

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.

YESüNO

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).

YESüNO

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 filerAccelerated filer

Non-accelerated filerSmaller reporting companyü

(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).

YESNOü

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	
liabilities	(14)
	85
Accrued	
sales,	
use	
and	
income	
taxes	(43)
	(97)
Other	
accrued	
liabilities	(16)
	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 reco