Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion of our results of operations and financial condition should be read together with our unaudited consolidated financial statements for the three months ended January 31, 2014 and 2013, including the notes thereto, which appear elsewhere in this quarterly report on Form 10-Q. All amounts are in thousands, except per share data. This discussion, including, without limitation, the section entitled "Summary of Operating Results", contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). All statements other than statements of historical facts are statements that could be deemed to be forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," "endeavors," "strives," "may," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, estimate, or verify, including those identified in Part I, Item 1A of our annual report on Form 10-K for the year ended July 31, 2013, and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

Overview

ARI Network Services, Inc. creates award-winning software as a service ("SaaS") and data as a service ("DaaS") solutions that help equipment manufacturers, distributors and dealers in selected vertical markets Sell More Stuff!™ – online and in-store. We remove the complexity of selling and servicing parts, garments and accessories ("PG&A") for our 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. Our customers include nearly all of the largest manufacturers and distributors in each of the vertical markets we serve, and we estimate that more than 22,000 equipment dealers, 195 distributors and 140 manufacturers worldwide leverage our web or eCatalog platforms to Sell More Stuff! ™.

Our Solutions

Our SaaS and DaaS solutions include: (i) eCommerce-enabled websites, which provide a web presence for dealers and serve as a platform for driving leads and eCommerce sales; (ii) eCatalogs, which drive sales of inventory and PG&A both online and within the dealership; and (iii) lead management software designed to increase sales for dealers through more efficient management and improved closure of leads. Our solutions also improve our customers' overall customer satisfaction through a highly efficient and accurate data lookup experience at the parts counter and a quicker response time to online inquiries, both of which serve to significantly improve a customer's overall experience with the dealer.

Our SaaS and DaaS solutions are sold through our internal sales force and are composed primarily of recurring license and eCatalog subscriptions. Customers typically sign annual, auto-renewing contracts. Today, more than 90% of our revenues are recurring.

In addition to our award-winning SaaS and DaaS solutions, ARI offers a suite of complementary products and services designed to supplement our three primary offerings in order to help our customers Sell More Stuff!

Web Platform Solutions

Our eCommerce-enabled websites provide consumers with information about a dealership and its product lines and allow consumers to obtain information on whole goods and purchase PG&A through the dealers' website 24 hours a day, 7 days a week. Our website solutions are tailored to each of the vertical markets we serve and tightly integrated with our electronic library of inventory and PG&A content. We also offer a mobile solution that allows dealers' websites to be fully functional on smart mobile phones.

Websites are sold through our inside sales teams, which are aligned by vertical market. The sales process will typically include a live demo of the site and may even include a free trial period (we refer to these as "test drives"). We typically charge a nominal,

one-time set-up fee to develop a new dealer website, monthly recurring subscription fees and variable transaction fees. Our websites are typically sold under one year, renewable contracts with monthly payment terms. We currently host and maintain more than 5,500 websites for dealers in all of our vertical markets. Websites have become ARI's largest source of revenue and accounted for 51% of total revenue during the first half of fiscal 2014.

eCatalog Platform Solutions

Our eCatalog solutions, which encompass our PartSmart®, PartSmart Web™ and PartStream™ products, leverage our industry-leading library of electronic whole goods and PG&A content to allow distributors and dealers to view and interact with this information to efficiently support the sales and service of equipment. We believe that our eCatalog solution is the fastest and most efficient in the market, as it allows multi-line dealers to quickly access data for any of the brands serviced from within the same software, allowing the dealer's parts and service operations to more quickly identify, locate and sell products and services to their customers. Our eCatalog solutions include:

> *PartSmart®,* our CD-based electronic parts catalog, is used by dealers worldwide in the OPE, powersports, marine, appliance and agricultural equipment industries to increase productivity by significantly reducing parts lookup time. Our PartSmart® software allows multi-line dealers to look up parts and service information for all manufacturer product lines that the dealer carries, and integrates with more than 90 of the leading dealer business management systems.
>
> *PartSmart Web™,* a SaaS solution, is used by distributors and manufacturers to provide their dealers with access to parts and pricing information via the Internet.
>
> *PartStream™,* a SaaS solution, is a modular, consumer-focused illustrated parts lookup application that integrates with existing dealer and distributor websites and shopping carts and allows consumers to quickly identify the desired part, add the part to their electronic shopping cart and check out. It leverages ARI's parts content, delivering it to PartStream™ users on demand from ARI servers.
>
> *AccessorySmart™,* a SaaS solution, is the only aftermarket PG&A lookup product of its kind, providing access to more than 500,000 SKUs from more than 1,400 powersports aftermarket manufacturers. AccessorySmart provides parts and service counter personnel a one-stop resource to look up products, cost and availability for all of the leading aftermarket PG&A distributors. AccessorySmart significantly decreases the time it takes to look up PG&A information and availability, allowing dealers to service and sell more stuff to customers on a given day. This product is powered by the fitment data we acquired with the assets of Ready2Ride, Inc. ("Ready2Ride") in August 2012.

We derived approximately 44% of our revenues from our eCatalog solutions during the six months ended January 31, 2014. Our eCatalog products are sold through our dedicated internal sales team, and fees charged include a recurring license fee, subscription fees for subscribed catalogs, and in some cases, page view fees.

Lead Management Product

Our award-winning SaaS solution, Footsteps™, is designed to efficiently manage and nurture generated leads, increasing conversion rates and ultimately revenues for our customers. Footsteps™ connects equipment manufacturers with their dealer channel through lead consolidation and distribution, and allows the dealers to handle leads more efficiently and professionally through marketing automation and business management system integration. The product is used as a complete database of customers and prospects, and manages the dealer-to-customer relationship, from generating email campaigns and automated responses, to providing sales teams with a daily follow-up calendar and reminder notices. We derived approximately 3% of our revenues from Footsteps™ in the first half of fiscal 2014.

Other Solutions

We also offer a suite of complementary solutions, which include search engine marketing, software and website customization services and website hosting. On a combined basis, these other services accounted for approximately 2% of revenue during the six months ended January 31, 2014.

Our Growth Strategy

ARI's goal is to become the leading provider of SaaS and DaaS solutions that help our customers, in selected vertical markets, efficiently and effectively sell and service more whole goods and PG&A – in other words, to Sell More Stuff! Our goal is to grow revenues at a double-digit rate and to grow earnings faster than revenues through scalability. We will provide our solutions to dealers, distributors, manufacturers, service providers, and consumers in vertical markets where the finished goods are complex equipment requiring service and are primarily sold and serviced through an independent dealer channel. We believe this strategy will drive increased value to our shareholders, employees, and customers.

We also believe the execution of the following strategic pillars will enable us to achieve the growth and profitability needed to drive long-term sustainable value for our shareholders. These strategic foundations are primarily centered on enhancing the value proposition to our customers, which will lead to additional revenues through pricing actions, product and feature upsells, and reduced customer churn rates, and expansion by leveraging our core competencies in new markets where appropriate. Each of these strategic pillars is a long-term foundation for growth; within each one we have established near-term goals, as discussed below.

Drive organic growth through innovative new solutions, differentiated content, entering new markets and expanding geographically

As a subscription-based, recurring revenue ("RR") business, the most important drivers of future growth are increasing the level of our RR and reducing the rate of our customer churn. We define RR as revenue from products and services which are subscription-based and renewable, including license fees, maintenance fees, catalog subscription fees and hosting fees, and we define churn as the percentage of RR that does not renew. During the six months ended January 31, 2014, our RR increased 34.5% over the same period last year and the percentage of our total revenues that were RR increased to 94.7% from 85.5% in fiscal 2013.

- *Develop and deploy innovative new solutions*. We have resources assigned to each of our core products that continue to research and develop new value-added features and functionality for our existing. The introduction of new solutions, upgrades to existing products, and new feature sets are all designed to grow our average revenue per dealer ("ARPD"), an important measure for a subscription-based business, and the increase in our customer base serves to quickly compound the benefits of an increased ARPD.

  In the second quarter of fiscal 2014, we completed a number of new enhancements to our services, including the following:

  - Web Platform – During the quarter we made several enhancements to our Endeavor website solution, including new application programming interfaces ("APIs") that enable our customers to update information via external applications such as smartphones; value-added consumer usage and feedback analytics capability; expanded integration with ADP, the leading business management system in PowerSports; and a new administration panel with improved site performance metrics and various new content management tools.

  - eCatalog – During the quarter we launched a new version of PartSmart Web, which includes enhanced security encryption, error detection and expanded web browsing capabilities. We completed the development of additional electronic marketing capabilities and integration with two new dealer management systems in our AccessorySmart service, as well as consumer usage and feedback analytics capability. We also released several updates to our eCatalog suite of products which include: new search functionality using manufacturer serial numbers, allowing consumers to uniquely identify the exact part needed for a specific model; expanded integration with several new manufacturer parts catalogs; and a new automatic parts diagram hot-spotting tool with optical character recognition technology.

- *Differentiate our content.* We believe we have the largest library of whole goods and PG&A content in the vertical markets we serve. However, simply offering the largest content library in the markets we serve is not sufficient to drive the long-term revenue growth we desire. We strive to deliver more value to our customers through enrichment of our content. Content enrichment can take several forms, including the incorporation of user reviews and feedback into our existing content, further enhancing content provided to us by our OEM customers, and creating new forms of content that further our customers' ability to efficiently service and sell more whole goods and PG&A. Our content library includes aftermarket fitment data for the powersports industry, which is the only content of its type available

electronically. We have developed consumer analytic tools to several of our products, offering value-added feedback to our customers to help them "Sell More Stuff!"

- *Enter new markets.* ARI currently maintains a significant share of the OPE and white goods markets. Accordingly, we anticipate low single-digit growth in these markets. The acquisition of 50 Below more than doubled our website business, providing ARI entrance into two new potentially high-growth markets – ATW and DME, and catapulting the Company into one of the leaders in the powersports industry. As we continue to increase our share in our current markets, leveraging our technology in new and underserved markets will be important to maintaining substantial organic growth rates. ARI currently has more than 2,000 dealer websites in the ATW market. We estimate that the total market approximates 18,000 dealers and further, the broader automotive aftermarket comprises nearly 80,000 dealers, more than all of our other markets combined. We intend to continue to invest heavily in this market, including seeking opportunities to leverage our products and services in the broader automotive aftermarket. 50 Below was one of the first website providers to service the DME. We estimate that this market comprises nearly 25,000 dealers, and believe the market to be in its infancy with respect to eCommerce. We recently invested in dedicated resources designed to expedite our growth in this market.

  Ready2Ride was the first to market with electronic aftermarket fitment data for the power sports industry. We estimate that the availability of this data almost doubles the size of our addressable market in the powersports industry. In February 2013, we launched our new AccessorySmart™ product. AccessorySmart is the only aftermarket PG&A lookup solution of its kind, providing access to more than 500,000 SKUs from more than 1,400 aftermarket manufacturers. AccessorySmart provides parts and service counter personnel a one-stop resource to look up products, cost and availability for all of the leading aftermarket PG&A distributors. AccessorySmart significantly decreases the time it takes to look up PG&A information and availability, allowing dealers to service and sell more customers on a given day. We plan to leverage our aftermarket publishing experience and product capabilities in our other vertical markets where the market will support it.

- *Expand geographically*. Although we maintain relationships with dealers throughout the world, we have very low penetration into international markets. Growing our international business will require us to secure and publish electronic content from OEMs outside the U.S. and make changes to our existing products that will allow us to rapidly deploy these products in a scalable and efficient manner and without the need to have "boots on the ground" in those countries.

  To this end we have a business development resource solely dedicated to obtaining new international content and to date, we have added 10 new catalog content offerings in the international OPE market and begun to establish relationships with OEMs in China and Europe. Also, we have upgraded our product roadmaps to allow us to rapidly deploy our products in these markets as discussed above.

Nurture and retain existing customers through world-class customer service and value-added product feature updates

In order to achieve sustained double-digit organic growth, we not only need to execute the new growth strategies described above, we must also retain our existing customers. In a SaaS business, the cost to retain an existing customer is much less than the cost to acquire a new customer. Accordingly, customer churn is one of the most important metrics we track and manage. We experienced marked improvements in our churn rates the past several years as a result of strategic actions taken by the Company, all of which are designed to enhance the "stickiness" of our product within our customers' operations. We will continue to leverage our relationships with existing customers and closely monitor and manage the level of customer churn. On a trailing twelve month basis, customer churn increased from 12.4% in January 2013 to 12.5% in January 2014. We will continue to leverage our relationships with existing customers and closely monitor and manage the level of customer churn.

Lead the market with open integration to related platforms

One of our strategic advantages is our focus on integrating our solutions with dealer business management systems ("DMS") in order to pass key information, including customer and transactional data, between our solutions and the DMS, saving our customers valuable time and eliminating redundant data entry. We currently have integration capabilities with over 90 DMSs (we refer to these relationships as "Compass Partners") and we continue to seek other strategic alliances that can be integrated with our product and service offerings. We integrated our AccessorySmart service with two new business management systems in the first quarter of fiscal 2014.

Successfully execute acquisitions that align with our core strategy

Since 1995 we have had a formal corporate development program aimed at identifying, evaluating and closing acquisitions that align with our strategy. Since the program's inception, we have closed twelve acquisitions. A summary of some of our most recent acquisitions is as follows:

Acquisition	Date	Strategy
OC-Net, Inc.	January 2007	▪ New website platform
Info Access	July 2008	▪ Market-leading entrance into white goods market
Channel Blade Technologies	April 2009	▪ Market-leading entrance into marine and RV markets ▪ New lead management product, Footsteps™
Ready2Ride, Inc.	August 2012	▪ First of its kind aftermarket fitment data for the powersports industry
50 Below Sales & Marketing, Inc. (Retail Division)	November 2012	▪ A market leader in the powersports industry ▪ Entrance into ATW and HME industries ▪ New award-winning website platform
DUO Web Solutions	November 2013	▪ A leading provider of social media and online marketing services in the powersports industry

All of these acquisitions, with the exception of 50 Below and DUO Web Solutions, have been fully integrated into our operations. We continue to integrate the 50 Below operations into ARI and anticipate that the 50 Below and DUO Web Solutions operations will be fully integrated into ARI during fiscal 2014.

Summary of Operating Results

We achieved 8.8% total revenue growth in the second quarter of fiscal 2014, and 21.4% total revenue growth year to date, over the same periods last year. Recurring revenue now constitutes 94.7% of our total revenue for the six months ended January 31, 2014, compared to 85.8% for the same period last year. Recurring revenue increased 17.1% for the quarter and 34.5% year to date during fiscal 2014 compared to the same periods last year. The growth in both total and recurring revenue is largely attributable to revenue from the 50 Below acquisition in November 2012.

Loss from operations decreased 7.1% or $40,000 for the three months ended January 31, 2014, compared to the same period last year and increased 66.9% or $176,000 for the six months ended January 31, 2014, compared to the same period last year. Operating expenses increased $732,000 and $2,934,000 for the three and six month periods ended January 31, 2014, compared to the same periods last year, primarily due to the additional costs of the 50 Below operation, an increase in our sales and marketing resources and termination benefits incurred in connection with a workforce reduction in January 2014.

During January 2014, the Company implemented a 14% reduction in workforce as a result of consolidating operations and other operational efficiencies achieved as we have continued to integrate the 50 Below operation, primarily in the catalog conversion and website implementation and support areas, thereby eliminating duplicate efforts. The Company expensed approximately $234,000 in severance and related costs as a result of this workforce reduction.

Net loss was $461,000 and $436,000 for the three and six months ended January 31, 2014, compared to net income of $4,000 and $117,000 for the same periods last year. The decrease in earnings is primarily due to a non-cash tax gain of $941,000 recognized in the second quarter of fiscal 2013 related to a reduction in the valuation allowance against our net operating loss carryforwards.

Cash flows from operations were $55,000 and $29,000 during the three and six months ended January 31, 2014 compared to $868,000 and $1,377,000 during the same periods last year. The decline in cash generation was primarily due to costs associated with the integration of the 50 Below operation, the timing of customer receipts and the timing of vendor payments. We expect cash from operations to improve during the remainder of fiscal 2014 due to the cost savings from the operational efficiency improvements made in the second quarter of fiscal 2014 and an increase in cash receipts as a result of RR growth.

Revenue

The following table summarizes our RR and non-recurring revenue by product (in thousands). Certain reclassifications were made to amounts previously reported in our financial statements in order to conform to the current presentation.

	Three months ended January 31		Percent	Six months ended January 31		Percent
	2014	2013	Change	2014	2013	Change
Recurring revenue						
Websites	$ 3,973	$ 2,955	34.5 %	$ 8,041	$ 4,213	90.8 %
eCatalog	3,391	3,293	3.0 %	6,758	6,575	2.8 %
Lead management	212	211	0.5 %	424	423	0.2 %
Other	124	115	8.3 %	206	262	(21.2) %
Total recurring revenue	$ 7,700	$ 6,573	17.1 %	$ 15,429	$ 11,473	34.5 %
Non-recurring revenue						
Lead generation	$ 72	$ 276	(73.9) %	$ 136	$ 583	(76.7) %
Professional services	127	409	(68.9) %	248	856	(71.0) %
Usage fees	129	110	17.1 %	284	285	(0.4) %
Other	107	110	(2.5) %	198	223	(11.1) %
Total non-recurring revenue	$ 435	$ 905	(51.9) %	$ 866	$ 1,947	(55.5) %
			-			
Total revenues	$ 8,135	$ 7,478	8.8 %	$ 16,295	$ 13,420	21.4 %
Recurring revenue	94.7 %	87.9 %		94.7 %	85.5 %	
Non-recurring revenue	5.3 %	12.1 %		5.3 %	14.5 %	
	100.0 %	100.0 %		100.0 %	100.0 %	

Total revenue increased 8.8% or $657,000 and 21.4% or $2,875,000 for the three and six months ended January 31, 2014, compared to the same periods last year. Recurring revenue increased 17.1% or $1,127,000 and 34.5% or $3,956,000 for the three and six months ended January 31, 2014, compared to the same periods last year. RR represented 94.7% of total revenues in the first six months of fiscal 2014 versus 85.5% in the first six months of fiscal 2013. We anticipate that RR will continue to increase over the comparable prior year period, for the remainder of fiscal 2014.

Recurring Revenue

RR is one of the most important growth drivers of our business. Increasing the percentage of our revenues that are recurring while at the same time reducing the rate of customer churn enhances our ability to generate profitable growth. Our subscription-based SaaS and DaaS products generate higher margins than our non-recurring products and services, and the incremental cost of selling these products to new dealers (we refer to these as new "logos") is relatively low. Reducing the rate of our customer churn, which is the percentage of RR that do not renew, helps drive organic growth as it allows for a greater percentage of our new logos to be incremental to the top line (versus making up for lost logos) and also increases the base upon which we can apply price increases and sell additional products and features.

We generate RR from each of our three primary product categories. Web platform products generate RR from monthly subscription fees. Web platform RR increased 34.5% or $1,018,000 and 90.8% or $3,828,000 for the three and six months ended January 31, 2014, compared to the same periods last year. Web platform RR represented 52.1% of total RR in the first half of fiscal 2014 and is our largest source of RR.

The growth in Web platform RR was largely the result of our acquisition of 50 Below in November 2012. Since the acquisition, we have integrated our sales, support and implementation teams related to our website products. As part of the 50 Below acquisition, the Company assumed a significant recurring revenue service obligation and has had a high success rate in renewing those contracts. We anticipate that our web platforms will continue to be the Company's largest source of growth, much of this growth coming in the ATW and HME markets, both of which are new to ARI.

Our eCatalog products generate RR from software license and renewal fees, catalog subscriptions, and software maintenance and support fees. eCatalog RR increased 3.0% or $98,000 and 2.8% or $183,000 for the three and six months ended January 31, 2014, compared to the same periods in fiscal 2013. eCatalog is now our second largest source of RR, representing 43.8% of total RR for the six months ended January 31, 2014.

eCatalog revenues have historically had the Company's lowest revenue growth rates, primarily attributable to ARI's already strong market position. We have seen eCatalog growth rates begin to increase since our new AccessorySmart product was introduced to the market and expect this growth to accelerate in the second half of fiscal 2014. AccessorySmart is a fitment-powered aftermarket PG&A lookup solution and is a first-of-its-kind in the powersports industry. The product won a "Nifty 50 Award" from Powersports Business, a leading industry trade publication, at the powersports industry's largest trade show in February 2014.

Lead management RR is generated from subscription fees for the use of our Footsteps™ products. Lead management RR was $212,000 and $424,000 for the three and six months ended January 31, 2014, which was relatively consistent with the same periods in fiscal 2013. The Company is currently reviewing various options with respect to the Footsteps™ product, including the possibility of including the core functionality of the product within our web platforms and expects this product to continue to be instrumental in our goal of helping our customers Sell More Stuff!™.

Non-recurring Revenues

Non-recurring revenues are generated from the Company's SearchEngineSmart™ lead generation service, professional services related to software customization and data conversion, usage fees charged on our RR products, and other complementary products and services. Total non-recurring revenues were $435,000 for the three months ended January 31, 2014, versus $905,000 for the same period in fiscal 2013, a decline of 51.9% and $866,000 for the six months ended January 31, 2014, versus $1,947,000 for the same period last year, a decline of 55.5%. As a percentage of total revenues, non-recurring revenues were 5.3% in the first half of fiscal 2014, versus 14.5% for the same period in fiscal 2013. Our goal is to maintain non-recurring revenues of less than 10% of total revenues, as the margins on these revenues tend to be lower than our RR products. Furthermore, these revenues must be resold each year. We expect non-recurring revenues to be less than 10% of total revenues for the remainder of fiscal 2014.

The fiscal 2014 decline in non-recurring revenues was primarily driven by a change in business model for our lead generation service. The largest cost associated with this service is the purchase of ad words from Internet search providers such as Google. Historically, the revenues recognized on this service included the cost associated with the ad word spend. These costs were then "passed through" directly to the Internet search provider. Under this model, GAAP requires these costs to be recognized as both a revenue and a cost of sale. Not only did this treatment have the impact of reducing gross margins as a percentage of revenue, but also provided negative float to ARI as the ad word costs were at times paid to the Internet search provider prior to receiving the funds from the customer.

During the latter part of fiscal 2013, we made a change to this business model whereby the customer is now responsible for paying the cost of the ad words directly to the Internet search provider. ARI now simply charges the customer a fee for the service provided. This change had the impact of reducing GAAP revenues associated with this service, as discussed above. However, the change had little or no net impact on the gross profit or net cash receipts associated with the service.

Non-recurring revenues from our professional services business declined 68.9% or $282,000 and 71.0% or $608,000 during the three and six months ended January 31, 2014, compared to the same periods in fiscal 2013. This decline is due to our goal of focusing on RR, which generates higher gross profits. Revenues from non-recurring professional services will fluctuate from period to period based on the timing of custom projects.

Pro forma Revenue

The following unaudited pro forma revenue information for the three and six months ended January 31, 2013 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 financial information presented is for information purposes only and does not purport to represent what the Company's and 50 Below's revenue would have been had the acquisition in fact occurred on such date or at the beginning of the period indicated, nor any future date or period.

	Three months ended January 31		Percent	Six months ended January 31		Percent
	2014	2013	Change	2014	2013	Change
Recurring revenue	$ 7,700	$ 7,374	4.4 %	$ 15,429	$ 14,675	5.1 %
Non-recurring revenue	$ 435	$ 905	(51.9) %	$ 866	$ 1,947	(55.5) %
Total pro forma revenue	$ 8,135	$ 8,279	(1.7) %	$ 16,295	$ 16,622	(2.0) %

50 Below revenues are all classified as recurring revenue. Pro forma recurring revenue grew 4.4% or $326,000 and 5.1% or $754,000 for the three and six months ended January 31, 2014, compared to the same periods last year. Non-recurring revenue decreased 51.9% or $470,000 and 55.5% or $1,081,000 for the three and six months ended January 31, 2014, compared to the same periods in fiscal 2013, primarily due to the change in our lead generation business model described above. Management expects recurring revenue to continue to increase over the previous year pro forma recurring revenue for the remainder of fiscal 2014.

Cost of Revenue and Gross Margin

We classify as cost of revenue those costs directly attributable to the provision of services. These costs include (i) software amortization, which represents the periodic amortization of costs for internally developed or purchased software sold to customers; (ii) direct labor for the provision of catalog production, product implementations and professional services revenue; and (iii) other direct costs, which represent amounts paid to third party vendors for data royalties, as well as data conversion and replication fees directly attributable to the services we provide our customers.

The table below breaks out cost of revenue into each of these three categories (in thousands):

	Three months ended January 31				Six months ended January 31			
	2014	% of Revenue	2013	% of Revenue	2014	% of Revenue	2013	% of Revenue
Net revenues	$ 8,135		$ 7,478		$ 16,295		$ 13,420	
Cost of revenues:								
Amortization of capitalized	519	6.4 %	464	6.2 %	962	5.9 %	860	6.4 %
Direct labor	605	7.4 %	566	7.6 %	1,249	7.7 %	1,014	7.6 %
Other direct costs	562	6.9 %	691	9.2 %	1,035	6.4 %	1,255	9.4 %
Total cost of revenues	1,686	20.7 %	1,721	23.0 %	3,246	19.9 %	3,129	23.3 %
Gross profit	$ 6,449	79.3 %	$ 5,757	77.0 %	$ 13,049	80.1 %	$ 10,291	76.7 %

Gross profit was $6,449,000 or 79.3% of revenue for the three months ended January 31, 2014, compared to $5,757,000 or 77.0% of revenue for the same period last year and $13,049,000 or 80.1% of revenue for the six months ended January 31, 2014, compared to $10,291,000 or 76.7% of revenue for the same period last year. The increase in gross profit margin was primarily attributed to our strategy to focus on recurring SaaS and DaaS services, which have a much higher gross margin than our non-recurring services. In conjunction with this, we made a change to our lead generation service business model, eliminating the pass-through cost of purchased ad words from the search engine providers on behalf of our customers. The Company expects fluctuations in gross margin from quarter to quarter and year over year based on the mix of products sold.

Operating Expenses

We categorize net operating expenses as follows:

- Sales and marketing expenses consist primarily of personnel and related costs, including commissions for our sales and marketing employees, and the cost of marketing programs and trade show attendance;

- Customer operations and support expenses are composed of our customer hosting operations, software maintenance agreements for our core network, and personnel and related costs for operations and support employees;

- Software development and technical support expenses are composed primarily of personnel and related costs; we capitalize certain of these costs in accordance with GAAP, which is discussed below, while the remaining costs are primarily related to technical support and research and development;

- General and administrative expenses primarily consist of personnel and related costs for executive, finance, human resources and administrative personnel, legal and other professional fees and other corporate expenses and overhead;

- Depreciation and amortization expenses consist of depreciation on fixed assets, which are composed of leasehold improvements and information technology assets, and the amortization of acquisition-related intangible assets. Costs associated with the amortization of software products are a component of cost of revenue; and

- We allocate certain shared costs among the various net operating expense classifications. Allocated costs include facilities, insurance, and telecommunications. These costs are generally allocated based on headcount, unless circumstances dictate otherwise. Note that all public company costs, including legal and accounting fees, investor relations costs, board fees and directors and officers liability insurance, remain in general and administrative.

The following table summarizes our unaudited operating expenses by expense category (in thousands). 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.

	Three months ended January 31				
	2014	Percent of Revenue	2013	Percent of Revenue	Percent Change
Sales and marketing	$ 2,442	30.0 %	$ 1,913	25.6 %	27.6 %
Customer operations and support	1,780	21.9 %	1,515	20.3 %	17.5 %
Software development and technical support	781	9.6 %	710	9.5 %	10.0 %
General and administrative	1,713	21.1 %	1,846	24.7 %	(7.2)%
Depreciation and amortization [(1)]	339	4.2 %	339	4.5 %	-%
Net operating expenses	$ 7,055	86.7 %	$ 6,323	84.6 %	11.6 %

	Six months ended January 31				
	2014	Percent of Revenue	2013	Percent of Revenue	Percent % Change
Sales and marketing	$ 4,899	30.1 %	$ 3,135	23.4 %	56.3 %
Customer operations and support	3,391	20.8 %	2,561	19.1 %	32.4 %
Software development and technical support	1,337	8.2 %	1,323	9.9 %	1.1 %
General and administrative	3,201	19.6 %	2,917	21.7 %	9.8 %
Depreciation and amortization [(1)]	660	4.1 %	619	4.6 %	6.6 %
Net operating expenses	$ 13,488	82.8 %	$ 10,554	78.6 %	27.8 %

(1) Exclusive of amortization of software products of $518, $464, $962 and $860 for the three and six months ended January 31, 2014 and 2013, respectively, which are included in cost of revenue.

Net operating expenses increased 11.6% or $732,000 and 27.8% or $2,934,000 for the three and six months ended January 31, 2014, compared to the same periods last year. The increase in net operating expenses was largely due to the costs necessary to operate the 50 Below business, primarily in the sales and marketing and general and administrative categories. During January 2014, the Company implemented a 14% reduction in workforce as a result of consolidating operations and other operational efficiencies achieved as we have continued to integrate the 50 Below operation, primarily in the catalog conversion and website implementation and support areas, thereby eliminating duplicate efforts. The Company expensed approximately $234,000 in severance and related costs as a result of this workforce reduction. Management expects net operating expenses to decline, as a percentage of total revenues, over time as we leverage the growth of our core RR products, for which the incremental costs related to these products decrease for every dollar of new revenue and we realize the cost savings related to the operating efficiencies deployed in January 2014.

Sales and Marketing

Sales and marketing expense increased 27.6% or $529,000 and 56.3% or $1,764,000 for the three and six months ended January 31, 2014, compared to the same periods last year. Sales and marketing expense as a percentage of revenue increased from 23.4% of revenue for the first half of fiscal 2013 to 30.1% for the same period in fiscal 2014. The Company has focused its resources in the sales and marketing area designed to drive revenue growth, including: the hire of a Vice President of Marketing; increasing staff in both sales and marketing; and increasing involvement in trade shows and online publications. Management expects sales and marketing expense as a percentage of revenue to decrease as the Company recognizes revenue on new sales from the first half of fiscal 2014 and continues to increase new sales for the remainder of fiscal 2014.

Customer Operations and Support

Customer operations and support expense increased 17.5% or $265,000 and 32.4% or $830,000 for the three and six months ended January 31, 2014, compared to the same periods last year. Customer operations and support expense as a percentage of revenue increased from 19.1% of revenue for the first half of fiscal 2013 to 20.8% for the same period in fiscal 2014. Management expects customer operations and support expenses to decline, as a percentage of total revenues, over time as we realize the cost savings related to the efficiencies implemented in the catalog conversion and customer implementation and support areas, while RR continues to grow.

Software Development and Technical Support

Our software development and technical support staff have three essential responsibilities for which the accounting treatment varies depending upon the work performed: (i) costs associated with internal software development efforts (after technological feasibility is established) are typically capitalized as software product costs and amortized over the estimated useful lives of the product; (ii) professional services performed for customers related to software customization projects are classified as cost of revenue; and (iii) all other activities, including research and development, are considered operating expenses and included within the software development and technical support operating expense category.

The table below summarizes our internal software development and technical support (in thousands):

	Three months ended January 31		Percent	Six months ended January 31		
	2014	2013	Change	2014	2013	% Change
Total software development and technical support costs	$ 1,719	$ 1,695	1.4 %	$ 3,423	$ 3,149	8.7 %
Less: amount capitalized as software development*	(333)	(420)	(20.7) %	(837)	(813)	3.0 %
Less: direct labor classified as cost of revenues	(605)	(565)	7.1 %	(1,249)	(1,013)	23.3 %
Net software development and technical costs classified as operating expenses	$ 781	$ 710	10.0 %	$ 1,337	$ 1,323	1.1 %

**Does not include outside vendor costs or capitalized interest costs*

Total software development and technical support costs increased 1.4% or $24,000 and 8.7% or $274,000 for the three and six months ended January 31, 2014 versus the same periods last year. The increase was primarily driven by the development costs associated with our two acquisitions.

During the three and six months ended January 31, 2014, we capitalized $333,000 and $837,000 of software development labor and overhead, versus $420,000 and $813,000 during the same periods last year. We have devoted resources to several enhancements of our newly acquired website product, including search engine optimization and integration with inventory management systems in the ATW and powersports industries and the development of new APIs that enable our customers to update information via external applications such as smartphones. We have also completed additional electronic marketing capabilities and integration with two new dealer management systems in our AccessorySmart service, as well as consumer usage and feedback analytics capability.

We expect fluctuations in the percentage of software development and technical support costs classified as operating expenses from period to period, based on the mix of research and prototype work versus capitalized software development and professional services activities.

Other Income and Expense

The table below summarizes the components of other income and expenses (in thousands):

	Three months ended January 31		Six months ended January 31	
	2014	2013	2014	2013
Interest expense	$ (78)	$ (269)	$ (148)	$ (337)
Loss on change in fair value of stock warrants	(10)	-	(32)	-
Gain on change in fair value of earn-out payable	-	-	26	-
Other, net	7	4	15	8
Total other income (expense)	$ (81)	$ (265)	$ (139)	$ (329)

Interest Expense

Interest expense is composed of both interest paid on the Company's debt financing arrangements and amortization of non-cash interest charges related to deferred finance costs. Interest expense decreased 71.0% or $191,000 and 56.1% or $189,000 for the three and six months ended January 31, 2014, compared to the same periods last year. The decrease in interest expense is a result of the April 2013 restructuring of debt that the Company incurred in November 2012 to finance the 50 Below acquisition.

Loss on Change in Fair Value of Stock Warrants

In March 2013, we executed a private placement with certain institutional and accredited investors. As part of the transaction, the Company issued warrants to purchase an aggregate of 1,130,667 shares of common stock at an exercise price of $2.00 per share. The warrants contain a down-round protection feature which reduces the strike price of the warrants from $2.00 to $1.50 if there is a private placement for less than the $2.00 strike price. This feature resulted in the warrants being treated as a derivative instrument. Accordingly, the warrants are recorded as a liability on the balance sheet at fair market value and changes in the fair market value are recorded to gain or loss on change in fair market value of stock warrants on the statement of operations.

During the three and six months ended January 31, 2014, we incurred non-cash losses of $10,000 and $32,000 related to the warrants, primarily as a result of an increase in the market value of the Company's common stock. We have 214,000 warrants outstanding at January 31, 2014, which will require fair value accounting treatment until the earlier of their exercise or expiration of the down-round protection feature. Changes in the market price of the Company's common stock are likely to have the most significant impact on the fair value of the warrants. The down-round protection feature expires on June 20, 2014, at which time any remaining balance of warrants outstanding would no longer have a derivative feature and would be reclassified to equity.

Gain on Change in Fair Value of Earn-out Payable

The Company incurred a liability as part of the consideration for the Ready2Ride acquisition in August 2012, contingent on future revenues earned related to the acquired business. On October 22, 2013, the Company amended the Purchase Agreement in relation to the earn-out payments resulting in three fixed payments of $125,000 and an aggregate of 40,000 shares of common stock. During the six months ended January 31, 2014, we recorded a gain on change in fair value of earn-out payable of $26,000, or $0.00 per basic and diluted common related to this amendment.

Acquisitions

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., a leading provider of eCommerce websites in the powersports, ATW and HME industries for a purchase price of $5,000,000 and the assumption of contracts having deferred revenue originally 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. The balance of the purchase price was funded through a term note with a significant shareholder.

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 marketed 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 and assumed

liabilities totaling approximately $419,000 and contingent liabilities with an estimated fair market value of approximately $600,000.

On November 5, 2013, the Company acquired the assets of DUO Web Solutions, a leading provider of social media and online marketing services for the powersports industry. The transaction is not considered material to the financial statements.

Income Taxes

The Company has net deferred tax assets of $6,533,000, primarily consisting of net operating loss carryforwards ("NOLs") and book to tax temporary differences. Income tax expense is provided for at the applicable statutory tax rate applied to current U.S. income before taxes, plus or minus any adjustments to the deferred tax assets and to the estimated valuation allowance against deferred tax assets. Income tax expense, if any, does not represent a significant current cash obligation, as we continue to have NOLs to offset substantially all of the taxable income.

We had an income tax benefit of $226,000 and $142,000 during the three and six months ended January 31, 2014, compared to $835,000 and $709,000 during the same periods last year. We recorded a tax benefit related to a change in estimate of the valuation allowance against future NOLs of $32,000 for the three and six months ended January 31, 2014 and $941,000 for the three and six months ended January 31, 2013, because of an expected increase in future taxable income. We paid income taxes of $70,000 and $29,000 for the six month periods ended January 31, 2014 and 2013, respectively, primarily related to statutory alternative minimum taxes. Income tax expense may vary from period to period as we continue to evaluate the valuation allowance against net deferred tax assets on a semi-annual basis.

Liquidity and Capital Resources

The following table sets forth certain cash flow information derived from our unaudited financial statements (in thousands):

	Three months ended January 31		Six months ended January 31	
	2014	2013	2014	2013
Net cash provided by operating activities	$ 53	$ 868	$ 27	$ 1,377
Net cash used in investing activities	(997)	(1,103)	(1,949)	(3,629)
Net cash provided by financing activities	408	172	312	1,104
Effect of foreign currency exchange rate changes on cash	(4)	(8)	(4)	(12)
Net change in cash	$ (540)	$ (71)	$ (1,614)	$ (1,160)
Cash at end of period	$ 581	$ 190	$ 581	$ 190

We utilized $540,000 and $1,614,000 of cash during the three and six months ended January 31, 2014, compared to $71,000 and $1,160,000 during the same periods in fiscal 2013. Net cash provided by operating activities was $53,000 and $27,000 during the three and six months ended January 31, 2014, respectively, compared to $868,000 and $1,377,000 during the same periods last year. The decline in cash generation was primarily due to costs and assumed liabilities associated with the integration of the 50 Below operation, the timing of customer receipts and the timing of vendor payments. We expect cash from operations to improve during the remainder of fiscal 2014 due to the cost savings from the operational efficiency improvements made in the second quarter of fiscal 2014, the completion of assumed non-cash service obligations related to the 50 Below acquisition and an increase in cash receipts as a result of growth in RR.

Cash used in investing activities decreased $104,000 and $1,678,000 during the three and six months ended January 31, 2014, compared to the same periods last year. The year to date decrease in investing was primarily due to the $1,798,000 investment in the acquisitions of Ready2Ride and 50 Below in the first quarter of fiscal 2013. We invested $1,013,000 in capitalized software development costs, acquired $523,000 worth of technology equipment and leasehold improvements and invested $200,000 for the DUO acquisition during the first half of fiscal 2014. We will continue to invest cash in the business to further our growth strategies previously discussed.

Cash provided by financing activities was $408,000 and $312,000 for the three and six months ended January 31, 2014, as the Company borrowed $400,000 on its line of credit to partially fund its investments. Cash provided by financing activities was $172,000 and $1,104,000 for the three and six months ended January 31, 2013 as the Company borrowed an additional $1,500,000 of debt from Fifth Third, under its previous credit facilities, to fund its acquisitions of Ready2Ride and 50 Below.

Management believes that current cash balances and its ability to generate cash from operations, as well as the existing availability under our line of credit are sufficient to fund our needs over the next 12 months, although additional financing may be necessary if the Company were to complete a material acquisition or to make a large investment in its business.

Debt

Silicon Valley Bank

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

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to one or more of the following as may be selected by the Company: (a) the one, two or three-month LIBOR Rate (as defined in the Agreement, subject to a floor of 1.00%), plus the Applicable Margin for LIBOR Loans set forth in the chart below, determined based on the most recent senior leverage ratio, which is defined as total senior indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"), calculated by SVB on a quarterly basis (the "Senior Leverage Ratio"); or (b) the Prime rate plus the Applicable Margin for Prime Rate Loans set forth in the chart below determined based on the Senior Leverage Ratio (effective rate of 3.75% at January 31, 2014).

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

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

The Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to permit a change of control, incur debt, create liens on its assets, make certain investments, enter into merger or acquisition transactions and make distributions to its shareholders. Financial covenants include the maintenance of a minimum Senior Leverage Ratio equal to or less than 2.00 to 1.00, and the maintenance of a Fixed Charge Coverage Ratio (as defined in the Agreement) equal to or greater than 1.25 to 1.00. The Agreement also contains customary events of default that, if triggered, could result in an acceleration of the Company's obligations under the Agreement. The loans are secured by a first priority security interest in substantially all assets of the Company. The Company was in compliance with its debt covenants at January 31, 2014.

Off-Balance Sheet Arrangements

The Company has no significant off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.