ("NTE") entered into a joint venture agreement with Investec Asset Finance, PLC ("Investec") to form Virtual Lease Services Holdings Limited, a company formed under the laws of England and Wales ("VLS Holdings") for the purpose of acquiring Virtual Lease Services, Limited, a company formed under the laws of England and Wales ("VLS"). In the stock purchase agreement by and between the parties, VLS Holdings acquired 100% of the issued and outstanding shares of common stock of VLS in exchange for cash in the amount of £1,293,238.78. Under the terms of the VLS Holdings shareholders' agreement, NTE shall hold 51% of equity of VLS Holdings and Investec shall own 49% of VLS Holdings.

On October 24, 2011, the company filed a S3- \$40 MN universal shelf registration statement with SEC.

NETSOL TECHNOLOGIES, INC.

Item 2. Management's Discussion and Analysis Or Plan Of Operation

The following discussion is intended to assist in an understanding of the Company's financial position and results of operations for the quarter ending September 30, 2011.

Forward-Looking Information

This report contains certain forward-looking statements and information relating to the Company that is based on the beliefs of its management as well as assumptions made by and information currently available to its management. When used in this report, the words "anticipate", "believe", "estimate", "expect", "intend", "plan", and similar expressions as they relate to the Company or its management, are intended to identify forward-looking statements. These statements reflect management's current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should any of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this report as anticipated, estimated or expected. The Company's realization of its business aims could be materially and adversely affected by any technical or other problems in, or difficulties with, planned funding and technologies, third party technologies which render the Company's technologies obsolete, the unavailability of required third party technology licenses on commercially reasonable terms, the loss of key research and development personnel, the inability or failure to recruit and retain qualified research and development personnel, or the adoption of technology standards which are different from technologies around which the Company's business ultimately is built. The Company does not intend to update these forward-looking statements.

NetSol Technologies, Inc. (NasdaqCM: NTWK) (NasdaqDubai: NTWK) is a worldwide provider of IT and enterprise application solutions, NetSol Technologies, Inc. executes its mission of focusing technology on the operational needs of its clients. NetSol's services and solutions enable businesses to streamline their operations and compete more effectively.

The Company is organized into two main revenue areas, consisting of enterprise solutions – NetSol Financial Suite (NFS™) – for the global financing, leasing and lending industry and a portfolio of managed services, including customized application development, systems integration, and business process engineering. In addition, NetSol's solutions portfolio includes the smartOCI™ e-Procurement search engine for SAP SRM users.

NetSol's clients include Dow-Jones 30 Industrials and Fortune 500 manufacturers and financial institutions, global vehicle manufacturers, and enterprise technology providers, all of which are serviced by NetSol delivery locations across the globe.

Founded in 1997, NetSol is headquartered in Calabasas, California. While the Company follows a global strategy for sales and delivery of its portfolio of solutions and services, it continues to maintain regional offices in the San Francisco Bay Area and the corporate headquarters in Calabasas, for North America; the London Metropolitan area for Europe; and Bangkok, Thailand and Lahore, Pakistan for Asia Pacific. The Company continues to maintain services, product and/or sales specific offices in Australia, China, Thailand, the Kingdom of Saudi Arabia and Pakistan and, in any other country, on an as needed basis.

In today's highly competitive marketplace, business executives with labor or services-centric budgetary responsibilities are not just encouraged but, in fact, obliged to engage in "Make or Buy" decision process when contemplating how to support and staff new development, testing, services support and delivery activities. The Company business offerings are aligned as a BestShoring® solutions strategy. Simply defined, BestShoring® is NetSol Technologies' ability to draw upon its global resource base and construct the best possible solution and price for each and every customer. Unlike traditional outsourcing offshore vendors, NetSol draws upon an international workforce and delivery capability to ensure a "BestShoring® delivers BestSolution™" approach.

NetSol combines domain expertise, not only with lowest cost blended rates from its design centers and campuses located around the world, but also with the guarantee of localized program and project management while minimizing any implementation risk associated with a single service center. Our BestShoring® approach, which we consider a unique and cost effective global development model, is leading the way, providing value added solutions for Global Business Services™ through a win-win partnership, rather than the traditional outsourced vendor framework. Our focus on “Solutions” serves to ensure the most favorable pricing while delivering in-depth domain experience. NetSol currently has locations in Bangkok, Beijing, Lahore, the London metropolitan area, the San Francisco Bay Area, and Adelaide to best serve its clients and partners worldwide. This provides NetSol customers with the optimum balance of subject matter expertise, in-depth domain experience, and cost effective labor, all merged into a scalable solution. In this way, “BestShoring® delivers BestSolution™”.

Information technology services are valuable only if they fulfill the business strategy and project objectives set forth by the customer. NetSol’s expert consultants have the technical knowledge and business experience to ensure the optimization of the development process in alignment with basic business principles. The Company offers a broad array of professional services to clients in the global commercial markets and specializes in the application of advanced and complex IT enterprise solutions to achieve its customers' strategic objectives. Its service offerings include IT Consulting & Services; NetSol Defense Division; Business Intelligence, Information Security, Independent System Review, Outsourcing Services and Software Process Improvement Consulting; maintenance and support of existing systems; and, project management.

NETSOL TECHNOLOGIES, INC.

In addition to services, our product offerings are fashioned to provide a Best Product for Best Solution model. Our offerings include our flagship global solution, NetSol Financial Suite (NFS™). NFS™, a robust suite of five software applications, is an end-to-end solution for the lease and finance industry covering the complete leasing and finance cycle starting from quotation origination through end of contract. The five software applications under NFS™ have been designed and developed for a highly flexible setting and are capable of dealing with multinational, multi-company, multi-asset, multi-lingual, multi-distributor and multi-manufacturer environments. Each application is a complete system in itself and can be used independently to address specific sub-domains of the leasing/financing cycle. NFS™ is a result of more than eight years of effort resulting in over 60 modules grouped in five comprehensive applications. These five applications are complete systems in themselves and can be used independently to exhaustively address specific sub-domains of the leasing/financing cycle. When used together, they fully automate the entire leasing / financing cycle.

The NetSol Financial Suite™ also includes LeasePak. LeasePak provides the leasing technology industry with the development of Web-enabled and Web-based tools to deliver superior customer service, reduce operating costs, streamline the lease management lifecycle, and support collaboration with origination channel and asset partners. LeasePak can be configured to run on HP-UX, SUN/Solaris or Linux, as well as for Oracle and Sybase users. In terms of scalability, NetSol Technologies North America offers the basic product as well as a collection of highly specialized add on modules for systems, portfolios and accrual methods for virtually all sizes and complexities of operations. These solutions provide the equipment and vehicle leasing infrastructure at leading Fortune 500 banks and manufacturers, as well as for some of the industry's leading independent lessors.

Our product offerings and services also include: LeaseSoft Portals and Modules through our European operations; LeasePak 6.0b of our NFS™ product suite; enterprise wide information systems, such as or LRMIS, MTMIS, business intelligence and information security services.

To further bolster NetSol's Solutions capabilities, in October 2008, NetSol acquired Ciena Solutions, a preferred SAP and Business Objects systems integration firm. The Ciena Solutions practice will be integrated into the newly formed wholly owned subsidiary, Vroozi, Inc. This acquisition expanded NetSol's domain and subject matter expertise to include integration and consulting services for the SAP ERP platform as well as intellectual property targeted for the B2B supply chain market.

Vroozi develops innovative e-commerce solutions for all business sizes and industry verticals which help companies search, source, negotiate, and order goods and services from suppliers electronically optimizing organization's procurement and supply chain operations. Vroozi's Business to Business search engine, collaborative commerce, and electronic marketplace applications are deployed On Demand and can integrate seamlessly with major ERP vendor systems such as SAP or deployed independently on the Internet.

Vroozi's first product to market is smartOCI™. SmartOCI™ is a new search engine technology and buy-side content marketplace which provides corporate buyers and shoppers a simple and intuitive user interface to search multiple supplier catalogs simultaneously within the SAP procurement application. SmartOCI™ was officially released to the market in 2011 at the SAP SAPHIRE Conference in Orlando, Florida, targeting approximately 15,000+ SAP customers and has strengthened NetSol's presence in the global SAP Services market.

While the Company follows a global strategy for sales and delivery of its portfolio of solutions and services, it continues to focus operational responsibility along two regions, the Americas (including Brazil and Latin America) and Europe Region and the Asia Pacific Region covering, specifically, the markets of Australia, China, Pakistan, Saudi Arabia and Thailand. The Company continues to maintain services or products and specific sales offices in its current locations and will add offices on an as-needed basis.

The following discussion is intended to assist in an understanding of NetSol's financial position and results of operations for the quarter ended September 30, 2011. It should be read together with our consolidated financial statements and related notes included herein.

Page | 24

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NETSOL TECHNOLOGIES, INC.

A few of NetSol's major successes achieved during the quarter ended September 30, 2011 were:

- Further expansion in the China market by adding new customers.
- Formalized the Joint Venture Agreement with Brasilinvest Group to launch a joint venture in Brazil. Formed an e-commerce division, Vrooz Inc., to provide a dedicated sales and delivery channel for the company's existing smartOCI™ product line, as well as developing the next generation of e-commerce and search engine technologies. Vrooz Inc. formed this past quarter, is a wholly owned subsidiary of NetSol Technologies, Inc. Signed an agreement with a major U.S. aerospace defense contractor to implement NetSol's smartOCI™ search engine software in its SAP e-Procurement environment.
- Signed an agreement with a major U.S. chipmaker to implement smartOCI™ search engine in its SAP e-Procurement environment.
- Won a major contract in the area of 'Information Security' with a leading telecom company in Pakistan. NetSol Innovation, a majority owned subsidiary, recently expanded its services to Australia, Europe and North America. In turn, the demand of NetSol PK resources has increased to support the growing development and programming of our JV partner.
- Signed a new contract to supply LeaseSoft to a leading independent UK leasing and asset finance company. A major European Bank went live with the LeaseSoft portal application. The deployment included full integration with a Europe-wide credit search agency to provide enhanced data accuracy and better informed credit decisions.
- A major European auto finance captive and one of the Company's longest running client went live with NFS in India. This was delivered and implemented by NetSol Thai team in Bangkok.
- Restructured global operational units by streamlining the regional delivery capabilities and sales organization Consolidated from three global regions to two regions with Region 1 the Americas and Europe and Region 2 Asia Pacific and the Middle East.

The success of the Company, in the near term, will depend, in large part, on the Company's ability to: (a) continue to grow revenues and improve profits, (b) raise funds for continued operations and growth; (c) make a major entry in the US and Latin American markets and, (d) continue to streamline sales and marketing efforts in the Asia Pacific region, Europe, China and the Middle East, Japan and Australia. However, management's outlook for the continuing operations, which has been consolidated and has been streamlined, remains optimistic.

#### Marketing and Business Development Activities

Management has developed, and the board of directors has ratified, an aggressive 3-5 year growth strategy aimed at increasing competitiveness and financial strength.

This plan is designed to:

Return to annual top line growth with the anticipation of double digit growth from 2013 onwards.

Result in enhanced organic growth by next generation of NFS solutions, SAAS model, e-commerce entry and leveraging new markets based on joint ventures.

Pursue the most strategic and synergistic acquisitions and new alliances based on our latest products and services.

Enhance delivery and service capabilities in China, Thailand, USA and UK.

The plan contemplates the following enhanced activities and initiatives will accomplish these goals:

- o The remarkable success and demand of NFS™ in China has led to long term planning to expand in the Chinese market. The overall steady economic growth in China and historic transformation of the auto sector (China outsold cars against the United States in number of units in 2009) combined with growing consumer spending, warrants hiring additional local Chinese staff and infrastructure improvement. Management is poised to create a 'proximity development center' or PDC and clients support team to better serve our growing customers base. The Chinese market offers huge opportunities in the auto sectors in comparison with the US market, thus offers a very strong growth opportunities for NFS.

NETSOL TECHNOLOGIES, INC.

- o NetSol's Beijing office more than doubled its office space on March 1, 2011; new local Chinese staff has been added and additional hiring continues. The process of forming a new wholly owned subsidiary by the Company, as a Wholly Owned Foreign Enterprise under Chinese laws, is in progress and is expected to be completed in the current calendar year. NetSol is positioning China to become a dominant market for lending enterprise solutions for captive multinationals and local Chinese companies, including equipment finance, big ticket leasing markets and the banking industry. In the lease and finance domain NetSol can claim the de facto leadership position in the rapidly growing Chinese market.
- o Thailand has emerged as a new market for banking and auto finance. NetSol has formalized its presence in Bangkok by establishing a wholly owned subsidiary, NetSol Thai. The office space in Bangkok has been enhanced with new hires of local and international staff to address and support a very rapidly growing market. The pipeline of new customers is growing from the markets in Japan, South Korea, Australia, India and other regional markets. These markets will be serviced and supported from the Thailand office with strong sales and client support team. The Bangkok facility is intended to become the prime location for delivery and implementation for global customers and partners particularly in Asia Pacific.
- o To date, few US-based fortune 500 captive auto finance companies have shown serious interest in NFS™. We expect, however, to achieve stronger results through strengthening NetSol's North American operation by augmenting the service levels of the local technical team with effective integration of the NetSol PK center of excellence, resulting in a seamless integration of core project delivery and global support teams. Recently we have noticed elongated decision making by C level executives for NFS solutions and this is primarily due to challenging economic times in developed markets and economies. However NetSol is experiencing a growing interest in our next generation NFS solution which is positioned to go to market by late 2012 to expand our revenue base.
- o The new and fast growing manifestations of e-commerce, such as Cloud computing, are being utilized by some of our offerings and will be further explored by us for other offerings. Our new IP, AKA, smartOCI™ has been demonstrated and presented to major fortune 500 companies in the US as an on-demand, catalogue content management system. The demand of e-procurement search engine seems robust and attractive. Several new license sales activities are in the pipeline that led to formation of new subsidiary known as Vroozzi, Inc. Presently smartOCI™ is the main asset in this entity while we explore other channels of growth in e-commerce and search engine space. There has been a surge of interest amongst fortune 500 corporations for demos and workshops for smartOCI™ in recent months.
- o Europe continues to experience a severe recession coupled with regional debt crises.. Despite this, NetSol Europe's operations have been steady. Further, the business outlook is positive and, if this continues, NTE is expected to expand its product line and hire stronger management personnel. Our relationship with existing clientele is very strong and we are cautiously expanding the sales and marketing efforts in the region.
- o The market of the Kingdom of Saudi Arabia is robust, rich and well capitalized, offering vast opportunities for NetSol through our joint venture. Recently, there have been a few new local IT contracts awarded but our vision is based on long term and high value projects in the defense, public, infrastructure and multinational auto captive markets. In order to be equal partners with a major conglomerate, Atheeb Group, a \$2 billion group in revenue, we need to have the serious financial wherewithal and resources to bid on major projects exceeding \$100 million each in value. Currently, the joint venture has 10 employees based in Riyadh with direct delivery and implementation support from NetSol PK. The long term plan is to expand staffing levels and provide financial capability to bid in major projects with Atheeb. We are noticing an impressive traction for NFS in the Kingdom markets and ANSCL teams are aggressively positioning NetSol overall offering in this robust and rich economy.



- o Our NFS™ suite of products is currently undergoing a major initiative towards developing the next generation of solutions. The Company believes that this would change the landscape for NetSol and increase both demand and the market. We are in the middle of developing a comprehensive sales and marketing plan requiring new personnel, markets and investment.
- o In order to maximize the market and product potential of our SAP and Ecommerce line, highlighted by our smartOCI™ product, we are spinning this line off into its own operational entity. We believe this will better enhance product and market development by providing a dedicated management and fulfillment staff.

NETSOL TECHNOLOGIES, INC.

Growth – New Alliances, Mergers & Acquisition

o Pursue new opportunities in emerging markets of Latin America - such as Brazil and Argentina - through local partners. These focused and niche markets for leasing and finance verticals represent new opportunities to introduce NFS™ and related service offerings.

o The markets in the US and UK offer a host of complementary companies with impressive client bases to expand the distribution channels for NFS™ and its new generation product line. There are established small sized Companies, with relatively low valuations, which can become part of NetSol on an affordable basis. It is important to seek out these companies in order to grow our customer base, revenue and net margins by leveraging our delivery and implementation model.

Funding and Investor Relations:

The fundamental challenge constantly facing the management is to achieve sustainable and impressive growth with a much stronger balance sheet. In light of global opportunities for organic growth and through alliances and M&A, there are certain opportunity costs for an inability to tap into these markets and areas. The biggest hurdle to win large value contracts and projects in every market is the weak cash position. Therefore, management has the responsibility to broaden its horizon by prudently exploring all available vehicles to adequately capitalize the Company. Smart new capital may be needed to make NetSol a much healthier company with an impressive balance sheet and sufficient size to participate in and win major projects in key markets. To summarize, the following areas would need injections of new capital either from internal operations or external injections, dependent, in part, on market conditions.

- Expansion in China, Thailand and other emerging markets, including Latin America.
- Expanding the North American operation to roll out NetSol new generation solutions and enter Cloud Computing Solutions.
  - Diversify in Ecommerce space such as smartOCI™ search engine.
- Support of bigger IT related public and defense sectors projects in the Kingdom of Saudi Arabia with our joint venture partner.
  - Capital Expenditures for our next generation products, technology and infrastructure.
- Improve credit ratings for our new big customers and win the confidence of new and existing investors.
  - Hiring and training of programmers, engineers, sales and marketing.

Capital may be injected through: continued exercises of options by the officers in cash; new debt and stock offerings with accredited investors who typically hold for long term investment as well as through a public offering based on market conditions and dynamics. The board and management would be cognizant and prudent to make the best decision in the long term interest of shareholders.



NETSOL TECHNOLOGIES, INC.

Investor Relations efforts will include:

- Working to grow our institutional investor base.
- Sharing the NetSol story with sell side analysts, funds, portfolio managers and the financial media.
- Aggressively positioning NetSol in front of major investors' conferences and road shows to be organized by our newly hired IR firm and other major institutions.
  - Utilizing US mainstream media to highlight NetSol's image and 'niche' business offering.
- Founding management's anticipated continued investment in the Company displaying management's belief in NetSol's potential to new investors.
  - Dedicating and focusing efforts to improve shareholder value.

Improving the Bottom Line:

Management believes that these measures will improve the bottom line on an ongoing basis:

- Improve pricing, sales volume and fee structures.
- Continue consolidation and reevaluating operating margins as ongoing activities.
- Streamline further cost of goods sold to improve gross margins to historical levels over 60%, as sales ramp up.
  - Generate higher revenues per employee, enhance productivity and lower cost per employee.
- Optimize the utilization of NetSol's best talent and resources, infrastructure, processes and disciplines to maximize the bottom-line and fully leverage the cost arbitrage.
- Grow process automation and leverage the best practices of CMMI level 5. Global delivery concept and integration will further improve both gross and net margins.
  - Cost efficient management of every operation and continue further consolidation to improve bottom line.
- Create more visibility and predictability by implementing SaaS model in mature markets. Retire Debt to reduce the interest cost significantly and to make every effort to avoid any one time charges.

Management continues to be focused on building its delivery capability and has achieved key milestones in that respect. Key projects are being delivered on time and on budget, quality initiatives are succeeding, especially in maturing internal processes. CMMI level companies are reassessed every three years by independent consultants under the standards of the Carnegie Mellon University to maintain its CMMI Level 5 quality certification. As required, NetSol was reassessed in 2010 and was successfully recertified as CMMI Level 5. We believe that the CMMI standards are a key reason in NetSol's demand surge worldwide. We remain convinced that this trend will continue for all NetSol offerings promoting further beneficial alliances and increasing the number and quality of our global customers. The quest for quality standards is imperative to NetSol's overall sustainability and success. In 2008, NetSol became ISO 27001 certified, a global standard and a set of best practices for Information Security Management.

#### MATERIAL TRENDS AFFECTING NETSOL

Management has identified the following material trends affecting NetSol.

Positive trends:

- The global recession and consolidations have opened doors for low cost solution providers such as NetSol. The BestShoring® model of NetSol is a catalyst in today's environment.

- Global economic pressures and the recession have shifted users of IT processes and technology to utilize both offshore and onshore solutions providers, to control costs and improve ROIs.
- Serious interest in NetSol's next generation solution has been expressed by a few global companies. Demos and workshops with key global clients and partners of have been very well received. Hence, the new generation solution appears to be gaining momentum.
- GMAC – China, the implementation of first R2 for Wholesale Finance (WFS) is on track setting a strong foundation for growth. Two other key modules (CMS / CAP) are in the development stage and are expected to be marketed in fiscal 2012.

NETSOL TECHNOLOGIES, INC.

- China has become the world's second largest economy, continuing to grow by over 9% a year while growth in other industrial nations has declined or grown only marginally.
- China's automobile and banking sectors have been unaffected by the global meltdown and their recent automobile sales statistics have outperformed all other economies.
- As reported by the Associated Press, China surpassed the US as the number one automobile market in auto sales. JD Powers & Associates anticipated further strong growth in future auto sales. It is anticipated that this market opportunity will result in further penetration by NetSol into China's burgeoning leasing and finance market.
- E-Commerce, new technologies, innovations and online activities are gaining momentum in many verticals. New areas for diversification are opening for NetSol.
- The surviving IT companies, such as NetSol, with price advantage and a global presence, will gain further momentum as economic indicators turn positive. The bigger customers and targeted verticals are much more cost conscious and are seeking a better rate of return on investments in IT services. NetSol has an edge due to its BestShoring® model and proven track record of delivery and implementations worldwide.
- The Kingdom of Saudi Arabia is investing billions in healthcare, education, IT, infrastructure and many other new sectors. This makes it a most promising market for the Atheeb NetSol joint venture.
  - Noticeable new interest emanating from the Latin America markets for NFS™.
- NetSol has never lost a product customer despite the recent severe recession. The dependency of our blue chip clients on NetSol solutions has further elevated new enhancements and services orders in the US.
- Improved outlook and earnings of bellwether technology companies in USA, reflecting the turnaround of this sector after recession.
- Global opportunities for NetSol to diversify its delivery capabilities to Bangkok, Thailand and such other new emerging economies that offer geopolitical stability and low cost IT resources, thereby reducing dependency upon the Lahore technology campus.
- Our global multi-national clients have continued to pursue deeper relationships in newer regions and countries. This reflects our customers' dependencies and satisfaction with our NetSol Financial Suite of products.
- The levy of Indian IT sector excise tax of 35% (NASSCOM) on software exports is very positive for NetSol. In Pakistan there is a 15 year tax holiday on IT exports of services. There are 5 more years remaining on this tax incentive.

Negative trends:

- Geopolitical unrest due to extremism in the regions of Pakistan and Afghanistan.
  - Significant strains in US-Pakistan relations.
- Recent turbulent political developments in the Arab world might delay activities and plans.

- Natural disasters in Japan, Thailand and Pakistan have damaged these economies.
- The emergence of many smaller players offering IT solutions in China has resulted in greater price competition.
- The fear of renewed recession in light of U.S debt down-grade and the continued sluggish European market, could lead to our business in North America and Europe suffering.
- Dramatic and deep global recession has created a serious decline in business spending causing significant budget cuts for many of the Company's target verticals.

NETSOL TECHNOLOGIES, INC.

- Tightened liquidity and credit restrictions in consumer spending has either delayed or reduced spending on business solutions and systems, squeezing IT budgets and extending decision making cycles.
  - Tighter internal processes and budgets will cause delays in the receivables from a few clients.
- Anticipated worsening US deficit and a rise in inflation in coming years would put further stress on consumers and business spending.
- Volatility in oil prices, Euro zone in European markets and uncertainty overall in global economies could deter the growth and GDP in the US.
- Unrest and growing war in Afghanistan could increase the migration of both refugees and extremists to Pakistan, thus creating domestic and regional challenges.
- Management believes that the Pakistan rupee is overvalued and that once adjustments are made there might be both positive and negative impacts on the financial statements of the Company. Positive impact could be in terms of the price of our services while translating Pakistan revenues at a higher exchange rate in the consolidated revenue statement might result in negative impact on the financial statements in future.

#### CRITICAL ACCOUNTING POLICIES

Our financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management’s application of accounting policies. Critical accounting policies for us include revenue recognition and multiple element arrangements, intangible assets, software development costs, and goodwill.

#### REVENUE RECOGNITION

The Company recognizes revenue from license contracts without major customization when a non-cancelable, non-contingent license agreement has been signed, delivery of the software has occurred, the fee is fixed or determinable, and collectability is probable. Revenue from the sale of licenses with major customization, modification, and development is recognized on a percentage of completion method. Revenue from the implementation of software is recognized on a percentage of completion method.

Revenue from consulting services is recognized as the services are performed for time-and-materials contracts. Revenue from training and development services is recognized as the services are performed. Revenue from maintenance agreements is recognized ratably over the term of the maintenance agreement, which in most instances is one year.

#### MULTIPLE ELEMENT ARRANGEMENTS

We enter into multiple element revenue arrangements in which a customer may purchase a number of different combinations of software licenses, consulting services, maintenance and support, as well as training and development (multiple-element arrangements).



VSOE of fair value for each element is based on the price for which the element is sold separately. We determine the VSOE of fair value of each element based on historical evidence of our stand-alone sales of these elements to third-parties or from the stated renewal rate for the elements contained in the initial software license arrangement. When VSOE of fair value does not exist for any undelivered element, revenue is deferred until the earlier of the point at which such VSOE of fair value exists or until all elements of the arrangement have been delivered. The only exception to this guidance is when the only undelivered element is maintenance and support or other services, then, the entire arrangement fee is recognized ratably over the performance period.

Page | 30

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NETSOL TECHNOLOGIES, INC.

INTANGIBLE ASSETS

Intangible assets consist of product licenses, renewals, enhancements, copyrights, trademarks, trade names, and customer lists. Intangible assets with finite lives are amortized over the estimated useful life and are evaluated for impairment at least on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

SOFTWARE DEVELOPMENT COSTS

Costs incurred to internally develop computer software products or to enhance an existing product are recorded as research and development costs and expensed when incurred until technological feasibility for the respective product is established. Thereafter, all software development costs are capitalized and reported at the lower of unamortized cost or net realizable value. Capitalization ceases when the product or enhancement is available for general release to customers.

The Company makes on-going evaluations of the recoverability of its capitalized software projects by comparing the amount capitalized for each product to the estimated net realizable value of the product. If such evaluations indicate that the unamortized software development costs exceed the net realizable value, the Company writes off the amount which the unamortized software development costs exceed net realizable value. Capitalized and purchased computer software development costs are being amortized ratably based on the projected revenue associated with the related software or on a straight-line basis.

STOCK-BASED COMPENSATION

Our stock-based compensation expense is estimated at the grant date based on the award's fair value as calculated by the Black-Scholes-Merton (BSM) option pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including expected volatility and expected term. If any of the assumptions used in the BSM model changes significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience and our expectations regarding future pre-vesting termination behavior of employees. To the extent our actual forfeiture rate is different from our estimate, stock-based compensation expense is adjusted accordingly.

RECENT ACCOUNTING PRONOUNCEMENTES

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 3 of Notes to Condensed Consolidated Financial Statements included elsewhere in this Quarterly Report.

GOODWILL

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a purchase businesses combination. Goodwill is reviewed for impairment on an annual basis, or more frequently if

events or changes in circumstances indicate that the carrying amount of goodwill may be impaired. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

#### CASH RESOURCES

The company had \$3.12 million worldwide in cash as on September 30, 2011.

Page | 31

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NETSOL TECHNOLOGIES, INC.

AVAILABLE INFORMATION

Through the company's web sites, its customers, both existing and potential, and investors can access a wide range of information about its product offerings, and support and technical matters.

Our website is located at [www.netsoltech.com](http://www.netsoltech.com), and our investor relations website is located at <http://www.netsoltech.com/IR/>. The following filings are available through our investor relations website after we file with the SEC: Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and our Proxy Statements for our annual meetings of stockholders. These filings are also available for download free of charge on our investor relations website. We also provide a link to the section of the SEC's website at [www.sec.gov](http://www.sec.gov) that has all of our public filings, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, our Proxy Statements and other ownership related filings. Further, a copy of this Annual Report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, and blogs as part of our investor relations website. Investors and others can receive notifications of new information posted on our investor relations website by signing up for e-mail alerts. Further corporate governance information, including our committee charters and code of conduct, is also available on our investor relations website at <http://www.netsoltech.com/company/corporate-governance.php>. The content of our websites are not intended to be incorporated by reference into this 10-Q or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

## NETSOL TECHNOLOGIES, INC.

## CHANGES IN FINANCIAL CONDITION

Quarter Ended September 30, 2011 as compared to the Quarter Ended September 30, 2010:

Net revenues for the quarter ended September 30, 2011 and 2010 are broken out among the subsidiaries as follows:

|                          | 2011        |          | 2010        |          |
|--------------------------|-------------|----------|-------------|----------|
|                          | Revenue     | %        | Revenue     | %        |
| Corporate headquarters   | \$-         | 0.00 %   | \$-         | 0.00 %   |
| North America:           |             |          |             |          |
| Netsol Tech NA           | 909,069     | 14.59 %  | 1,242,982   | 14.79 %  |
| Vroozi                   | -           | 0.00 %   | -           |          |
|                          | 909,069     | 14.59 %  | 1,242,982   | 14.79 %  |
| Europe:                  |             |          |             |          |
| Netsol UK                | -           | 0.00 %   | -           | 0.00 %   |
| Netsol Tech Europe       | 916,618     | 14.72 %  | 2,089,979   | 24.87 %  |
|                          | 916,618     | 14.72 %  | 2,089,979   | 24.87 %  |
| Asia-Pacific:            |             |          |             |          |
| Netsol Tech (PK)         | 3,184,046   | 51.12 %  | 4,064,454   | 48.37 %  |
| Netsol-Innovation        | 902,195     | 14.48 %  | 666,805     | 7.94 %   |
| Netsol Connect           | 149,795     | 2.40 %   | 132,275     | 1.57 %   |
| Netsol-Abraxas Australia | 68,782      | 1.10 %   | 2,844       | 0.03 %   |
| Netsol-Thailand          | 98,202      | 1.58 %   | 203,732     | 2.42 %   |
|                          | 4,403,020   | 70.69 %  | 5,070,110   | 60.34 %  |
| Total                    | \$6,228,708 | 100.00 % | \$8,403,071 | 100.00 % |

## NETSOL TECHNOLOGIES, INC.

The following table sets forth the items in our unaudited condensed consolidated statement of operations for the three months ended September 30, 2011 and 2010 as a percentage of revenues.

|  | For the Three Months<br>Ended September 30, |        |   |              |        |   |
|--|---|--------|---|--------------|--------|---|
|  | 2011  | %      |   | 2010         | %      |   |
| Net Revenues:  |   | %      |   |              | %      |   |
| License fees   | \$ 1,075,850                                | 17.27  | % | \$ 3,477,793 | 41.39  | % |
| Maintenance fees                                       | 2,037,206                                   | 32.71  | % | 1,669,919    | 19.87  | % |
| Services   | 3,115,651                                   | 50.02  | % | 3,255,360    | 38.74  | % |
| Total revenues   | 6,228,708                                   | 100.00 | % | 8,403,071    | 100.00 | % |
| Cost of revenues:                                      |   |        |   |              |        |   |
| Salaries and consultants                               | 2,383,411                                   | 38.26  | % | 1,986,888    | 23.64  | % |
| Travel   | 285,673                                     | 4.59   | % | 231,612      | 2.76   | % |
| Repairs and maintenance                                | 74,194                                      | 1.19   | % | 57,058       | 0.68   | % |
| Insurance  | 35,868                                      | 0.58   | % | 30,992       | 0.37   | % |
| Depreciation and amortization                          | 789,105                                     | 12.67  | % | 630,941      | 7.51   | % |
| Other  | 516,409                                     | 8.29   | % | 243,138      | 2.89   | % |
| Total cost of revenues                                 | 4,084,660                                   | 65.58  | % | 3,180,629    | 37.85  | % |
| Gross profit   | 2,144,048                                   | 34.42  | % | 5,222,442    | 62.15  | % |
| Operating expenses:                                    |   |        |   |              |        |   |
| Selling and marketing                                  | 700,281                                     | 11.24  | % | 483,970      | 5.76   | % |
| Depreciation and amortization                          | 191,674                                     | 3.08   | % | 266,443      | 3.17   | % |
| Bad debt expense                                       | 192,250                                     | 3.09   | % | 254,632      | 3.03   | % |
| Salaries and wages                                     | 806,564                                     | 12.95  | % | 920,264      | 10.95  | % |
| Professional services, including non-cash compensation | 186,749                                     | 3.00   | % | 139,085      | 1.66   | % |
| General and administrative                             | 892,972                                     | 14.34  | % | 1,132,519    | 13.48  | % |
| Total operating expenses                               | 2,970,490                                   | 47.69  | % | 3,196,913    | 38.04  | % |
| Income from operations                                 | (826,442 )                                  | -13.27 | % | 2,025,530    | 24.10  | % |
| Other income and (expenses)                            |   |        |   |              |        |   |
| Loss on sale of assets                                 | (1,641 )                                    | -0.03  | % | (14,794 )    | -0.18  | % |
| Interest expense                                       | (251,430 )                                  | -4.04  | % | (315,644 )   | -3.76  | % |
| Interest income  | 32,805                                      | 0.53   | % | 84,461       | 1.01   | % |
| Gain (loss) on foreign currency exchange transactions  | (120,906 )                                  | -1.94  | % | 1,073,894    | 12.78  | % |
| Share of net loss from equity investment               | (100,000 )                                  | -1.61  | % | (70,438 )    | -0.84  | % |
| Beneficial conversion feature                          | (21,583 )                                   | -0.35  | % | (177,411 )   | -2.11  | % |
| Other expense  | (7,718 )                                    | -0.12  | % | (55,554 )    | -0.66  | % |
| Total other income (expenses)                          | (470,474 )                                  | -7.55  | % | 524,515      | 6.24   | % |
| Net income (loss) before income taxes                  | (1,296,916)                                 | -20.82 | % | 2,550,045    | 30.35  | % |
| Income taxes   | (24,534 )                                   | -0.39  | % | (8,556 )     | -0.10  | % |
| Net income (loss) after tax                            | (1,321,451)                                 | -21.22 | % | 2,541,489    | 30.24  | % |
| Non-controlling interest                               | (137,258 )                                  | -2.20  | % | (974,508 )   | -11.60 | % |
| Net income (loss) attributable to NetSol               | (1,458,708)                                 | -23.42 | % | 1,566,980    | 18.65  | % |

Net revenues for the quarter ended September 30, 2011 were \$6,228,708 as compared to \$8,403,071 for the quarter

ended September 30, 2010. This reflects a decrease of \$2,174,364 or 25.88% in the current quarter as compared to the quarter ended September 30, 2010. License revenue decreased from \$3,477,793 to \$1,075,850. This is decrease of \$2,401,942 or 69%. This unprecedented decrease is due to delay in signing of new contracts with some of our existing and new prospective customers. This is mainly due to the geo-political conditions of South Asia and overall global economic worries causing some of the customers to take more than normal time to sign off on the deals. The management anticipates this delay to be of a short term nature and is confident that transactions will be back on track very soon. Services revenue, which also includes consulting and implementation, decreased to \$3,115,651 as compared to \$3,255,360 last year. This is a slight decrease by 1.29%. During the current quarter, the company got one new contract of NFS including implementation, data migration and consulting services. Besides this new contract, the company also received additional enhancements and consultancy work from its existing customers. Maintenance fees increased by \$367,288, or 21.99%, as compared to the corresponding period last year. As we sell more licenses, this fee is expected to further increase in future.

## NETSOL TECHNOLOGIES, INC.

The gross profit was \$2,144,048 in the quarter ending September 30, 2011, as compared with \$5,222,442 for the same quarter of the previous year. This is a decrease of 58.95% or \$3,078,394. The gross profit percentage for the quarter decreased to 34.42% from 62.15% in the quarter ended September 30, 2010. This decrease in gross profit percentage is due to decrease in revenues of the company. The cost of sales was \$4,084,660 in the current quarter compared to \$3,180,629 in the comparable quarter of fiscal 2010. As a percentage of sales it increased from 37.85% for the quarter ended September 30, 2010 to 65.58% in the current quarter. Salaries and consultant fees increased by \$396,523, from \$1,986,888, in the prior comparable quarter, to \$2,383,411. As a percentage of sales, it increased by 19.96% from 23.64% in the prior comparable quarter to 38.26% in the current quarter. The increase in salaries is due to hiring of new employees in key locations including Pakistan, Thailand and North America. Depreciation and amortization expense also increased to \$789,105 compared to \$630,941 in the corresponding quarter last year or an increase of \$158,164. The company has certain intangible assets under development and as soon as an asset is ready for market, its amortization is started, hence this increase.

Operating expenses were \$2,970,490 for the quarter ending September 30, 2011 as compared to \$3,196,913, for the corresponding period last year for a decrease of 7.08% or \$226,423. As a percentage of sales it increased by 9.65% from 38.04% to 47.69%. Depreciation and amortization expense amounted to \$191,674 and \$266,443 for the quarter ended September 30, 2011 and 2010, respectively. Combined salaries and wage costs were \$806,564 and \$920,264 for the comparable periods, respectively. As a percentage of sales, these costs increased from 10.95% to 12.95%. General and administrative expenses were \$892,972 and \$1,132,519 for the quarters ended September 30, 2011 and 2010, respectively, a decrease of \$239,547 or 21.15%. As a percentage of sales, these expenses were 14.34% in the current quarter compared to 13.48% in the comparable quarter. The decrease is mainly attributable due to control over some non-cash expense on share based compensation. The Company has to recognize expense using the Black-Schole formula on the share based compensation of some of its employees and officers. Due to reduction in the share-based compensation, this expense has been reduced in the current quarter.

Selling and marketing expenses were \$700,281 and \$483,970, in the quarter ended September 30, 2011 and 2010, respectively. Professional services expense increased 34.27% to \$186,749 in the quarter ended September 30, 2011, from \$139,085 in the corresponding period last year.

Loss from operations was \$826,442 compared to income of \$2,025,530 for the quarters ended September 30, 2011 and 2010, respectively. This represents a decrease of \$2,851,971 for the quarter compared with the comparable period in the prior year. As a percentage of sales, net loss from operations was 13.27% in the current quarter compared to income of 24.1% in the prior period.

Net loss attributable to common shareholders was \$1,458,708 compared to net income of \$1,566,980 for the quarters ended September 30, 2011 and 2010, respectively. This is a decrease of \$3,025,689 compared to the prior year. Included in this loss is foreign currency exchange loss of \$120,906 compared to a gain of \$1,073,894. The current fiscal quarter amount includes a net reduction of \$137,258 compared to \$974,508 in the prior period for the 49.9% non-controlling interest in NetSol Innovation owned by other parties, and the 39.48% non-controlling interest in NetSol PK. Interest expense was \$251,430 in the current quarter as compared to \$315,644 in the comparable period. Net loss per share, basic and diluted, was \$0.03 as compared to net income of \$0.04 for the quarters ended September 30, 2011 and 2010.

The net EBITDA loss was \$234,769 compared to income \$2,704,103 for the quarters ended September 30, 2011 and 2010, after addition of amortization and depreciation charges of \$980,779 and \$897,384, income taxes of \$24,534 and \$8,556, and interest expense of \$251,430 and \$315,644, and deduction of interest income \$32,805 and \$84,461 respectively. The EBITDA loss per share, basic and diluted was \$0.004 for the quarter ended September 30, 2011 as compared with basic and diluted EBITDA earnings of \$0.07 and \$0.06 for the quarter ended September 30, 2010. As



a percentage of revenues EBITDA was 3.63% compared to 32.18% for the quarters ended September 30, 2011 and 2010, respectively. Although the net EBITDA income is a non-GAAP measure of performance, we are providing it because we believe it to be an important supplemental measure of our performance that is commonly used by securities analysts, investors, and other interested parties in the evaluation of companies in our industry. It should not be considered as an alternative to net income, operating income or any other financial measures calculated and presented, nor as an alternative to cash flow from operating activities as a measure of our liquidity. It may not be indicative of the Company's historical operating results nor is it intended to be predictive of potential future results.

## NETSOL TECHNOLOGIES, INC.

## LIQUIDITY AND CAPITAL RESOURCES

In summary, our cash flows were as follows (in millions):

|   | For the Three Months<br>Ended September 30, |          |
|---|---|----------|
|   | 2011  | 2010     |
| Net cash provided by (used in) operating activities | 0.884                                       | (0.114 ) |
| Net cash used in investing activities               | (3.294 )                                    | (2.687 ) |
| Net cash provided by financing activities           | 1.410                                       | 0.952    |

We note that the Company's cash position was \$3,123,686 at September 30, 2011, compared to \$2,154,813 at September 30, 2010.

Net cash provided by operating activities amounted to \$883,901 for the three months ended September 30, 2011, as compared to net cash consumed of \$113,820 for the comparable period last fiscal year. The increase is mainly due to an increase in accounts receivable and other current assets. The average collection cycle for accounts receivables ranges between three to six months from the date of invoicing. The average days sales outstanding, for the period ended September 30, 2011, was 205 days as compared with 173 days in same period of fiscal 2011.

Net cash used by investing activities amounted to \$3,293,974 for the three months ended September 30, 2011, as compared to \$2,686,900 for the comparable period in last fiscal year. The Company had net purchases of property and equipment of \$1,427,884 compared to \$682,676 for the comparable period last fiscal year. Besides purchasing new hardware and equipment, major expense was incurred on construction of additional infrastructure to house the increasing demand of resources. The Company also made a further investment of \$100,000 in Atheeb NetSol (KSA) in current period.. The increase in intangible assets which represents amounts capitalized for the development of new products was \$1,768,681 and \$1,574,143 for the comparable periods.

Net cash provided by financing activities amounted to \$1,410,133 and \$952,233 for the three months ended September 30, 2011, and 2010, respectively. The Company generated \$nil through sale of its common stock whereas in the corresponding period of fiscal 2010, the cash generated through sale of common stock was \$2,021,139. The three months ended September 30, 2011 included the cash inflow of \$140,000 from the exercising of stock options and warrants compared to \$186,875 in three months ended September 30, 2010. In the current fiscal period, the Company had net payments on account of bank loans, loans and capital leases of \$4,743,372 as compared to \$2,365,852 in the comparable period last year. The Company is operating in varying geographical regions of the world through its various subsidiaries. Those subsidiaries have financial arrangements from various financial institutions to meet both their short and long term funding requirements. These loans will become due at different maturity dates the detail of which is given in Note No. 12 of the annexed financial statements. The company and all its subsidiaries are in compliance with the covenants of the financial arrangements and there is no default, whatsoever, which may lead to early payment of these obligations. The Company anticipates to pay back all these obligations on their respective due dates from its own sources.

We remain open to strategic relationships that would provide value added benefits. The focus will remain on continuously improving cash reserves internally and as well on external capital raise to bolster our cash position.

As a growing company, we have on-going capital expenditure needs based on our short term and long term business plans. Although our requirements for capital expenses vary from time to time, for the next 12 months, we anticipate needing working capital of \$5.0 to \$7.0 million for US, European and UAE, new business development activities and

infrastructure enhancements. In addition, the Company needs to be ready to support larger projects and win higher value NFS contracts by constantly strengthening its balance sheet.

While there is no guarantee that any of these methods will result in raising sufficient funds to meet our capital needs or that even if available will be on terms acceptable to the Company, we will be very cautious and prudent about any new capital raise given the global market declines. However, the Company is very conscious of the dilutive effect and price pressures in raising equity-based capital.

Page | 36

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NETSOL TECHNOLOGIES, INC.

Financial Covenants

Our UK based subsidiary, NetSol Technologies Europe Limited (NTE) has an approved overdraft facility of £200,000 which requires that the aggregate amount of invoiced trade debtors (net of provisions for bad and doubtful debts and excluding intra-group debtors) of NTE, not exceeding 90 days old, will not be less than an amount equal to 200% of the facility. The Pakistani subsidiary, NetSol Technologies Limited (NTPK) has an approved facility for both export refinance and term finance from Askari Bank Limited amounting to Rupees 400 million (\$4,540,295 approximately) which requires NTPK to maintain a long term debt equity ratio of 60:40 and the current ratio of 1:1.

As of the date of this report, the Company and all its subsidiaries are in compliance with the financial covenants associated with its borrowings. The maturity dates of the borrowings of respective subsidiaries may accelerate if they do not comply with these covenants. In case of any change in control in subsidiaries, they may have to repay their respective credit facilities.

Item 3. Quantitative and Qualitative Disclosures About Market Risks.

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act, as of the end of the period covered by this Report (September 30, 2011). Based upon that evaluation, the Chief Financial Officer and Chief Executive Officer concluded that our disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting

Our management has the responsibility to establish and maintain adequate internal controls over our financial reporting, as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934. Our internal controls are designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our external financial statements in accordance with generally accepted accounting principles (GAAP).

Due to inherent limitations of any internal control system, management acknowledges that there are limitations as to the effectiveness of internal controls over financial reporting and therefore recognize that only reasonable assurance can be gained from any internal control system. Accordingly, our internal control system may not detect or prevent material misstatements in our financial statements and projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and participation of management, including the Chief Executive Officer and Chief Financial Officer, we have performed an assessment of the effectiveness of our internal controls over financial reporting as of September 30, 2011. This assessment was based on the criteria established in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the results of our assessment, the Company has determined that as of September 30, 2011, there was a material weakness in the Company's internal control over financial reporting. Specifically, while in the performance of this assessment, management identified that its accounting staff do not have sufficient technical accounting knowledge relating to

accounting for complex U.S. GAAP matters. In particular, although our CFO is a Chartered Accountant (CA) in Pakistan neither he, nor our controllers, holds a Certified Public Accounting (CPA) license in the United States. While the CA certification is recognized in several key countries relative to the Company's operations, including Pakistan, the United Kingdom, and other British Commonwealth countries, the Company has determined that a deficiency exists with respect to required financial reporting expertise in the United States. Based on this evaluation, management concluded that our internal control over financial reporting was not effective as of June 30, 2011. Notwithstanding the existence of such material weakness in our internal controls over financial reporting, our management, including our Chief Executive Officer, believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

NETSOL TECHNOLOGIES, INC.

Management is committed to remediating the material weakness as quickly as possible and we will continue to encourage our current accounting staff to both further their continuing education and to sit for the Certified Public Accountant exam in the United States. Additionally, and in recognition of immediate financial reporting needs, the Company intends to implement additional controls and procedures during the current fiscal year to continue to ensure timely and accurate financial reporting objectives. Such additional controls and procedures may include: The retention of a U.S. based CPA as Chief Financial Officer with U.S. GAAP experience and appropriate knowledge of internal controls over financial reporting, for purposes of appropriate oversight of the financial reporting process and continued training of the accounting staff; recruitment of additional personnel with relevant U.S. GAAP experience to enhance our financial reporting and internal control function; retention of the services of a consultant for advisory services with respect to SOX 404 compliance.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter of fiscal year 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

To the best knowledge of Company's management and counsel, there is no material litigation pending or threatened against the Company.

Item 1.A. Risk Factors

We have received a notice of failure to comply with the minimum bid price required by nasdaq listing rules. while we have 180 calendar days from the date of the notice to regain compliance, there is no guarantee that we will be able to regain compliance within the time frame, that should we fail to regain compliance during the initial grace period that we will be able to meet the criteria for a further grace period or that even if we regain compliance that we shall be able to continue to meet the minimum bid price requirements.

On September 2, 2011, we received a notice from NASDAQ of failure to comply with a continued listing rule, specifically the minimum bid price of NASDAQ Listing Rule 5550(a)(2). We have a grace period of 180 calendar days in which to regain compliance and there is no guarantee that this will happen. Should we fail to regain compliance during the initial grace period, there is no guarantee that we will meet the criteria for a further grace period. Failure to regain compliance could result in delisting of our common stock from NASDAQ.

**BOTH THE RECOVERY FROM THE RECENT ECONOMIC RECESSION AND RECOVERY FROM RECENT NATURAL DISASTERS MAY AFFECT OUR CUSTOMERS' PURCHASING AND PAYMENT DECISIONS, NEGATIVELY AFFECTING OUR PIPELINE AND ACCOUNTS RECEIVABLES.**

A number of our customers are auto manufacturers with corporate headquarters in Japan. The Japanese earthquake and tsunami has delayed some customers' decisions to upgrade or increase implementations of our projects. This, coupled with the sluggish economic recovery in North America and Europe, may slow new orders. A slowdown in new orders could result in less revenue. Further, economic pressures have caused some customers to slow payment of outstanding invoices. Should this slower payment cycle continue, our accounts receivables may increase and we could, potentially, be required to make provisions for bad debts.



NETSOL TECHNOLOGIES, INC.

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

In July 2011, the Company issues 80,000 shares of common stock to its independent directors as compensation for services performed through June 30, 2011. The shares were issued based on an exemption from registration under Rule 4(6) of the Securities Act of 1933, as amended. Each independent director is an accredited investor with access to information regarding the Company by virtue of their position on the board of directors.

In July 2011, the Company issued 12,000 shares of common stock to its investor relation firm as part of the compensation due to the firm in exchange for services performed. The shares were issued based on an exemption from registration under Rule 4(6) of the Securities Act of 1933, as amended. The firm is an accredited investor with access to information regarding the Company by virtue of its position as investor relations advisor.

In July 2011, the Company issued shares of common stock to non-director, officers of the Company. The shares were issued for services rendered through June 30, 2011 and were issued based on an exemption from registration under Rule 4(6) of the Securities Act of 1933, as amended. Each employee is an accredited investor with access to information regarding the Company by virtue of their position with the Company.

In September 2011, NetSol Technologies, Inc. entered into a purchase agreement to sell convertible notes with a total principal value of \$4,000,000 and warrants to purchase shares of common stock to an investment fund managed by CIM Investment Management Limited and another accredited investor. The notes have a 2 year maturity date and are convertible into shares of common stock at the initial conversion price of \$0.895 per share, which conversion price was determined as of September 13, 2011, the date of the purchase agreement. The warrants have a 5 year term and have an initial exercise price of \$0.895 per share. The issuance of the notes and warrants was made in reliance on an exemption from registration available under Regulation D of the Securities Act of 1933, as amended.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission Of Matters To A Vote Of Security Holders

None.

Item 5. Other Information

On November 7, 2011, the Compensation Committee of the Company, consisting of the independent members of the board, approved amendments to the employment agreements of the executive members of the board as well as the Chief Financial Officer and the Secretary. These amendments provide for a 5% cash compensation increase for the executive members of the board (as compensation solely for their executive duties) and a 10% cash compensation increase for the Chief Financial Officer and Secretary. The amendments of the executives' employment agreements are filed with this 10-Q.

Item 6. Exhibits

10.45 Amendment to Employment Agreement of Najeeb Ghauri dated November 7, 2011

10.46 Amendment to Employment Agreement of Naeem Ghauri dated November 7, 2011



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- 10.47 Amendment to Employment Agreement of Salim Ghauri dated November 7, 2011
- 10.48 Amendment to Employment Agreement of Boo-Ali Siddiqui dated November 7, 2011
- 10.49 Amendment to Employment Agreement of Patti L. W. McGlasson dated November 7, 2011
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CEO)
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CFO)
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CEO)
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CFO)

Page | 39

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NETSOL TECHNOLOGIES, INC.

SIGNATURES

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

NETSOL TECHNOLOGIES, INC.

Date: 8-Nov-11 /s/ Najeeb  
Ghauri  
NAJEEB  
GHAURI  
Chief  
Executive  
Officer

Date: 8-Nov-11 /s/Boo-Ali  
Siddiqui  
BOO-ALI  
SIDDIQUI  
Chief  
Financial  
Officer  
Principal  
Accounting  
Officer

