ARI NETWORK SERVICES INC /WI
Form 424B3
December 20, 2013
Filed Pursuant to Rule 424(b)(3)

Registration No. 333-188093

PROSPECTUS SUPPLEMENT NO. 3

ARI NETWORK SERVICES, INC.

4,330,667 shares of Common Stock

This prospectus supplement relates to the prospectus dated November 15, 2013, as supplemented by Prospectus Supplement No. 1 dated August 1, 2013 and Prospectus Supplement No. 2 dated December 10, 2013, which covers the sale of an aggregate of up to 4,330,667 shares of our common stock, $0.001 par value per share (the "Common Stock"), by the selling security holders identified in the prospectus (collectively with any such holder's transferee, pledgee, donee or successor, referred to below as the "Selling Shareholders"). The Common Stock covered by the prospectus consists of (i) 3,200,000 shares of Common Stock which were issued in a private placement pursuant to a Securities Purchase Agreement we entered into on March 12, 2013 with selected accredited investors (the "Securities Purchase Agreement"); (ii) 1,066,667 shares of Common Stock issued or issuable upon exercise of warrants issued pursuant to the Securities Purchase Agreement (the "Purchaser Warrants"); and (iii) 64,000 shares of Common Stock issuable upon exercise of the warrants issued to affiliates of the placement agent in connection with the private placement as consideration for the placement agent's services (together with the Purchaser Warrants, the "Warrants").

We will not receive any proceeds from the sale by the Selling Shareholders of the shares covered by the prospectus. To the extent Warrants are exercised for cash, we will receive the exercise price for those Warrants.

This prospectus supplement is being filed to include the information set forth in our quarterly report on Form 10-Q filed on December 16, 2013, which is set forth below. This prospectus supplement should be read in conjunction with the prospectus, which is to be delivered with this prospectus supplement.

Our Common Stock is traded on the NASDAQ Capital Market under the symbol "ARIS". The last reported market price of our Common Stock on the NASDAQ Capital Market on December 16, 2013 was $3.35 per share. Our executive offices are located at 10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224, and our telephone number is (414) 973-4300.

Investing in our securities involves risks. You should carefully consider the Risk Factors beginning on page 1 of the prospectus before you make an investment in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if the prospectus or this prospectus supplement are truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is December 19, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

(X)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.

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ARI Network Services, Inc.

FORM 10-Q

FOR THE THREE MONTHS ENDED OCTOBER 31, 2013

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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
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

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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	444	396
Amortization of discount related to present value of earnout	(4)	(8)
Amortization of bank loan fees	31	12
	321	279

Depreciation and other amortization		
Loss on change in fair value of stock warrants	22	-
Gain on change in fair value of contingent liabilities	(26)	-
Provision for bad debt allowance	32	25
Deferred income taxes	121	105
Stock based compensation related to stock options	36	37
Net change in assets and liabilities:		
Trade receivables	(451)	(153)
Work in process	37	(119)
Prepaid	115	15
expenses and		

other		
Other long term assets	(17)	(32)
Accounts payable	(158)	(195)
Deferred revenue	(638)	(295)
Accrued payroll and related liabilities	(140)	85
Accrued sales, use and income taxes	(43)	(97)
Other accrued liabilities	269	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 received on earnout from	37	49

disposition of a component of the business		
Cash paid for contingent liabilities related to acquisitions	(252)	-
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	2,195	1,350
Cash and cash equivalents at end of period	$ 1,121	$ 261

Cash paid for interest	$ 71	$ 65
Cash paid for income taxes	$ 66	$ 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-ofcompletion 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

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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 Instrinsic 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 Instrinsic 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 Options	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