ARI NETWORK SERVICES

Moderator: Steven Hooser
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Operator: This is conference # 74152099.

Ladies and gentlemen, thank you for standing by and welcome to the ARI Network Services Second Quarter Fiscal Year Ending 2015 Earnings Conference Call.

At this time, all participants are in a listen only mode. Later, we will conduct the question-and-answer session, and instructions will follow at that time. If anyone should require assistance during the conference, please press star then zero on your touch-tone telephone. As a reminder, this conference call is being recorded.

I would now like to turn the conference to our host, Mr. Steven Hooser, ARI's Investor Relations Representative. Sir, you may begin.

Steven Hooser: Thank you, (Eric). Thank you, everyone, for joining us today to discuss our second quarter fiscal year ending 2015 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 this call. These risks are detailed in our most recent Annual Report on Form 10-K, and such may be amended or supplemented by subsequent quarterly reports on Form 10-Q or other reports filed with the Securities and Exchange Commission. These 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. 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 and within the earnings release.

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

Roy W. Olivier: Thanks, Steven, and thanks to all of you on the line for participating in today's call. We appreciate your time and your continued interest in ARI. I am very pleased with our second quarter results. We achieved record revenues breaking $10 million during a quarter for the first time. We improved our gross margin and reduced our overall cost structure, resulting in operating income for the quarter that was more than all of FY 2014.

This also resulted in net income for the quarter outperforming our annual results for fiscal 2013 and fiscal 2014. We continue to share a nice progress toward returning the company to our EBITDA objectives of 18 percent to 20 percent and continue to show improved cash flow.

We, again, had a very strong quarter in terms of new bookings. And we believe that all of this is the result of having a right strategy in place and executing well against our operating plan. Virtually all of our sales groups are posting impressive new bookings with automotive wheel and tire being number in terms of new booking dollars when you incorporate business management software sales, and home medical equipment showing the strongest year-over-year gain of all of our sales teams.

As a result of new product enhancements rolled out at the end of Q1, we have seen improved results in almost all of our verticals, but particularly in outdoor power, which is also posting very strong new bookings. A combination of strong sales execution and a strong general U.S. economy is resulting in more new opportunities than I've seen in many years.

The TCS integration continues to go well, and the results for the quarter were in line with our expectations. I feel like most of the typical integration challenges are now behind us and that the new business unit is now hitting its stride in terms of new bookings and revenues. I'll remain enthusiastic about this addition into our business and think they will continue to show results going forward.

I'm very excited about the remainder of fiscal 2015 and the first half of fiscal 2016 in terms of new business opportunities. But for now, I'll turn the call over to Bill to go over the financials in more detail, and then I'll be back to comment further on our strategic progress and outlook.

William Nurthen: 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 second quarter of our fiscal year, which ended on January 31, 2015.

To start, I wanted to remind everyone that our second quarter results incorporate three full months of performance from TCS. When comparing results sequentially to the first quarter, there was approximately one month of TCS's performance consolidated into the first quarter numbers.

Total revenues for the second quarter were $10.1 million, which compares to $8.1 million in the same period last year and $9.1 million in the prior quarter.

The year-over-year increase of 24.6 percent represents approximately 7 percent organic growth with the remainder coming from the incorporation of TCS.

Recurring revenues were $9.1 million compared to $7.7 million in the same period last year and $8.2 million in the prior quarter. Recurring revenues represented 90.2 percent of total revenues for the three months ended January 31, 2015, versus 94.7 percent in the same period last year and 89.5 percent in the prior quarter. The primary reasons for the year-over-year decline in the percentage of recurring revenue are that TCS has a lower mix of recurring revenues and our Professional Services revenue in the quarter was roughly $180,000 higher than the prior year.

With respect to the TCS mix, as previously noted on our last quarter's call, their recurring revenues are technically lower given their business management software suite is, at present, sold through perpetual licenses.

Turning to profitability, we are very pleased with our Q2 profit performance as we experienced substantial improvement, both year-over-year as well as over the prior quarter. Our gross profit improved to $8.3 million or 81.6 percent of revenue compared to $6.4 million or 79.3 percent in the same period last year and $7.4 million or 80.8 percent of revenue in the prior quarter. The growth in gross profit on a year-over-year and sequential basis is primarily attributable to incorporating three months of TCS performance, also aided by organic revenue growth.

The year-over-year growth in gross margin was driven by revenue growth and efficiencies from the headcount reductions we made at the end of our second quarter in fiscal 2014. Sequentially, the gross margin improved as a result of growth in recurring revenues, as well as about $110,000 less in Professional Services revenue for the quarter, which has a lower gross margin.

The firm recorded an operating profit this quarter of $670,000 versus an operating loss of $606,000 in the same period last year and a profit of $283,000 in the prior quarter. The improvement in year-over-year performance is primarily a result of the strategic headcount reductions we

made in the second quarter of fiscal 2014, which also had a termination benefits charge of $234,000 associated with them. Sequentially, we experienced improvement as we put behind us the transaction-related cost associated with the purchase of TCS. Recall that in Q1, we had over $200,000 in nonrecurring charges related to the acquisition. The charges remaining in Q2 were immaterial.

Additionally, as noted on last quarter's call, Q1 is traditionally a time of high trade show spend for us. The improvement in operating profit was also a result of lower marketing expenses in the quarter, as sales and marketing spend as a percent of revenue was 26.3 percent versus 27.9 percent in the prior quarter.

The quarterly operating profit of $670,000 marks our highest operating profit since the third quarter of our fiscal 2011. Below the operating line, the interest expense was up $62,000 year-over-year and $51,000 sequentially, as a result of the refinancing of our term loan and the issuance of a seller note associated with the TCS transaction. Despite the increase in interest expense, we still managed to see increases both year-over-year and sequentially, in pretax profit. Pretax profit was $534,000 versus a pretax loss of $687,000 in the prior year and a profit of $193,000 in the prior quarter.

From an earnings per share perspective, net income for Q2 was $260,000 or 2 cents per diluted share compared to a net loss of $461,000 or 3 cents a year ago, and net income of $104,000 or 1 cent in the prior quarter. The quarterly net income and EPS performance was our highest since the fourth quarter of our fiscal 2012.

Looking at EBITDA. EBITDA was $1.6 million in the second quarter of 2015 compared to $300,000 in the same period last year and $1.2 million in the prior quarter. Similar to our operating profit, this EBITDA was the highest performance since the third quarter of fiscal 2011. Our EBITDA margin was 16.1 percent compared to 3.2 percent in the prior year and 13.2 percent in the prior quarter.

Turning to cash flow. We continue to see strong performance as we posted our fourth straight quarter of over $1 million in cash flow from operations. Cash from operations in the quarter was $1.1 million compared with $53,000 in the same period last year and $1.6 million in the prior quarter. Recall from last earnings call that I stated we expected a sequential quarterly decline in cash flow given Q2 as seasonally a time of our lowest receipts combined with some of our highest outflows.

Free cash flow, which we calculate as cash flow from operations less capital expenditures and software capitalization, was $500,000 for the period versus negative $700,000 in the same period last year and $1.3 million in the prior quarter. I also noted in our last call that we expected capital expenditures to rise in Q2 as they were very light in Q1. This was the case as we had $258,000 in CapEx for the quarter compared with $21,000 for Q1.

Looking at where we are at the midpoint this year, we are pacing well ahead of last year as we have already generated $2.7 million of cash flow from operations versus $27,000 last year and $2.4 million for all of fiscal 2014. Additionally, we generated $1.7 million of free cash flow in the first six months of fiscal 2015 compared with negative $46,000 for all of fiscal 2014.

As we turn to the balance sheet, our Q2 performance allowed us to reduce some of our debt levels from Q1, while also modestly increasing our cash balance. The cash balance at the end of Q2 was $1.7 million versus $1.6 million at the end of Q1. We accomplished this while reducing our debt by approximately $500,000 in the quarter, $250,000 of which came off the line of credit, and approximately $150,000 off the principal on our term debt.

Total debt, which we calculated as debt from our line of credit, notes payable, and capital lease obligations, was $10 million as of quarter end versus $10.5 million at the end of Q1. The company's debt-to-equity ratio at the end of Q2 stood at 49.6 percent compared to 54.1 percent at the end of last quarter.

As we look ahead to Q3, we continue to see promising growth opportunities, both in the core ARI business as well as within TCS. Roy will touch on our customer acquisition cost or CAC ratio later. However, the ratio for the

quarter was one of our lowest ever. And as a result, we began to bring in some additional sales and marketing personnel in Q2 as well as some additional fulfillment personnel.

Depending upon the timing of the ramp-up of these sales personnel and the fulfillment of new websites and software sold, we could see a dip in profitability in Q3. However, overall, we do not expect significant deviation from the results we have posted over the last four quarters, and believe this sets us up well for Q4 and to scale profitability over time. From a cash flow perspective, Q3 is typically better for us from a seasonality perspective so we are targeting improved cash flow for the quarter, which should allow us to continue to drive down our debt.

Lastly, it was this time last year when we made a headcount reduction in line with our integration efforts for the 50 Below transaction as well as our desire to better align our cost base for the future. We now have a trailing 12 months of performance since those cost reductions, and we are pleased with the improvement and consistency in both our profitability and cash flow.

To give some perspective, over the last 12 months, we have posted $1.7 million in operating profit, $5.5 million in EBITDA and $5.1 million in cash flow from operations. If you look at all of our fiscal year ending results for the fiscal years 2011 through 2014, these numbers are all higher than in each of those years. We have been able to accomplish these things while also generating organic revenue growth and working to complete and integrate a new acquisition in the TCS transaction.

I will now turn the call back over to Roy.

Roy W. Olivier: Thanks, Bill. To start, I'd like to update you on some of the key accomplishments we discussed during our last call. Last quarter, we discussed several new product releases, including a major upgrade to our website platform, a new mobile application, and a marketplace listing tool that allows dealers to feed their new unused inventory to all major online marketplaces.

I'm happy to report that we are seeing nice traction with each of these. We have seen an increase in upsells to our existing clients and improving average revenue per dealer for our new sales. As a result of the new platform upgrade, new bookings in most verticals have improved. And we have seen particularly strong new bookings in outdoor power and marine. On a year-to-date basis, total dealer bookings are up 20.1 percent.

Digital marketing new bookings were slightly down versus Q1. However, they did post a triple digit gain year-over-year. New bookings were in line with expectations as November and December are the slowest months of the year for this service. While this area of the business continues to grow, we can and will do more to accelerate our sales velocity in this important area.

Before I discuss our progress on our key performance indicators and strategy, I'd like to quickly review our growth strategy. As we've discussed previously, we expect to grow ARI through a combination of organic growth and acquisitions that are in line with our strategy. We expect almost half of that growth to be organic, with the remaining coming through strategic acquisitions.

Given our current market share in many of the markets that we serve, we expect organic growth in our current verticals to primarily be driven by automotive wheel and tire, home medical equipment, and from the sales of our new digital marketing services into all verticals. We also plan on launching a solution suite into the automotive aftermarket service segment. We believe that ARI software and digital marketing solutions provide for a powerful value proposition in new and existing vertical markets.

Within the markets we currently serve, we think about growing them in three ways. First, we focus on adding new customers or new logos. A majority of our sales and marketing spend is dedicated to on boarding new logos. Over the past 12 months, we've seen strong new bookings in this area and we are up about 11.9 percent year-to-date. We plan on continuing to invest and adding salespeople to take market share as long as the economic conditions support it and it generates results.

The payback period for our sales and marketing investment was about nine months during the quarter versus 12 months last quarter and 12 months for all of last year. As long as the payback period that we referred to as our CAC ratio remains under an 18-month payback and especially when it's under 12 months, we will continue to invest in growing our market share, and as Bill noted, we indeed made some additional investments in sales and marketing at the end of Q2. In the long term, however, we do not expect our sales and marketing spend to grow at the same rate as revenues.

Second, we have a team that focuses on upsells with the intent to raise our average revenue per dealer across our base. Example of upsells include adding new catalog content for an existing customer or adding new features like our new mobile application or marketplace feed solution discussed earlier. With the addition of these new features, we have also seen upsell bookings, net of digital marketing upsells, to be up 9.8 percent over last year and we expect to continue to see growth in this important area of the business.

Finally, we spent considerable time on reducing churn. This is the measurement, in dollars, of customers that do not renew their subscription. Some of the new upgrades and features discussed earlier in the call are specifically targeted at improving the return on investment for the dealer and ultimately reducing ARI's churn rates.

While we have successfully reduced churn over the past four years, our annualized churn rate in Q2 was slightly higher than our expectations at 16.7 percent. Keep in mind that this is a quarterly number that is annualized, as such, can be volatile and subject a unique situations in a given quarter but tends to smooth out over the year. We do expect the number to decline for the remainder of the fiscal year.

As previously mentioned, the TCS acquisition is off to a great start. Their performance is in line with our plan, and we are starting to see strong new bookings in websites and in dealer business management software. We are investing in growing the dealer business management software sales team, and are starting to see traction in this area. That team has closed approximately $0.25 million of software sales in the last 60 days and has built an impressive

pipeline for the future. The website business continues to post strong new bookings as well.

Turning to recent events. We have seen improved performance out of our OEM sales team. We have closed and announced three significant OEM successes and a partnership in the last few months. Most recently, we closed a large engagement with a leading manufacturer of outdoor power equipment for both the web-based B2B solution for their dealer portal and a bulk license agreement to provide our award-winning PartSmart product to as many as 5,000 dealers. Shipments will begin in July and revenue for this agreement could be as high as $800,000 over the next three years.

In addition, we recently upgraded Briggs & Stratton's consumer facing solution to our PartStream product that will allow their customers to order replacement parts on their website. We also entered to an agreement to build consumer part solution for another OEM using our PartStream product to help their marine customers order replacement parts.

Finally, we announced a partnership with ChannelAdvisor, which will help our very large dealers sell more parts on third-party marketing sites like Amazon, eBay, et cetera.

In short, we continued nice progress against the five strategic pillars we have discussed in previous calls, and we believe that our leading indicators point to another record year for ARI in almost all respects. We continue to expect high single-digit organic growth early in fiscal 2015 and low double-digit growth as we progress through the latter half of the year.

However, given that we have merged our wheel and tire business with the TCS business, reporting on organic growth will get more challenging as we continue to consolidate and merge the business and platforms. We continue to expect TCS to generate about $5 million of revenue during fiscal 2015 and to be accretive to our EBITDA and cash flow.

Finally, we see a lot of new sales and business development opportunities, and we will continue to aggressively pursue those to the extent that they are

consistent with our overall strategy. I remain very bullish about our prospects for the remainder of fiscal 2015 and the first half of fiscal 2016.

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

Operator: Certainly. Ladies and gentlemen, if you have a question at this time, please press the star then one key on your touch-tone telephone. You may remove yourself from the queue at anytime by pressing the pound key. Again, to ask a question at this time, please press star then one on your touch-tone telephone. In the interest of time, we ask you to please limit yourselves to one question and follow-up before reentering the queue.

And our first question comes from Ed Woo of Ascendiant Capital. Please go ahead.

Edward Woo: Yes, congratulations on the quarter. I had a clarifying question. You pretty much kept your revenue guidance the same. It looks like low single – or single-digit growth in the first half organically, low double digit in the back half. But you didn't provide comment on your, I guess, EBITDA goals. Is that pretty much unchanged from the last quarter?

William Nurthen: Yes. I think we continue to target trying to get to 18 percent to 20 percent on the EBITDA side. Where we will potentially have some issues with that is where we intend to make some additional sales and marketing expenditures. So this quarter was a relatively clean quarter. We showed a nice trajectory to 16.1 percent EBITDA margin. Q3, we are layering in some additional sales.

So depending upon the timing of the revenue and how it gets turned up in Q3, you could see some dip in Q3 from an EBITDA perspective. But I don't think you're looking at significant deviation from what we've done over the prior four quarters. I think you're potentially looking at something that, from an EBITDA perspective, is maybe between our Q1 and our Q2 today. And then I think that does set us up to scale much better for Q4 results and beyond into '16.

Edward Woo: Great. I have a follow-up. In terms of your long-term EBITDA margins of 18 percent to 20 percent, as you guys gain scale, do you think that, that target potentially can be higher?

William Nurthen: Yes. We think it can. We look at that as something being achievable in the near term here. Historically, the company has posted EBITDA as high as 24 percent, but there really wasn't a lot of sales and marketing spend there. But there are some advantages with scale, and I think we started to see some of that in Q2. Certainly, from a sales and marketing perspective, as Roy mentioned, we don't see that growing as fast as our revenue does. So we think that will come down from where it is today. Not down potentially to the levels that we saw in 2011 and 2012, but it will come down. And I think we'll also get some scale in both our fulfillment and our operation side of the business – I mean, our G&A side of the business. We have some costs that are obviously just built in for being a public company that definitely scale over time and as the revenue grows. So I think you'll see some percentage points gained on the G&A line as well.

Roy W. Olivier: Yes. Just to add some additional color. Back when we were running 19 percent and 24 percent EBITDA margin, we were investing approximately 20 percent of revenue in sales and marketing. Today, last quarter, we run 16 percent EBITDA margin, and we're investing about 28 percent in sales and marketing. So we believe right now is the right time to put the pedal to the metal, so to speak, in terms of taking market share and adding new logos as quickly as we can because we know that the economic conditions we have today will not last forever. So we can – we expect to see some EBITDA margin expansion naturally as the business gets bigger, but there also could be some significant margin expansion if we decide to slow down or dial back sales and marketing investment.

Edward Woo: Great. Well, thank you and good luck.

Roy W. Olivier: Thank you.

William Nurthen: Thanks.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press the star then the one key on your touch-tone telephone. As a reminder, please limit yourselves to one question and follow-up or reenter in queue.

And our next question comes from Kevin Dede of H.C. Wainwright.

Kevin Dede: Good afternoon, guys. It's Kevin Dede. First, congrats on a great quarter. I think you really showed people what potential is here and congrats on the success with TCS.

So I have a long list of questions for you. I'll just take it with organic first. Roy, you mentioned home medical equipment and wheel and tire is your best avenues of growth. And I think you mentioned sort of a third vertical and I may have missed it?

Roy W. Olivier: Well, we continue to see strong year-over-year growth in home medical and digital marketing, but they're growing off a relatively small base. We continue to see very strong growth in wheel and tire. And last quarter, based on the product rollout that we did at the end of Q1, we saw really impressive growth in outdoor power and some of our older verticals that haven't grown in a number of years.

We're also doing some things now to line up and improve our products appeal in some of the other verticals for fiscal 2015. So we're already kind of laying a groundwork to keep that sales momentum bookings going into 2015 through a series of new product releases and enhancements that, hopefully, will kick some sales growth into other verticals that are not growing as quickly as digital marketing, wheel and tire or outdoor power equipment.

Kevin Dede: All right. You mentioned the percentage increase in bookings somewhere, I think, in the low-20 percent. Can you just repeat that number for me and give me a background on how you offered it or how it's measured?

William Nurthen: Sure. Yes. The number given was 20.1 percent and that was a total bookings number which includes new sales and upsells, and that's comparing the first six months of this year to the first six months of last year.

Roy W. Olivier: And that's with or without software license.

William Nurthen: That does not include business management software licensing.

Kevin Dede: OK. Just the last one for me here on the first round. I know that the strategy was not to fully integrate TCS. I just wanted to -- I mean, and I know you said that things appear to be going well. Obviously, the numbers point to that. But I'm just wondering if you can add some detail on the aspects that you have integrated, what's left to do, and what the overall feedback is.

Roy W. Olivier: Yes. I mean I think in terms of what have we integrated, we certainly integrated the treasury and accounts payable and kind of cash management. We have integrated the sales teams. The Duluth, Minnesota sales teams now report into the Tennessee organization, which is the headquarters of our new wheel and tire group. We have made some progress in other parts of the business. But what is remaining is, because we still have two platforms, we still published data for two platforms in two different publishing groups. So as we continue to execute on the strategy to migrate to a single platform, there'll be a small amount of cost rationalization as we publish only to a single platform. But overall, I think the major integration steps we wanted to do, we've done. We've got a few little ones left.

In terms of your last question, I think, overall, it's going very well. I think whenever you acquire a company and put two groups together that have been competitors for a number of years, there's a certain amount of tension that's natural as people kind of work through. Yesterday, you were an archrival of mine and today, you're my friend. But a lot of that seems to be behind us and the sales team seemed to start – they appear to be starting the fire on all cylinders and we've had some really nice new bookings both on the website side and on the dealer business management software side.

Bill, anything you'd like to add?

William Nurthen: No. I think you covered it pretty much, yes.

Roy W. Olivier: Yes.

Kevin Dede: OK. Thanks, guys. Congrats again.

Roy W. Olivier: Oh thank you.

William Nurthen: Thanks, Kevin.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press star then one on your touch-tone telephone.

And our next question comes from Avi Fisher of Long Cast Advisers.

Avram Fisher: Hi, good afternoon. Thanks for taking my question. Just a quick question on G&A. Last quarter, I think you said there is about $200,000 in acquisition cost that weren't expected to repeat, but you're roughly flat quarter-over-quarter. I just wonder if you can comment on that.

William Nurthen: Yes. That's really just the addition of TCS for a full three months. So we only had them on for one month in the prior quarter.

Avram Fisher: So is this roughly where we should be going forward? Holding all things steady?

(Crosstalk)

William Nurthen: Yes. As I just said – go ahead.

Avram Fisher: Sorry, at either 15 percent, 16 percent of revenues or $1.6 million roughly?

William Nurthen: Yes. I mean that's – as I said before, this was a fairly clean quarter for us. There wasn't a lot of noise in the G&A number. So I think that's a fairly clean number it operate off of.

Roy W. Olivier: The dollar number?

William Nurthen: The dollar number. Again, we're trying to get some scale out of there. You may see some incremental add there. But really, where we're adding headcount is in the sales space, primarily with a little bit of sales – excuse me, a little bit of headcount in the operations space as well.

Avram Fisher: And, Roy, how long (in your history) to sort of usually take to get a new sales person up and running?

Roy W. Olivier: Yes. That's a great question. In the dealer sales teams, it actually only takes between 16 and 120 days. In the OEM team, which is a much smaller team and we don't have a lot of turnover in the OEM team, it takes nine months to a year. But dealer sales teams, they ramp very, very quickly.

Avram Fisher: And what's been the kind of supply and demand for people these days? Is it a pretty tight market? Or I mean other companies are doing all right, too?

Roy W. Olivier: You know, I think the profile of dealer sales is somebody that's been out of school a couple of years, and they might have some sales experience at a cell phone store, or Best Buy or someplace like that. And we have a pretty good success rate in finding those people and on boarding them. We do have challenges like everybody does, hiring highly technical people like software developers or IT people or database administrators. But on boarding salespeople has been fairly straightforward and has not been an issue up until now.

(Crosstalk)

William Nurthen: No. Go ahead, follow-up your question. I had a clarifying point as well on the operating expenses.

Avram Fisher: Okay. Go ahead, what was it?

William Nurthen: Yes. All I was going to say, too, is just again, when you look at the -- just all of the operating expenses in general, what I wanted to clarify for everybody, they're up about 500 quarter-over-quarter, but that is primarily the addition of TCS for the full three months. If you'd look at this sort of ARI component to that, that was down about 200,000 quarter-over-quarter.

Avram Fisher: Got you. Thank you. I appreciate the work you’re doing. Thank you.

William Nurthen: Thank you.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press star then one on your touch-tone telephone.

Our next question comes from Kevin Dede of H.C. Wainwright.

Kevin Dede: Hi, guys. I just wanted some clarity on a couple of other things, please, Roy. One is the acquisition pipeline. I know that's a key component of your growth. I was wondering if you could highlight some of the things that you're looking at, to the greatest degree you can, and just give us an indication of how you see that market developing for you.

Roy W. Olivier: We continue to have a lot of activity in that area. We look at a lot of targets. We see a lot of interesting opportunities out there. Today, we look in a lot of areas, but we particularly like to take out direct competitors. We like to look at folks that have unique content that lines up with our differentiating content strategy, especially if it's something we can build our other products around to accelerate their sales velocity with their content.

But there's a lot of opportunities out there that challenge, of course today is finding valuations that makes sense and timing when we want to do something and making sure that it's accretive to our EBITDA within a reasonable period of time. As I've said previously, we like to look at a little bit larger acquisitions then we've done in the past, although we have looked at some small ones. But one of the big differences is we are looking for acquisitions that are going to be accretive to EBITDA and cash flow much quicker than some of the ones we've done previously. And I'm referring to things like 50 Below where it was an 18-month project to get it to EBITDA and cash flow in line with our expectations.

(Crosstalk)

Roy W. Olivier: Sorry.

Kevin Dede: Yes. That's sort of in line with your integration strategy, which is mostly hands-off at this point?

Roy W. Olivier: Right.

Kevin Dede: OK. Then would you mind talking a little bit in greater detail about the ChannelAdvisor's partnership? It just seems that – I mean back from a 20,000-foot perspective, it's almost a cannibalistic environment, right? If you're allowing what eBay and Amazon to offer the services that you do, I just didn't really – I couldn't put that partnership together.

Roy W. Olivier: Yes, that's a great question now. First off, the partnership is – we have dealers that subscribe the catalog data from us. This is predominantly in the aftermarket parts, garment, and accessory area; so it's not OEM parts. It's aftermarket parts. And these are dealers that want to list and sell those parts on marketing sites like Amazon and eBay.

ChannelAdvisor, as you know, is a public company. They have a very interesting tool that will allow a dealer to post inventory on multiple marketing sites and allow that dealer to receive orders, pick, pack and ship, see status in one tool instead of having to go to each marketplace individually. Well, those dealers have not been allowed to use our content because it's proprietary content to list on those services.

So the ChannelAdvisor partnership now allows that dealer to subscribe to yet a different data set from us, feed it into ChannelAdvisor that allows them to feed it to Amazon, eBay, et cetera. I will tell you that we do not provide that dealer the ability to feed all of our content to Amazon and eBay. In other words, if you look at a SKU in there of a jacket, there are certain aspects of the data associated with that jacket that are pretty normal and you can find it anywhere. The secret sauce that we add to that data that makes it valuable to our dealers and makes it valuable to other people to subscribe to it, we don't allow that secret sauce to be passed to an Amazon and eBay.

So predominantly, think about it like this, the guy's got an SKU in stock, he's got a helmet in stock, he can list that helmet on Amazon and eBay, including a picture of the helmet and a brief description of the helmet and the price of the helmet and the SKU. But all of the other metadata that we have associated with that helmet that allows a consumer on one of our websites or a dealer using our software in their store to quickly identify that helmet by type, by

color, by weight, by all kinds of other parameters, we don't allow that information to be passed through the ChannelAdvisor tool to Amazon or eBay.

The second thing I would say to you is that the number of customers that are prospects for that product are a few hundred. It's targeted toward super dealers that want to compete nationally for that business. I think that our, as I mentioned, it's not something that a mass appeal product for our base of 25,000 dealers. It's something that's going to apply to 100, 200 dealers maximum. And it's priced that way too. It's very expensive, both from ChannelAdvisor and from us.

Kevin Dede: OK. That's very helpful. Thanks.

Roy W. Olivier: No, thank you.

Kevin Dede: Yes. And right, so the – I mean, you mentioned a fairly high churn number this time around. What do you think are the most important initiatives that you'll be able to put in place to sort of put a clamp on that and reverse it going forward?

Roy W. Olivier: Yes. A lot of the churn reduction things that we do are basic blocking and tackling that we just need to continue to execute on. Certainly, there's an element of product road map and product innovation that's associated with that. And we have continued to add product managers and developers this year, including actually working with some third parties to accelerate our development velocity to get new product out to the field faster. All those will have an impact on churn.

I would also tell you, though, that we started an initiative last year to raise prices on a lot of legacy dealers that may have bought a product from us back in 2006 or 2007, and they were literally paying 1/4 or 1/5 what the going rate is for that same product today. And we, frankly, dramatically raised prices on a number of dealers. That drove our churn percentage up. But what we're not reporting is, if you look at the recurring revenue, the dealers that stayed are generating well more recurring revenue than the dealers that churned out. So there are some things that affected our churn rate in the quarter that we don't

necessarily expect to continue that's why we said that we expect it to go down for the remainder of the year. But a lot of that reduction is continuing to do the basic blocking and tackling and product management efforts that we've done for the last four years that have caused it to continue to decline.

Kevin Dede: OK. So with the raise and praises, how much of an impact do you think that would have on gross margin going forward? I mean I know Bill's comments were directed towards seeing margin improvement predominantly on scale. But if you're turning out some of your less profitable customer, you think you'd see maybe a higher tick, it was almost, what, 100 basis points sequentially here.

William Nurthen: Yes. I mean I think that there was a – that component of customers that were subject to that increase was not the broad swap of our customers. I do think we'll see some improvement there. But I think that the kind of the 81.6 percent level that we were for the quarter, is there room up from there? Yes, but I think it gets a little bit harder over time to continue to push that higher.

Kevin Dede: So – and, Roy, given that your customer acquisition costs are down or at least within a nine-month ball park, is there – I mean is one aspect of your customer acquisition strategy to perhaps present an opening package at a lower price and with the hope that your customer will accept your initial deal and then ramp-up on price as they accept more aspects of the offering?

Roy W. Olivier: Yes. Currently, we don't expect to lower price or offer a lower market price point product. We continue to position our product as a high-value product with a premium price point. And I've said a million times around the building, it's always easy to go down, and price, it's hard to go back up. And I don't think we want to introduce a concept of having to go back to a customer a year into their contract or a few months into their contract and raise prices. We would rather, if we're looking at a price-sensitive customer, we'd rather waive a setup fee or do something with the onetime fee and leave the recurring revenue fee where it is today.

Kevin Dede: OK. All right. Last question about acquisitions. I appreciate the color on the pipeline. Is there – are there any hints that you might be able to offer your

constituents on when you might be able to show us something else that you're working on, given that TCS apparently is almost fully integrated?

Roy W. Olivier: Yes. I mean, historically, we've done acquisitions every 18 months. I think I've said previously that we're not going to wait that long. And so, we acquired TCS in September. And, again, there's a lot of variable, a lot of moving pieces here. But if the stars line up, we could do another acquisition within 12 months of the TCS acquisition.

Kevin Dede: OK. Well, congrats again. Thanks so much for entertaining my list of questions.

Roy W. Olivier: Yes, no, problem, Kevin. Thank you very much.

William Nurthen: Thanks.

Operator: There are no further questions at this time. I'd like to turn it back to Roy Olivier for closing remarks.

Roy W. Olivier: Thank you. And thanks, again, to everyone for joining us on today's call. We look forward to discussing our Q3 results with you soon. Have a great evening.

Operator: Ladies and gentlemen, this does conclude today's conference. Thank you for your attendance. You may now disconnect. Everyone, have great day.

END