

ARI NETWORK SERVICES INC /WI
Form 10-Q
December 16, 2013
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2013

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

For the transition period from _____ to _____

Commission file number 000-19608

ARI Network Services, Inc.

(Exact name of registrant as specified in its charter)

WISCONSIN 39-1388360

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

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

(Address of principal executive offices)

(414) 973-4300

(Registrant's telephone number, including area code)

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

YES ☐ NO ☒

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (S232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☐ NO ☒

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

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☒ Smaller reporting company ☐

(Do not check if a smaller reporting
reporting company)

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

YES ☐ NO ☒

As of December 9, 2013 there were 13,131,588 shares of the registrant's common stock outstanding.

ARI Network Services, Inc.

FORM 10-Q

FOR THE THREE MONTHS ENDED OCTOBER 31, 2013

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Item 1. Financial Statements

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

	October 31 2013	July 31 2013
ASSETS		
Cash and cash equivalents	\$ 1,121	\$ 2,195
Trade receivables, less allowance for doubtful accounts of \$227 and \$220 at October 31, 2013 and July 31, 2013, respectively	1,369	945
Work in process	117	154
Prepaid expenses and other	819	934
Deferred income taxes	2,817	2,938
Total current assets	6,243	7,166
Equipment and leasehold improvements:	2,752	2,641

Computer equipment and software for internal use		
Leasehold improvements	612	609
Furniture and equipment	2,636	2,561
	6,000	5,811
Less accumulated depreciation and amortization	4,125	3,948
Net equipment and leasehold improvements	1,875	1,863
Capitalized software product costs:		
Amounts capitalized for software product costs	21,362	20,814
Less accumulated amortization	17,048	16,604
Net capitalized software product costs	4,314	4,210
Deferred income taxes	3,451	3,451
Other long term assets	120	141
Other intangible assets	3,949	4,099
Goodwill	12,198	12,198

Total assets	\$ 32,150	\$ 33,128
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ARI Network Services, Inc.
Consolidated Balance Sheets
(Dollars in Thousands, Except per Share Data)
(Unaudited)

	October 31 2013	July 31 2013
LIABILITIES		
Current portion of long-term debt	\$ 506	\$ 450
Current portion of contingent liabilities	318	303
Accounts payable	553	710
Deferred revenue	7,933	8,571
Accrued payroll and related liabilities	1,295	1,434
Accrued sales, use and income taxes	104	147
Other accrued liabilities	590	316
Current portion of capital lease obligations	30	24
Total current liabilities	11,329	11,955
Long-term debt	3,882	4,050
Common stock warrants at fair value	276	254
Long-term portion of contingent liabilities	151	418
Capital lease obligations	163	169
Other long term liabilities	228	233
Total non-current liabilities	4,700	5,124
Total liabilities	16,029	17,079
SHAREHOLDERS' EQUITY		
Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at October 31, 2013 and July 31, 2013, respectively	-	-
Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at October 31, 2013 and July 31, 2013, respectively	-	-
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 12,996,588 and 12,976,588 shares issued and outstanding at October 31, 2013 and July 31, 2013, respectively	13	13
Additional paid-in capital	104,868	104,816
Accumulated deficit	(88,737)	(88,762)
Other accumulated comprehensive loss	(23)	(18)
Total shareholders' equity	16,121	16,049
Total liabilities and shareholders' equity	\$ 32,150	\$ 33,128

See accompanying notes

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

	Three months ended October 31	
	2013	2012
Net revenue	\$ 8,160	\$ 5,942
Cost of revenue	1,560	1,408
Gross profit	6,600	4,534
Operating expenses:		
Sales and marketing	2,457	1,221
Customer operations and support	1,611	1,046
Software development and technical support (net of capitalized software product costs)	556	613
General and administrative	1,488	1,071
Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue)	321	280
Net operating expenses	6,433	4,231
Operating income	167	303
Other income (expense):		
Interest expense	(70)	(68)
Loss on change in fair value of stock warrants	(22)	-
Gain on change in fair value of estimated contingent liabilities	26	-
Other, net	8	4
Total other expense	(58)	(64)
Income before provision for income tax	109	239
Income tax expense	(84)	(126)
Net income	\$ 25	\$ 113
Net income per common share:		
Basic	\$ 0.00	\$ 0.01
Diluted	\$ 0.00	\$ 0.01

See accompanying notes

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

	Three months ended October 31	
	2013	2012
Net income	\$ 25	\$ 113
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(5)	(10)
Total other comprehensive income	(5)	(10)
Comprehensive Income	\$ 20	\$ 103

See accompanying notes

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

Three months ended	
October 31	
2013	2012
Operating activities:	
Net income	
\$ 25	\$ 113
Adjustments to reconcile net income to net cash provided by operating activities:	
Amortization of software products	
44	396
Amortization of discount related to present value of earned	
(4)	(8)
Amortization of bank loan fees	
31	12
321	279

Depreciation and other amortization Loss on change in fair value of stock warrants	-
Gain on change in fair value of contingent liabilities	-
Provision for bad debt allowance	25
Deferred income taxes	105
Stock based compensation related to stock options	37
Net change in assets and liabilities:	
Trade receivables	(153)
Work in process	(119)
Prepaid expenses and	15

other	
Other	
long	
term	
assets(17)	(32)
Accounts	
payable(158)	(195)
Deferred	
revenue(68)	(295)
Accrued	
payroll	
and	
related	
liability(140)	85
Accrued	
sales,	
use	
and	
income	
taxes(43)	(97)
Other	
accrued	
liability(169)	341
Net	
cash	
provided	
by	
(used	
in)	
operating	
activities(26)	\$ 509
Investing	
activities:	
Purchase	
of	
equipment,	
software	
and	
leasehold	
improvements(189)	(381)
Earnest	
money	
paid	
for	
business	
acquisition	(900)
Cash 37	49
received	
on	
earnout	
from	

disposition		
of		
a		
component		
of		
the		
business		
Cash		
paid		
for		
contingent		
liabilities		
related		
to		
acquisitions	(250)	-
Net		
cash		
paid		
for		
net		
assets		
related		
to		
acquisitions	(898)	
Software		
development		
costs		
capitalized	(548)	(396)
Net		
cash		
used		
in		
investing		
activities	(952)	\$ (2,526)
Financing		
activities:		
Borrowings		
(repayments)		
under		
line		
of		
credit-	220	
Payments		
on		
long-term		
debt (112)	(247)	
Borrowings		
under		
long-term		
debt -	1,000	
-	(49)	

Payments of capital lease obligations		
Proceeds from issuance of common stock	16	8
Net cash provided by (used in) financing activities	(96)	\$ 932
Effect of foreign currency exchange rate changes on cash	-	(4)
Net change in cash and cash equivalents	(1,074)	(1,089)
Cash and cash equivalents at beginning of period	1,195	1,350
Cash and cash equivalents at end of period	1,121	\$ 261

Cash paid for interest	\$ 65
Cash paid for income taxes	\$ 114
Noncash investing and financing activities	
Issuance of common stock in connection with acquisitions	\$ 101
Accrued liabilities assumed in connection with acquisitions	86
Issuance of common stock related to payment of executive compensation	22
Contingent liabilities incurred in connection with acquisition	749
See accompanying notes	

Notes to Unaudited Consolidated Financial Statements

1. Description of the Business and Significant Accounting Policies

Description of the Business

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

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

Basis of Presentation

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

marketing, customer operations and support, software development and technical support and general and administrative expenses. This had no impact on gross profit, total operating expenses or net income.

Significant Accounting Policies

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

Revenue Recognition

Revenue from software licenses, annual or periodic maintenance fees and catalog subscription fees, which are included in multiple element arrangements, are all recognized ratably over the contractual term of the arrangement, as vendor specific objective evidence does not exist for these elements. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

Revenue for use of the network and for information services is recognized on a straight-line basis over the term of the contract.

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

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

Revenue for variable transaction fees, primarily for use of the shopping cart feature of our websites, is recognized as it is earned.

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

Amounts received for shipping and handling fees are reflected in revenue. Costs incurred for shipping and handling are reported in cost of revenue.

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

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

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

Capitalized and Purchased Software Product Costs

Certain software development and acquisition costs are capitalized when incurred. Capitalization of these costs begins upon the establishment of technological feasibility. The establishment of technological feasibility and the on-going assessment of recoverability of software costs require considerable judgment by management with respect to certain

external factors, including, but not limited to, the determination of technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technologies.

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

Fair Value Assets and Liabilities

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

Common Stock Warrants

ARI has periodically issued common stock warrants in connection with debt and equity financing arrangements. The terms of the agreements are assessed to determine whether the instrument qualifies as an equity arrangement or a debt arrangement. Arrangements determined to be derivatives are recorded at fair value as liabilities on the balance sheet, with periodic gains and losses related to the change in fair value recorded to earnings on the Statement of Income.

Legal Provisions

ARI may be periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable and can be reasonably estimated. We had no legal provisions for the three months ended October 31, 2013 and 2012.

Deferred Loan Fees and Debt Discounts

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

Deferred Income Taxes

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

2. Basic and Diluted Net Income per Share

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

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

	Three months ended October 31	
	2013	2012
Net income	\$ 25	\$ 113
Weighted-average common shares outstanding	12,995	8,123
Effect of dilutive stock options and warrants	763	126
Diluted weighted-average common shares outstanding	13,758	8,249
Earnings per share		
Basic	\$ 0.00	\$ 0.01
Diluted	\$ 0.00	\$ 0.01
Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive	-	902

3. Stock-based Compensation Plans

Stock Option Plans

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

As recognizing stock-based compensation expense is based on awards ultimately expected to vest, the amount of recognized expense has been reduced for estimated forfeitures based on the Company's historical experience. Total stock compensation expense recognized by the Company was approximately \$36,000 and \$37,000 for the three month

periods ended October 31, 2013 and 2012, respectively. There was approximately \$110,000 and \$155,000 of total unrecognized compensation costs related to non-vested options granted under the Company's stock option plans as of October 31, 2013 and 2012, respectively. There were no capitalized stock-based compensation costs at October 31, 2013 or July 31, 2012.

The fair value of each option granted was estimated in the period of issuance using the assumptions in the following table for the three months ended October 31, 2013 and 2012:

	Three months ended October 31	
	2013	2012
Expected life (years)	n/a	10 years
Risk-free interest rate	n/a	1.6 %
Expected volatility	n/a	130.1 %
Expected forfeiture rate	n/a	22.0 %
Expected dividend yield	n/a	- %
Weighted-average estimated fair value of options granted during the year	\$ n/a	\$ 0.96
Cash received from the exercise of stock options	\$ 15,400	\$ 8,191
2000 Stock Option Plan		

The Company's 2000 Stock Option Plan (the "2000 Plan") had 1,950,000 shares of common stock authorized for issuance. Each incentive stock option that was granted under the 2000 Plan is exercisable for a period of not more than 10 years from the date of grant (five years in the case of a participant who is a 10% shareholder of the Company, unless the stock options are

nonqualified), or such shorter period as determined by the Compensation Committee, and shall lapse upon the expiration of said period, or earlier upon termination of the participant's employment with the Company. The 2000 Plan expired on December 13, 2010, at which time it was terminated except for outstanding options. As a result, no new options may be granted under the 2000 Plan. Changes in option shares under the 2000 Plan during the three months ended October 31, 2013 and 2012 were as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/12	1,099,769	\$ 1.41	5.06	\$ 105,849
Granted	-	n/a	n/a	n/a
Exercised	(10,800)	0.58	n/a	6,194
Forfeited	(86,508)	1.58	n/a	n/a
Outstanding at 10/31/12	1,002,461	\$ 1.40	4.97	\$ 114,006
Exercisable at 10/31/12	926,874	\$ 1.46	4.73	\$ 78,772
Outstanding at 7/31/13	986,786	\$ 1.41	4.22	\$ 1,564,296
Granted	-	n/a	n/a	n/a
Exercised	(20,000)	0.77	n/a	50,000
Forfeited	(3,125)	0.95	n/a	n/a
Outstanding at 10/31/13	963,661	\$ 1.43	3.93	\$ 1,773,485
Exercisable at 10/31/13	948,700	\$ 1.44	3.88	\$ 1,733,891

The range of exercise prices for options outstanding under the 2000 Plan was \$0.49 to \$2.74 and \$0.15 to \$2.74 at October 31, 2013 and 2012, respectively.

Changes in the 2000 Plan's non-vested option shares included in the outstanding shares above during the three months ended October 31, 2013 and 2012 were as follows:

	Number of Options	Wtd. Avg. Exercise Price
Non-vested at 7/31/12	78,087	\$ 0.69
Granted	-	n/a

Vested	-	n/a
Forfeited	(2,500)	0.73
Non-vested at 10/31/12	75,587	\$ 0.68
Non-vested at 7/31/13	27,461	\$ 0.64
Granted	-	n/a
Vested	(12,500)	0.67
Forfeited	-	n/a
Non-vested at 10/31/13	14,961	\$ 0.62

The weighted average remaining vesting period was .75 and 1.12 years at October 31, 2013 and 2012, respectively.

2010 Equity Incentive Plan

The Board of Directors adopted the ARI Network Services, Inc. 2010 Equity Incentive Plan (the “2010 Plan”) on November 9, 2010, and the plan was approved by the Company's shareholders in December 2010. The 2010 Plan is the successor to the Company’s 2000 Plan.

The 2010 Plan includes the following provisions:

- the aggregate number of shares of Common Stock subject to the 2010 Plan is 650,000 shares;
- the exercise price for options and stock appreciation rights cannot be less than 100% of the fair market value, as defined, of the Company’s Common Stock on the date of grant;

- the exercise prices for options and stock appreciation rights cannot be repriced without shareholder approval, except to reflect changes to the capital structure of the Company as described in the 2010 Plan;
- a maximum term of ten (10) years for options and stock appreciation rights;
- a maximum of 325,000 of the shares available for issuance under the 2010 Plan can be in the form of restricted shares or restricted stock units, and the 2010 Plan does not have liberal share counting provisions (such as provisions that would permit shares withheld for payment of taxes or the exercise price of stock options to be re-granted under the plan); and
- awards cannot be transferred to third parties, with the exception of certain estate planning transfers, which can be made if the committee that administers the 2010 Plan approves such transfers.

Changes in option shares under the 2010 Plan during the three months ended October 31, 2013 and 2012 were as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/12	310,667	\$ 1.10	9.28	\$ 41,962
Granted	20,000	1.00	n/a	n/a
Exercised	(3,000)	0.66	n/a	1,485
Forfeited	(3,500)	0.66	n/a	n/a
Outstanding at 10/31/12	324,167	\$ 1.10	9.09	\$ 57,070
Exercisable at 10/31/12	111,710	\$ 1.09	8.97	\$ 22,325
Outstanding at 7/31/13	394,460	\$ 1.25	8.70	\$ 691,485
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(8,875)	1.43	n/a	n/a
Outstanding at 10/31/13	385,585	\$ 1.24	8.45	\$ 781,652
Exercisable at 10/31/13	224,440	\$ 1.21	8.24	\$ 463,167

The range of exercise prices for options outstanding under the 2010 Plan was \$.58 to \$2.50 and \$0.58 to \$1.70 at October 31, 2013 and 2012, respectively.

Changes in the 2010 Plan's non-vested option shares included in the outstanding shares above during the three months ended October 31, 2013 and 2012 were as follows:

	Number of	Wtd. Avg. Exercise Price
Non-vested at 7/31/12	192,707	\$ 1.12
Granted	20,000	1.00
Vested	-	n/a
Forfeited	(250)	0.66
Non-vested at 10/31/12	212,457	\$ 1.11
Non-vested at 7/31/13	177,145	\$ 1.25
Granted	-	n/a
Vested	(15,000)	0.84
Forfeited	(1,000)	1.09
Non-vested at 10/31/13	161,145	\$ 1.29

The weighted average remaining vesting period was 1.49 and 1.61 years at October 30, 2013 and 2012, respectively.

Restricted Stock

During the three months ended October 31, 2012, the Company issued 18,000 shares of restricted stock under the 2010 Plan as a discretionary bonus to an executive of the Company. The shares vest as follows: 4,500 shares vested immediately; 4,500 shares vested on July 31, 2013; 4,500 shares vest on July 31, 2014; and 4,500 shares vest on July 31, 2015. No restricted shares were issued during the three month period ended October 31, 2013.

Employee Stock Purchase Plan

The Company's 2000 Employee Stock Purchase Plan, as amended, ("ESPP") has 225,000 shares of common stock reserved for issuance, of which 200,311 of the shares have been issued as of October 31, 2013 and July 31, 2013, respectively. All employees with at least nine months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.

Long-Term Executive Bonus Plan

The Compensation Committee adopted the Long-Term Executive Bonus Plan ("LTEB") for eligible executive officers of the Company effective beginning in fiscal 2013. The amount of the awards will be determined after the close of the fiscal year based on subjective and performance criteria. Except as otherwise provided by the Compensation Committee, awards will consist of (i) restricted stock based on a percentage of base salary and the number of shares granted will be based upon the closing price of the shares at the time the Committee determines the amount of the Award, which will be the same as the grant date of the restricted stock and (ii) cash, to cover the minimum withholding taxes on the Award. The restricted stock will be granted under the ARI 2010 Equity Incentive Plan and will vest in four installments, beginning on the date of grant and the next three anniversaries of the date of grant. Awards under the LTEB are expensed over the requisite service period plus the vesting period. The Company expensed \$30,000 and \$0 related to the LTEB for the three months ended October 31, 2013 and 2012, respectively.

The Compensation Committee has the ability, at its discretion, to grant restricted stock based on subjective factors as the Compensation Committee may deem appropriate and granted 18,000 of restricted shares with a market price of \$1.25 on the date of grant, valued at \$22,000, in October 2012 as a discretionary bonus. 9,000 shares were vested as of October 2013 and the remaining 13,500 shares vest equally in October 2014 and October 2015. In connection with this grant, the Company expensed \$4,000 in fiscal 2013 and \$1,000 during the three months ended October 31, 2013, with the remaining balance, included in prepaid and other on the balance sheet at October 31, 2013.

4. Business Combinations

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

The Company funded \$1,500,000 of the purchase price through a combination of the Company’s operating cash flows and availability under its existing credit facilities, including a \$900,000 earnest money payment made on October 29, 2012. The balance of the purchase price was funded through a secured non-negotiable promissory note (the “Sifen Note”) issued to Michael D. Sifen, Inc., an affiliate of an existing shareholder of the Company.

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

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

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

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

The following unaudited results of operation for the three months ended October 31, 2013 reflect actual results of the Company, which include the results of the 50 Below operation for the entire period. The unaudited pro forma information for the three months ended October 31, 2012 reflects the historical results of operations of both companies, with pro forma adjustments as if the acquisition had occurred on August 1, 2012. The unaudited pro forma combined financial information does not reflect any cost savings, operating synergies, revenue enhancements or implementation costs that the combined company have achieved as a result of the acquisition. The unaudited pro forma financial information presented is for information purposes only and does not purport to represent what the Company's and 50 Below's financial position or results of operations would have been had the acquisition in fact occurred on such date or at the beginning of the period indicated, nor does it project the Company's and 50 Below's financial position or results of operations for any future date or period.

	Three months ended October 31	
	2013	2012
Revenue	\$ 8,160	\$ 8,343
Net income (loss)	\$ 25	\$ (381)
Net income (loss) per common share:		
Basic	\$ 0.00	\$ (0.04)
Diluted	\$ 0.00	\$ (0.04)

Pro forma adjustments to net income include amortization costs related to internally developed technology and intangible assets, acquisition-related professional fees, interest expense on the debt incurred to acquire the assets of 50 Below and the related debt discount, and the tax effect of the historical 50 Below results of operations and the pro forma adjustments at an estimated tax rate of 40% as follows:

	Three months ended October 31	
	2013	2012
Amortization of internally developed technology	\$ -	\$ 26
Amortization of intangible assets	-	51
Acquisition-related professional fees	-	-
Interest expense	-	129
Income tax benefit	-	(330)

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

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

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

The contingent earn-out payable was initially measured at fair value on a recurring basis calculated using the present value of future estimated revenue over the next three years, which was originally estimated at \$500,000. Prior to the amendment, because the contingent earn-out payable had no comparable market data or significant observable inputs to determine fair value, it was classified as a Level 3 measurement. Because the amended Purchase Agreement defines the future payments and the payments are no longer contingent on future events, the contingent earn-out is

now classified as a Level 1 fair value measurement. Unrealized gains and losses for changes in fair value are recognized in earnings.

The following table shows changes in the estimated holdback and earn-out payable for the three months ended October 31, 2013 (in thousands):

	2013	2012
Beginning Balance	\$ 721	\$ -
Original fair value of holdback and earnout payable	-	749
Payments made	(250)	-
Imputed interest recognized	24	-
Gain on change in fair market value	(26)	-
Ending Balance	\$ 469	\$ 749

The balance of the holdback and the earn-out payable includes \$318,000 in current portion of contingent liabilities and \$151,000 in other long-term liabilities on the unaudited balance sheet at October 31, 2013, with estimated payments as follows (in thousands):

Year Ending July 31,	Contingent Liabilities
2014	\$ 33
2015	315
2016	190
Total Estimated Payments	538
Less imputed interest	44
Present value of Contingent Liabilities	\$ 469

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

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

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

Intangible assets consist primarily of customer contracts and relationships with an estimated useful life of 16 years. Goodwill consists of operating synergies, vendor relationships, new sales territories and industries. The Company incurred legal fees of \$55,000 for the three month period ended October 31, 2012 in connection with the Ready2Ride acquisition, which were included in general and administrative expense. The Company determined that the Ready2Ride assets acquired as described above do not constitute a business that is “significant” as defined in the applicable SEC regulations.

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

5. Disposition of a Component of an Entity

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

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

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

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

An assessment of the expected future cash flows of the earn-out receivable is performed annually in the third fiscal quarter based on historical receipts over the previous twelve-month period. Changes in estimate and cash received in excess of expected cash receipts are recorded as a gain or loss in other expense (income).

The remaining earn-out receivable is composed of \$100,000 included in prepaid expenses and other and \$27,000 included in other long term assets on the unaudited balance sheet at October 31, 2013, with estimated receivables as follows (in thousands):

Year Ending July 31,

2014	\$ 91
2015	51
Total Estimated Payments	142

Less imputed interest	(15)
Present value of Earnout Receivable	\$ 127

The following table shows changes in the earn-out receivable during the three and nine months ended October 31, 2013 and 2012 respectively (in thousands):

	2013	2012
Beginning Balance	\$ 160	\$ 218
Net receipts	(37)	(49)
Imputed interest recognized	4	8
Ending Balance	\$ 127	\$ 177

6. Other Intangible Assets

Amortizable intangible assets include customer relationships, trade names and employee non-compete agreements associated with the Company's acquisitions. Amortizable intangible assets are composed of the following at October 31, 2013 and 2012 (in thousands):

	Customer Relationships			Wgtd avg
	Cost	Accumulated	Net	remaining
	Basis	Amortization	Value	life
Balance 7/31/12	\$ 4,004	- \$ (2,654)	\$ 1,350	
Activity	880	(84)	796	
Balance 10/31/12	\$ 4,884	\$ (2,738)	\$ 2,146	
Balance 7/31/13	\$ 7,064	- \$ (3,090)	\$ 3,974	
Activity	-	(121)	(121)	
Balance 10/31/13	\$ 7,064	\$ (3,211)	\$ 3,853	11.49

	Trade Names			
	Cost	Accumulated	Net	
	Basis	Amortization	Value	
Balance 7/31/12	\$ 253	- \$ (164)	\$ 89	
Activity	-	(11)	(11)	
Balance 10/31/12	\$ 253	\$ (175)	\$ 78	
Balance 7/31/13	\$ 383	- 0 (258)	\$ 125	
Activity	-	(29)	(29)	
Balance 10/31/13	\$ 383	\$ (287)	\$ 96	0.93

	Total Intangibles			
	Cost	Accumulated	Net	
	Basis	Amortization	Value	
Balance 7/31/12	\$ 4,257	- \$ (2,818)	\$ 1,439	
Activity	880	- (95)	785	
Balance 10/31/12	\$ 5,137	\$ (2,913)	\$ 2,224	
Balance 7/31/13	\$ 7,447	- \$ (3,348)	\$ 4,099	
Activity	-	- (150)	(150)	
Balance 10/31/13	\$ 7,447	\$ (3,498)	\$ 3,949	11.23

The estimated amortization expense related to intangible assets for the fiscal years subsequent to October 31, 2013 is as follows (in thousands):

2014	\$ 437
2015	506
2016	485
2017	414
2018	200
Thereafter	1,907
	\$ 3,949

7. Debt

Silicon Valley Bank

On April 26, 2013, the Company entered into a Loan and Security Agreement (the “Agreement”) with Silicon Valley Bank (“SVB”), pursuant to which SVB extended to the Company credit facilities consisting of a \$3,000,000 revolving credit facility with a maturity date of April 26, 2015 and a \$4,500,000 term loan with a maturity date of April 26, 2018. The Agreement replaced the Company’s Loan and Security Agreement with Fifth Third Bank, which is described below.

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to one or more of the following as may be selected by the Company: (a) the one, two or three-month LIBOR Rate (as defined in the Agreement, subject to a floor of 1.00%), plus the Applicable Margin for LIBOR Loans set forth in the chart below, determined based on the most recent Senior Leverage Ratio, defined as total senior indebtedness to earnings before interest, taxes, depreciation and amortization (“EBITDA”), calculated by SVB on a quarterly basis (the “Senior Leverage Ratio”); or (b) the Prime rate plus the Applicable Margin for Prime Rate Loans set forth in the chart below determined based on the Senior Leverage Ratio (effective rate of 3.75% at October 31, 2013).

Senior Leverage Ratio	Applicable Margin for Libor Loans		Applicable Margin for Prime Rate Loans	
>= 1.75 to 1.0:	3.25	%	1.00	%
> 1.25 to 1.00 but <1.75 to 1.00:	3.00	%	0.75	%
<= 1.25 to 1.00:	2.75	%	0.50	%

Principal in respect of any loans made under the revolving facility is required to be paid in its entirety on or before April 26, 2015. Principal in respect of the term loan is required to be paid in quarterly installments on the first day of each fiscal quarter of the Company as follows: \$112,500 commencing on August 1, 2013 through May 1, 2014; \$168,750 commencing on August 1, 2014 through May 1, 2015; and \$281,250 commencing on August 1, 2015 through February 1, 2018. All remaining principal in respect of the term loan is due and payable on April 26, 2018. The Company is permitted to prepay all of, but not less than all of, the outstanding principal amount of the term loan upon certain notice to SVB and, in certain circumstances, the payment of a prepayment penalty of up to \$90,000.

The Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to permit a change of control, incur debt, create liens on its assets, make certain investments, enter into merger or acquisition transactions and make distributions to its shareholders. Financial covenants include the maintenance of a minimum Senior Leverage Ratio equal to or less than 2.00 to 1.00, and the maintenance of a Fixed Charge Coverage Ratio (as defined in the Agreement) equal to or greater than 1.25 to 1.00. The Agreement also contains customary events of default that, if triggered, could result in an acceleration of the Company’s obligations under the Agreement. The loans are secured by a first priority security interest in substantially all assets of the Company. The Company was in compliance with its debt covenants at October 31, 2013.

Fifth Third Bank

On July 27, 2011, the Company entered into a Loan and Security Agreement (the “Loan and Security Agreement”) with Fifth Third Bank (“Fifth Third”). Pursuant to the terms of the Loan and Security Agreement, Fifth Third extended to the Company credit facilities consisting of a \$1,500,000 revolving credit facility (the “Revolving Loan”) and a \$5,000,000 term loan facility (the “Term Loan” and, together with the Revolving Loan, the “Credit Facilities”).

On August 17, 2012, the Credit Facilities were amended to increase the principal amount of the Term Loan by \$1,000,000, and extend the maturity date to December 15, 2014. Each of the Credit Facilities bore interest at a rate based on the one, two, three or six month LIBOR (as selected by the Company on the last business day of each month) plus 4.0%

On November 28, 2012 the Credit Facilities were further amended to waive the provisions of the Agreement that would prohibit ARI’s acquisition of 50 Below and the financing of \$3,500,000 of the acquisition with a secured subordinated promissory note in the same amount. Under the amendment, Fifth Third consented to the acquisition of the 50 Below assets and the related transactions and provided waivers of certain provisions of the Credit Facilities, subject to certain terms and conditions. Such terms and conditions included, among others: (i) amendments to the fixed charge coverage ratio and senior

leverage (maximum senior funded debt to EBITDA) ratio financial covenants; (ii) the addition of a maximum total funded debt to EBITDA ratio financial covenant; (iii) amendment of the revolving loan and term loan maturity dates from July 27, 2014 to December 15, 2013; and (iv) other customary terms and conditions.

On March 8, 2013, the Company entered into the Third Amendment to the Loan and Security Agreement. The Third Amendment was intended for the following purposes: (i) to amend the definition of EBITDA to permit adjustments for certain non-recurring transaction expenses and certain other non-cash expenses; (ii) to amend the required fixed charge coverage ratio for the rolling four fiscal quarter periods ending January 31, 2013 and April 30, 2013 to 0.90 x and 1.00 x, respectively; (iii) to restrict the Company's ability to enter into certain transactions without the prior written consent of Fifth Third, including, without limitation, certain change in control transactions, reclassifications, reorganizations and recapitalizations of the Company's Common Stock; and (iv) to permit the Company to use the net cash proceeds from an equity raise transaction in excess of \$1,500,000 for working capital or to prepay the outstanding principal balance under other debt obligations described below. The Loan Agreement Amendment also contained Fifth Third Bank's consent to the Company raising additional capital by selling and issuing additional equity securities, and waivers by Fifth Third of the provisions of the Loan and Security Agreement that would otherwise have prohibited such a transaction, subject to certain terms and conditions. All amounts owed under the Loan and Security Agreement were paid in full as of April 26, 2013 in connection with the Company's entry into the Agreement with SVB, as described above.

Sifen Note

On November 28, 2012, the Company issued a Secured Non-Negotiable Subordinated Promissory Note (the "Sifen Note") to Michael D. Sifen, Inc. (the "Holder"), an affiliate of an existing shareholder of the Company, in aggregate principal amount of \$3,500,000, the proceeds of which were used to partially fund the 50 Below acquisition. Interest accrued on the outstanding unpaid principal under the Sifen Note at a rate of 10.0% per annum. Accrued interest only was payable quarterly commencing on February 28, 2013 and continuing until May 28, 2016, at which time all accrued interest and outstanding principal would be due and payable in full. As partial consideration for the Sifen Note, the Company issued 440,000 shares of the Company's common stock to the Holder valued at approximately \$585,000, which was recorded as a reduction to long-term debt and was being amortized to interest expense over the life of the note. A portion of the outstanding balance on the Sifen Note was retired in March 2013 in connection with the Holder's acquisition of Company common stock under the Securities Purchase Agreement, described in Note 9, and the remaining balance on the Sifen Note was paid in full as of April 26, 2013.

In the third quarter of fiscal 2013, the Company recognized a loss on the early extinguishment of primarily the Sifen Note and Fifth Third Bank debt totaling \$682,000 related to unamortized deferred loan fees and debt discount.

The following table sets forth certain information related to the Company's long-term debt, derived from our unaudited balance sheet as of October 31, 2013 and audited balance sheet as of July 31, 2013 (in thousands):

	October	
	31	July 31
	2013	2013
Notes payable principal	\$ 4,388	\$ 4,500
Less current maturities	(506)	(450)
Notes payable - non-current	\$ 3,882	\$ 4,050

8. Income Taxes

The unaudited provision for income taxes for the three months ended October 31, 2013 and 2012 is composed of the following (in thousands):

	Three months ended October 31	
	2013	2012
Current:		
Federal	\$ -	\$ -
State	(6)	(22)
Deferred, net	(78)	(104)
Income tax benefit (expense)	\$ (84)	\$ (126)

The provision for income taxes is based on taxes payable under currently enacted tax laws and an analysis of temporary differences between the book and tax bases of the Company's assets and liabilities, including various accruals, allowances, depreciation and amortization, and does not represent current taxes due. The tax effect of these temporary differences and the estimated benefit from tax net operating losses are reported as deferred tax assets and liabilities in the balance sheet. We have unused net operating loss carry forwards ("NOLs") for federal income tax purposes, and as a result, we generally only incur alternative minimum taxes at the federal level.

As of October 31, 2013, after deducting year to date taxable income, the Company had accumulated net operating loss carryforwards for federal and state tax purposes of approximately \$7,180,000 and \$3,819,000, respectively, which expire as follows (in thousands):

Year ended July 31, *	Federal	State
2014	\$ -	\$ 482
2015	-	3,258
2019	182	4
2020	6,043	-
2024	4	-
2025	-	75
2030	946	-
2034	5	-
	\$ 7,180	\$ 3,819

* Years not shown have no amounts that expire.