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ARIS - Q1 2017 ARI Network Services Inc Earnings Call

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## CORPORATE PARTICIPANTS

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**Roy W. Olivier** *ARI Network Services, Inc. - CEO*

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## CONFERENCE CALL PARTICIPANTS

**Louie Toma** *Craig-Hallum Capital Group LLC - Analyst*

**Gary Prestopino** *Barrington Research Associates, Inc. - Analyst*

**Ed Woo** *Ascendiant Capital Markets LLC - Analyst*

## PRESENTATION

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**Operator**

Good day, everyone, and welcome to the ARI Network Services Fiscal First Quarter Year Ending 2017 Earnings Conference Call. Today's call is being recorded.

I would now like to turn the call over to Matthew Zomboracz, ARI's Corporate Controller. Please go ahead.

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**Matthew Zomboracz** - ***ARI Network Services, Inc. - Corporate Controller***

Thank you for joining us today to discuss our first quarter of fiscal year 2017 financial results. With me on the call today are Roy W. Olivier, Chief Executive Officer; and Bill Nurthen, Chief Financial Officer. After prepared remarks, we will open up the call to a Q&A session. Please note that we are also webcasting this call on our Investor Relations website at investor.arinet.com. The earnings press release was issued earlier and is also posted on the Investor Relations website.

Before I turn the call over to management, I'd like to remind everyone that during today's call, including the Q&A session, we may make forward-looking statements regarding expected revenue, earnings, future plans, opportunities and other expectations of the company. These estimates and plans and other forward-looking statements involve known and unknown risks and uncertainties that may cause actual results to differ materially from those expressed or implied on the call. These risks are detailed in our most recent annual report on Form 10-K. As such, may be amended or supplemented by subsequent quarterly reports on Form 10-Q or other reports filed with the Securities and Exchange Commission. The statements made during this conference call are based upon information known to ARI as of the date and time of this call. ARI assumes no obligation to update the information presented in today's call.

During today's call, we will also discuss non-GAAP financial measures, including EBITDA and adjusted EBITDA. These measures, when used in combination with GAAP results, provide us with additional analytical tools that allow us to better understand our business. A reconciliation of GAAP to non-GAAP measures can be found on our Investor Relations website.

With that, I'd like to turn the call over to Roy W. Olivier, ARI's President and Chief Executive Officer.

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**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

Thanks, Matt, and thanks to all of you on the line for participating in today's call. Overall, it was a good start for FY '17 with some notable progress in important areas of the business. We continue to execute well around our strategy of expanding our total addressable markets, creating and launching new products, raising our average revenue per dealer and executing on acquisitions that align with our strategy.

For the quarter, we reported record revenues and I'm excited to report the churn improvement we saw during the last quarter of FY '16 continue through the first quarter. We did experience a slowdown in new bookings versus Q1 FY '16, but saw a strong pick up after the election, which we hope will continue as we enter our prime selling seasons of Q2 and Q3.

ARI's average share price for the first quarter was $4.67, up 27.2% from the same period last year. We will discuss all these items in more detail. But for now, I'll turn the call over to Bill to go over the financials in detail and then I'll be back to comment further. Bill?

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**Bill Nurthen** *- ARI Network Services, Inc. - CFO*

Thanks, Roy, and good afternoon to everyone listening on the call. I will now share with you some more details regarding our financial results for the first quarter of our fiscal 2017, which ended on October 31, 2016.

Before I go through some of the financial details, I wanted to remind everyone that we closed the acquisition of Auction123 on November 1, 2016. So while we experienced some costs associated with completing that acquisition in Q1, its operations did not have any impact on our Q1 results. Also, all prior acquisitions were fully anniversaried as of the start of Q1. And as such, all comparables to the prior year can be considered organic comparables.

Total revenues for the first quarter were $12.3 million, which compares to $11.7 million in the same period last year. Year-over-year, the total growth was 4.6%. We remain focused on recurring revenue growth, however, and organic recurring revenue growth in the first quarter was 7.4%. Recurring revenue comprised 93.7% of revenue in the first quarter of fiscal 2017 compared with 91.2% of revenue in the prior year.

In Q1, we experienced year-over-year growth in recurring revenues across three of our four core offerings of lead generation and eCommerce websites, eCatalog, business management software and digital marketing services, with the most notable organic growth occurring in digital marketing services revenue which, similar to last quarter, more than doubled. The only recurring offering which did not grow year-over-year was business management software, which was relatively unchanged compared to the prior year. You may recall we churned a large business management customer last year due to them being acquired, and that customer accounted for approximately $30,000 of monthly revenue. The result indicates we have essentially earned that revenue back with new sales.

Looking ahead, as we continue to grow our recurring revenues as a percent of total revenue, and as we continue to experience a reduction in churn as we have seen in the last two quarters, we expect that the growth in our recurring revenue will also begin to lift our overall growth rate.

Breaking down total revenue by products for the first quarter. Lead generation website revenue for the quarter was $6.3 million compared with $5.9 million in the prior year. eCatalog revenue was $4.4 million compared with $4.5 million in the prior year. Business management software revenue was $700,000 compared with $800,000 in the prior year. Digital marketing revenue was $700,000 compared with $400,000 in the prior year. Lastly, our Other revenue was $200,000, which is consistent with last year.

Turning to profitability. On a whole, our profit performance in the first quarter of fiscal '17 was similar to last year, however, the result included cost for our India operation, of which there were none in the first quarter of fiscal 2016 as well as approximately $140,000 in charges related to the acquisition of Auction123 and our proxy matter.

Looking at gross profit, our gross profit was $10 million in Q1 or 81.3% of revenue compared to $9.7 million or 82.4% in the same period last year. The decline in margin performance for the quarter was primarily due to an increase in the direct labor component of our cost of sales as we continue to dedicate resource time to fulfilling on our sales backlog as well as migrating certain of our clients off older web platforms. The margin also continued to be impacted by an increase in digital marketing services revenue, which tends to have a lower gross margin than our other recurring offerings. All things considered, the gross margin performance was the best performance in the last three quarters and we are pleased to see at the higher end of our target 80% to 82% range.

Turning to operating profit. The firm recorded an operating profit in the first quarter of $768,000 or 6.3% of revenue versus an operating profit of $808,000 or 6.9% in the same period last year. The slight year-over-year decrease was the result of continued scaling of our India office, which impacted the quarter by approximately $145,000 and charges related to the acquisition of Auction123 and our proxy matter. Both of those impacted the quarter by approximately $140,000.

Regarding the latter, the majority of these charges were related to the acquisition of Auction123 and less so to the proxy matter. While the acquisition related charges are primarily behind us, we expect the charges related to the proxy matter to grow significantly in Q2 as we approach our annual meeting on January 5. After Q2, charges related to both these matters will largely be behind us and this is also the time when we should begin to see some scale from our India office.

Looking a little deeper at some of the operational lines on our P&L compared to last year. Sales and marketing was slightly down from last year as we continue to experience greater productivity in our sales headcount. Customer operations and support was up approximately $300,000, as this is where most of the India office expenses are recorded and we also have some higher IT infrastructures charges related to our new product rollout and our CRM implementation, which are expensed on this line. Software development was flat year-over-year. And finally, the increase in general and administrative costs was primarily due to the nonoperational charges I previously noted.

On a side note, our CRM implementation went live on December 12 this week and this should result in a reduction in IT charges going forward, as we consolidate to one CRM system.

Pretax profit for the quarter was similar to last year as well. It was $661,000 versus a pretax profit of $688,000 in the prior year. Net income for the quarter was $356,000 or $0.02 per share compared with net income of $389,000 or $0.02 per share in the prior quarter.

One thing I will note is that our tax rate for the quarter was 46.1% compared with 43.5% in the same period last year. While our tax rate is quite high, we are hoping that we will start to experience a reduction in the coming quarters as our India operation becomes profitable and as we take other steps to reduce the recorded rate.

Looking at adjusted EBITDA. Adjusted EBITDA was $2 million in the first quarter of fiscal '17 or 16.4% of revenue compared to $2 million or 17.2% of revenue in the same period last year. The similar year-over-year performance was again due to the items I noted previously in the call. I will discuss how we expect adjusted EBITDA to trend for the remainder of fiscal 2017 later in the call.

Turning to cash flow, we did experience a slight increase in cash flow for the quarter. Cash flow from operations in Q1 was $1.8 million versus $1.7 million in the same period last year. Free cash flow, which we calculated cash flow from operations less capital expenditures and software capitalization, was $1.1 million in Q1 compared with $1.2 million in the same period last year.

Free cash flow was lower as we experienced higher software capitalization in the quarter. That said, it is our expectation that software capitalization related to our new product rollouts will peak in Q1 and Q2 of this year and will subside a bit thereafter. During this time, we are on a position where we can keep our capital expenditures relatively low for the first half of the year. Thus, normalizing our investment outflows and keeping free cash flow in line.

Looking at the balance sheet, the firm continued to increase its cash balance and reduce its net debt in the quarter. Cash and cash equivalents was $5.6 million at quarter end on October 31, 2016, compared with $5.1 million at our fiscal year-end, which was one quarter ago on July 31, 2016.

Looking at debt, as of the end of Q1, there was not an outstanding balance on our line of credit. And total debt, which we calculate as debt from our line of credit, notes payable and capital lease obligations was $8.6 million at quarter end compared with $9.2 million at our fiscal year-end on July 31, 2016. Thus, in one quarter, we reduced our net debt by over $1 million.

It is important to note that our balance sheet will change as a result of the acquisition of Auction123. To complete this acquisition, we refinanced our term loan with Silicon Valley Bank to $13 million in total with a five-year maturity, which added about $8.2 million to our debt. We also covered the remaining purchase price of the transaction with approximately $2.3 million of excess cash. We did not issue any stock associated with the transaction.

As a result, at transaction close on November 1, 2016, we had about $16.8 million of total debt, which is just under two times our trailing 12 months EBITDA and cash and cash equivalents of approximately $3.3 million or a net debt of $13.5 million. That said, as we look ahead and consider our expected cash flow and debt payment schedule, we anticipate by our fiscal year-end on July 31, 2017, our cash balance will be back above $5 million and our net debt will be below $10 million.

In conclusion, I would like to elaborate further on our expectations for the second quarter and the remainder of our fiscal year. If you recall from my previous earnings call, I stated that we may experience adjusted EBITDA in the first half of the year that is relatively flat compared to the prior year due to the scaling of our India office and charges associated with the acquisition of Auction123 and our proxy matter. I also stated that we expect to see significant improvement in the second half of the year as the nonrecurring cost from the first half of the year dissipate and as we begin to realize efficiencies related to our India office.

Lastly, I stated that we continue to expect improvement in adjusted EBITDA for fiscal 2017 over fiscal 2016, and anticipated that it will be another record year for ARI. These statements continue to be our feeling as of today and we also expect additional upside from our acquisition of Auction123. For Q2, to remain cautious, I would expect it to be similar in adjusted EBITDA performance to Q2 of last year. There is some potential upside in these numbers related to Auction123 and to the extent we can contain costs associated with our proxy matter. Even if we assume a flat Q2, however, we expect adjusted EBITDA in the second half of fiscal 2017 to outperform the second half of fiscal 2016, both in aggregate and from a margin perspective. As such, we believe the outperformance in the second half of this year will not only allow us to grow adjusted EBITDA but also produce similar margins for fiscal 2017 compared to fiscal 2016, despite the charges we will incur in the first half of the year.

If we perform in accordance with our expectation, we should comfortably push adjusted EBITDA over $9 million for fiscal 2017, and be performing at an adjusted EBITDA run rate of over $10 million for the second half of the year.

I will now turn the call back over to Roy.

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

Thanks, Bill. Before I get into the details, I want to reiterate our strategy and how we got to where we are now. Today, ARI is a SaaS platform business helping manufacturers and dealers in selected vertical markets to sell more stuff. It is our intention to be the leader in omnichannel retailing as it applies to our markets by helping our customers navigate the growing trend of researching online and buying in-store. We're excited about this shift in consumer behavior and believe that we are in the best position to help dealers in our markets capitalize and benefit from this shift.

We have spent the last several years executing on a strategy to increase our total addressable market, or TAM, increase the number of solutions we offer, increase our average revenue per dealer and execute on acquisitions that align with our strategy. We continue to have ambitions to grow ARI to over $100 million in revenues by fiscal 2021 and expand our adjusted EBITDA margins to the low to mid-20s.

I believe that during fiscal 2016, and in the first quarter of fiscal 2017, we made progress in each area. First, we've continued to focus on the three acquisitions we closed in fiscal 2015, which expanded our markets to include automotive, tire and wheel, dealer business management software and related tools, auto aftermarket service centers and aftermarket auto performance parts. Those new markets have helped us increase our TAM from 25,000 U.S. customers a few years ago to over 150,000 customers today. In addition, the acquisition of Auction123 provides us with an additional 60,000 dealers to increase our TAM to about 210,000 dealers in the United States.

During fiscal 2016, we invested in extensions and upgrades to our current products and developed new products which lay the groundwork for our future and we continued that investment in the first quarter. As we have discussed, we have completed new eCatalog product called Data Manager RT, which has been in final beta testing. That testing includes two large OEMs using the application, and I'm delighted to report that the product is exceeding their expectations.

We continue to believe that this product will extend our TAM with manufacturers who build complex equipment that require service from a service or dealer network. This product dramatically reduces the amount of time it takes a manufacturer to develop and deploy technical documentation, and we believe it can drive new organic revenue growth in our eCatalog business.

We also reported last quarter that we rewrote our current eCommerce and lead gen platform, which has been in beta testing now with a major upgrade that we released in November. I'm also delighted to report that we have several customers operating on the platform, and both ARI and those customers are very happy with the performance so far. As I mentioned in our last call, I expect to see the impact of these two new products in the second half of fiscal 2017.

In our last call, we also discussed the dealership of the future concept which we demonstrated during our fall trade show season. That concept included the use of beacon technology to track customers in store and market to them based on their online history or where they were browsing in the store. We also featured a parts bar concept, where customers in the store could browse and buy parts, garments and accessories in kiosks while they were waiting for dealer personnel to help them.

Finally, we showed our new B2C mobile application that is a platform for that dealer to target market to their customers based on several criteria. I'm pleased to report that the parts bar and mobile application were big hits with dealers at the first few shows, and we will continue to develop those concepts toward full products to help drive additional organic growth opportunities in fiscal 2017.

The product investments we have been making and the other operational improvements we have made are starting to positively impact our churn rates. I'm excited to report that our churn rate for the quarter was 10.7%, down from 14.2% last year. This is the second lowest quarterly churn number in ARI's recorded history. We are optimistic that this will continue and will set us up for improving organic growth going forward.

We're also excited about the opportunity that comes with the Auction123 acquisition. We closed that transaction in early November and have already made progress integrating the company and its products. We have communicated in the past that it was our intent to use the scale we have demonstrated in our model to fund acquisitions with minimal dilution. Auction123 was a good example of that, as Bill discussed, it was funded entirely through senior debt and cash. We did not issue any stock associated with this transaction.

From a multiples perspective, we paid 7.2 times the trailing 12-month EBITDA for Auction123 at closing. If the first two-year earnout is paid and considered part of the transaction, then we paid 8.2 times the trailing 12-month EBITDA. ARI was trading between 10 times and 11 times at the time of closing.

As a reminder, Auction123 has over 1,000 customers in several vertical markets using their technology to list new and used inventory on many of the major online marketplaces. Their platform integrates with dealer business management systems and website platforms to automatically pick up inventory, create product detail pages and feed them to online marketplaces like eBay, craigslist, CycleTrader and more. The TAM for Auction123's products and services is about 60,000 new dealers.

In addition, Auction123 services a few hundred dealers in ARI's core vertical markets, and we will be making immediate investments in Auction123 to drive more growth out of this platform. We have assigned one of our existing sales managers and a sales team, and expect them to start selling the products using our proven sales model in January. I'm excited about the opportunity to grow this business both in ARI's core verticals, but in the auto dealership vertical as well.

We have now grown revenues significantly every year I've been at ARI, and we expect FY '17 to be no different. We expect revenues to be between $53 million and $55 million. And as Bill mentioned, we expect our EBITDA margin to be in line with fiscal 2016, in spite of the additional costs he discussed. We have shown a dramatic improvement in cash flows and EBITDA and we will continue to focus on generating those sometimes at the expense of organic growth in order to position the company to continue to execute our strategy without diluting shareholders. I continue to believe that we are in a great position to continue that profitable growth path going forward.

Turning to the proxy matter. I would like to reinforce that our entire management team and board believes that delivering a superior return to shareholders and maximizing shareholder value is our primary report card. We are very proud to have delivered an average annual return to shareholders of 25% since I became CEO in 2008. We wake up every day with the intent of continuing that trend and are not close minded to any viable options that can help us achieve that end.

While we typically do not comment on business development activities unless we have something definitive to report, I will make some general comments about activities in this area. In virtually every board meeting since 2015, maximizing shareholder value has not only been on the agenda, it has been discussed vigorously in some cases. In fact, as part of our ongoing analysis, we have had a number of conversations with investment bankers over the past two years and invited several to provide more in-depth analysis in detail of how they think about ARI's value and what actions the company should consider to increase that value.

In addition, we have been contacted by and have spoken to over 10 strategic and private equity firms over the past 24 months. We have been open and responsive with those that have direct relevant experience in our markets. And in our view, we're not just conducting a research project on our industry and markets. In some cases, those conversations included a discussion around rough valuations for ARI.

We believe we have a good feel for the market value of the company and the board regularly assesses that value against our go-forward growth prospects and the risks associated with executing our operational plan. We also have a very close relationship with many of our top 30 shareholders, and we take their suggestions and desires for maximizing shareholder value very seriously.

In summary, we are pleased with our progress and excited about the opportunities in front of us. We will continue to work hard every day to maximize shareholder value. We have made and expect to continue to make significant progress in terms of growing the business both on the top and bottom line. I am confident that fiscal 2017 will be another record year for ARI in all respects.

With that, let me open up the call for your questions. Operator, please instruct our listeners how to queue up.

## QUESTION AND ANSWER

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**Operator**

(Operator Instructions) Our first question comes from the line of Louie Toma from Craig-Hallum Capital. Your question please.

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**Louie Toma** *- Craig-Hallum Capital Group LLC - Analyst*

Just a couple of quick questions. You've mentioned that you've seen increase in average revenues per dealer. Can you quantify that and give us some sense of how fast or what level, just give us some way of putting that in into perspective, please.

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**Roy W. Olivier** *- ARI Network Services, Inc. - CEO*

Bill, you want to take that?

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**Bill Nurthen** *- ARI Network Services, Inc. - CFO*

Yes. So just on the first piece. One piece we look at is the subscribers. Again, we continue to see increases in subscribers. I think we ended the year about 16,589 and we're at about 16,671. I think, again, I have to go back and look and we'll post after this call the changes in our average recurring revenue per dealer for each of our offerings at the end of the call. However, I don't think those are substantially changed. The one thing I will say is that -- substantially changed by a product category. The one thing I will say is, again, we are selling more and more digital marketing services, which are at the higher end of the average revenue per dealer spend.

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**Louie Toma** - ***Craig-Hallum Capital Group LLC - Analyst***

Got it. Okay. And on the acquisition front, can you give us a sense for how active you currently are with -- after the Auction123? Are you still in the market looking? And what kind of capacity do you have at this point?

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**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

This is Roy. I'll touch on the activity and then Bill can touch on the capacity. We never slow down or stop our activities. So at any given point in time, we have anywhere from 8 to probably 15, maybe maximum, a little bit higher than that, opportunities that we're evaluating. That could be anywhere from early stage, which is initial meet and greets and getting to know each other. That could be all the way through relatively serious due diligence. We do, in fact, speed up or slowdown those depending on our capacity, but there remains a number of interesting opportunities out there both in the U.S. and outside the U.S. that we look at.

Bill, do you want to comment on capacity?

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**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. I mentioned in the script part of the call that we're just under about two times our trailing 12 months EBITDA from a debt standpoint. Typically, we exercise caution in going above that amount. I think if we did go above that amount from a debt perspective, we would need to see a path to a quick paydown to get us closer to two times.

The other thing I'll say though as every quarter goes by, I mentioned last quarter, we knocked about $1 million off of our net debt. So every quarter goes by, we keep reducing debt and our net debt, and that just positions us with more capacity to do deals.

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**Operator**

Our next question comes from the line of Gary Prestopino from Barrington Research. Your question please.

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**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

I've got a lot of questions, so I'll try and segment them. Could you maybe just give us some idea of what, if you haven't done already, I mean I'm trying to write all this down, what were new sales bookings growth year-over-year in the quarter?

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**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

Bill can address this. Sales bookings growth or new sales bookings were actually down Q1 to Q1 of last year. And as I mentioned in my comments, I think the elections slowed everything down because we saw a significant pickup in bookings, literally, within a few days of the election closing out.

But Bill, do you want to touch on the exact numbers?

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**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. So the total bookings for the first quarter of '16 were $2.8 million. They were $2.1 million first quarter this year. And I think, as Roy noted, October, in particular, was not a very good month. We do speculate that, that potentially had something to do with the election. The good news is November, we have those numbers and we did have an uptick. And November was actually the best bookings month for our fiscal year so far.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Was it like up double digits?

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

As compared to the prior month?

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Yes, yes.

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. I mean, from a percentage basis, yes. It was significantly up from our October results. I think it's still -- we still want to see improvement, in particular, in tire software sales, we have been lagging a bit compared to last year, and I think that remains the case. But again, in November, we had our best tire software sales month of the fiscal year. And the good news there is we have a really strong pipeline there, so it is a matter of just trying to bring some of these deals in. And again, I think the trend is in the right direction.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Okay. Did you say in total you paid $10.5 million for Auction123?

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes, that's correct. It's $10.5 million. There's a contingent earnout piece that would be an additional $1.5 million, based upon revenue.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

So -- and that was 7.2 times trailing EBITDA.

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. The $10.5 million, yes.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

So do I -- is my math right that this is generating about $1.5 million of EBITDA on an annualized basis?

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes, that's correct. And we will also file audited statements probably in January for that acquisition. The one thing I will note and I do want to caution people against is we are very excited about the growth prospects of that firm, so we are going to add some additional costs to that. And what we've said is we are going to add additional costs, but we will maintain it accretive to our EBITDA. And what I say about it is we ran EBITDA at about 17.8% last year so we will not let that fall below 17.8%, but we are going to add some costs there to try to uptick the growth. We do see a big potential there with the total addressable market that Roy noted.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

But you said in the press release that it's going to add $3 million of revenues for the next nine months, right?

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Correct.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

So if you annualized that, that's $4 million of revenues. I mean -- or am I wrong? Am I looking at this wrong? You've got this -- this is kind of an adjusted EBITDA margin of over 30%.

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

That's why we're excited about it.

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. That is correct. And again, I just want to caution -- yes. It's a big growth opportunity so we're going to put some caution, but that is correct, yes.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Okay. Thank you. I just want to make sure I'm right with my numbers.

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

It's a very, very scalable business, very interesting business, very automated. They do what they do with 17 people and it's remarkable the amount of automation they built into the platform.

**Operator**

(Operator Instructions) And it looks like we have a follow-up from the line of Gary Prestopino from Barrington Research. Your question please.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Just a couple of housekeeping questions here. I didn't get this, Bill, but why was the -- it looks like the sales and marketing expense was down. I couldn't write down fast enough. Why was that down year-over-year?

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. Essentially what we've been able to experience there is doing more with less headcount. And so our sales folks are becoming more productive as we go deeper into some of the verticals that we that we have been. And so as a result, they're carrying higher monthly quotas and producing a higher annual contract value sale each period. So it is one of the benefits that we believe that scale brings to the business is that, as we get deeper into these markets, we'll be able to sell more with less headcount.





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It's also -- gives you a nice comparison to Auction123 because, I think, again, we'll put some heavy sales expense into that to get it going. But over time, that sales expense will become more productive.

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**Gary Prestopino** *- Barrington Research Associates, Inc. - Analyst*

Okay. And then in terms of the expenses for India and the charges for Auction123, are those in -- where are those on the income statement? Are they in cost of goods sold and customer operations and support?

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**Bill Nurthen** *- ARI Network Services, Inc. - CFO*

Yes. Customer operations and support with some reclass in the cost of goods sold is where you're going to find most of the India cost. The cost associated with Auction123 are in the G&A bucket.

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**Gary Prestopino** *- Barrington Research Associates, Inc. - Analyst*

And you didn't back those out of adjusted EBITDA, so to get a real true adjusted EBITDA number, you've got to add almost $300,000 back to this year, right?

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**Bill Nurthen** *- ARI Network Services, Inc. - CFO*

Yes. I mean, the India cost, again, I -- the India was about $145 million and the Auction123 and proxy stuff was about $140 million. But yes, when we report, we don't back that out from our adjusted EBITDA number.

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**Operator**

Our next question comes from the line of Ed Woo from Ascendiant Capital. Your question please.

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**Ed Woo** *- Ascendiant Capital Markets LLC - Analyst*

Just a very high level view, what is your view on international opportunities? I know we keep talking about it, I was just wondering if anything has changed over the past couple of months? Thank you.

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**Roy W. Olivier** *- ARI Network Services, Inc. - CEO*

Yes. This is Roy. I think that we haven't talked about it much, but we installed a new General Manager of our European operations a few months ago. He spent a considerable amount of time in the United States being trained on all of our products and the services here. He's been on the road pretty aggressively, going to trade shows, learning the business and meeting with existing customers and prospective customers. He is now kind of developing a rebooted plan of how we grow our European operation. As you know, it's only 2% or 3% of revenue. I continue to believe there are some phenomenal opportunity over there, especially for the new Data Manager RT and another project that we're working on, which we developed out-of-the-box for global distribution in terms of currency and the language.

So I'm pretty excited about what I've seen from him, so far, in terms of what he's doing and how he's approaching it. Too early to kind of give you any numbers or specifics as to when we think we'll see some additional growth out of Europe, Middle East, Africa, but pretty excited about what he's doing.

So it's been something that's been on our radar. We've made some investments in bringing in a new VP GM. I think, it was either late fiscal year, or very early this year, and I'm hoping to start to see that translate into increasing revenues over there shortly.

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**Ed Woo** *- Ascendiant Capital Markets LLC - Analyst*

Great. And in terms of India, everything progressing as planned?

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

Bill can comment as well. From my point of view, it's ahead of plan. They really ramped up their productivity very quickly. We measure development productivity in a very scientific way and we measure the back office operations that we call web dev in a very scientific way. And those teams have -- they've certainly exceeded my expectations in terms of coming up to speed, so pretty excited about what I've seen so far. But Bill is closer to the operation than I am.

**Bill Nurthen** - ***ARI Network Services, Inc. - CFO***

Yes. No, I think -- as Roy noted, it has been going very well. We have been working primarily on our web products and catalog products. And from the web standpoint, they are getting up to speed on the new platform. They are migrating customers to the new platform. They are building sites on the old platform as well. And they are also doing -- there's a group there that's doing development. We've also got them involved in the Data Manager RT project in some of our eCatalog projects.

And so I think the real benefit is we are seeing velocity increase both in migrating customers and building websites as well as velocity increase in our development. We're able to get releases out quicker. We're able to QA things much better. And so we're really excited about what we see there.

**Operator**

(Operator Instructions) Our next question is a follow-up from the line of Gary Prestopino from Barrington Research. Your question please.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

I promise, these will be my last. Your Data Manager RT, that, as I read it, what you said in your commentary, that really is something that's going to extend your market. It's not something where you can actually go to your existing holders of the eCatalog business and sell it as an upcharge. Is that kind of correct, Roy?

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

No. We have, as you know, we publish about 120 manufacturers' worth of OEM parts data today. We have, I'd have to pull the exact number, I'd say somewhere around a dozen of those manufacturers subscribed to our old version of Data Manager RT. So they're all upsell opportunities to the new version.

But, frankly, those other 108 manufacturers all have the same challenges, and that's how do I take this engineering bill-of-material that was created by the engineer who designed the new fill-in-the-blank boat or bike or RV, and how do I convert that into technical documentation that I can distribute to my remote service organization, whether it's through a dealership or some other method.

So I think it's an opportunity for us to pursue the 108 manufacturers that we have relationships with already. And I also think it is an opportunity for us to pursue any manufacturer of complex equipment that services it in virtually any industry out there.

So I think it kind of flattens out that approach. We've always approached that part of the business in a very verticalized way and only focused primarily on four or five verticals. I think this is going to allow us to go after verticals we have not pursued in the past and it's a manufacturer sale.

So it is a little bit different. We're not selling it to dealers one at a time. We're selling Data Manager RT to the manufacturer to use it to create the information that then gets shipped down to the dealer or service providers.

**Gary Prestopino** - ***Barrington Research Associates, Inc. - Analyst***

Okay. So in order to extend the market in that sense, you've got to get the manufacturer first to agree to take the product then that gives you the ability to have the data to sell it to whoever is repairing it. Is that how it works?

**Roy W. Olivier** - ***ARI Network Services, Inc. - CEO***

Yes. Although we will also offer a model in certain industries where the dealer network is not really applicable to us or the manufacturer just pays us and utilizes it across the entire spectrum. So as an example, in the appliance industry today, which we have a nice little robust business in, almost 100% of our revenue in the appliance business is with the manufacturer or the distributors. It's -- very little revenue comes from the dealer because people buy appliances from big box. There is no concept of dealer there. In that type of industry, we would sell Data Manager RT and the licenses to view the data to the manufacturer or the distributors and they would provide it downstream to the service technicians either as part of their relationships or for a nominal charge.

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**Gary Prestopino** *- Barrington Research Associates, Inc. - Analyst*

Okay. And then same thing with the lead generation platform, is that something where you really are targeting more flexibility on the platform and it helps to reduce churn? It's just ease of use?

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**Roy W. Olivier** *- ARI Network Services, Inc. - CEO*

Yes. The new platform is really all about improving performance. And performance is defined as speed, lead conversion rate, eCommerce sales rate. It also, from a by-product point of view, it dramatically affects through reducing the amount of time it takes us to build out a new customer or make modifications to an existing customer. So I think I've mentioned in previous calls, our target was to reduce the amount of time it takes us to set up a new customer between two-thirds and three-fourths. So something that takes us 15 hours today, we'd like to get down to five hours or less.

And ultimately, because of the higher performance of the platform, we expect it to impact churn rates in a positive way and we expect it to impact new bookings velocity. So we ought to be able to sell more of it because it's so much better than our older platform and the other platforms that are being offered by competition.

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**Operator**

Thank you. This does include the question-and-answer session of today's program. I'd like to hand the program back to Roy W. Olivier for any further remarks.

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**Roy W. Olivier** *- ARI Network Services, Inc. - CEO*

Well, thank you, again, for joining us on today's call. We look forward to talking to you at the conclusion of the current quarter, and hope you have a great evening.

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**Operator**

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.