UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 30, 2015

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission file number 000-19608

**ARI Network Services, Inc.**

(Exact name of registrant as specified in its charter)

| WISCONSIN | 39-1388360 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224
(Address of principal executive offices)
(414) 973-4300
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☑ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (S232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☑ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☐ |
| Non-accelerated filer<br>(Do not check if a smaller reporting company) | ☐ | Smaller reporting company | ☑ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☑

As of June 9, 2015, there were 16,909,055 shares of the registrant’s common stock outstanding.

**ARI Network Services, Inc.**

FORM 10-Q
FOR THE THREE MONTHS ENDED APRIL 30, 2015
INDEX

## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

**ARI Network Services, Inc.**
**Consolidated Balance Sheets**
***(Dollars in Thousands, Except per Share Data)***

| | *(Unaudited)* Apr 30 2015 | *(Audited)* July 31 2014 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | $ 2,161 | $ 1,808 |
| Trade receivables, less allowance for doubtful accounts of $386 and $359 at April 30, 2015 and July 31, 2014, respectively | 2,271 | 1,212 |
| Work in process | 169 | 294 |
| Prepaid expenses and other | 1,114 | 1,030 |
| Deferred income taxes | 3,235 | 2,655 |
| *Total current assets* | 8,950 | 6,999 |
| Equipment and leasehold improvements: | | |
| Computer equipment and software for internal use | 2,722 | 2,382 |
| Leasehold improvements | 626 | 626 |
| Furniture and equipment | 2,546 | 2,327 |
| | 5,894 | 5,335 |
| Less accumulated depreciation and amortization | (4,026) | (3,564) |
| *Net equipment and leasehold improvements* | 1,868 | 1,771 |
| Capitalized software product costs: | | |
| Amounts capitalized for software product costs | 24,729 | 22,676 |
| Less accumulated amortization | (20,216) | (18,656) |
| *Net capitalized software product costs* | 4,513 | 4,020 |
| Deferred income taxes | 2,451 | 3,507 |
| Other long-term assets | 82 | 72 |
| Other intangible assets | 8,092 | 3,612 |
| Goodwill | 18,517 | 12,367 |
| *Total non-current assets* | 35,523 | 25,349 |
| Total assets | $ 44,473 | $ 32,348 |

*See accompanying notes*

**ARI Network Services, Inc.**

**Consolidated Balance Sheets**

***(Dollars in Thousands, Except per Share Data)***

| | *(Unaudited)* Apr 30 2015 | *(Audited)* July 31 2014 |
|---|---|---|
| LIABILITIES | | |
| Current portion of long-term debt | $ 1,094 | $ 675 |
| Current portion of contingent liabilities | 627 | 295 |
| Accounts payable | 766 | 656 |
| Deferred revenue | 7,796 | 7,415 |
| Accrued payroll and related liabilities | 1,690 | 1,336 |
| Accrued sales, use and income taxes | 137 | 123 |
| Other accrued liabilities | 773 | 472 |
| Current portion of capital lease obligations | 216 | 195 |
| *Total current liabilities* | 13,099 | 11,167 |
| Long-term borrowings on line of credit | 1,750 | — |
| Long-term debt | 7,587 | 3,375 |
| Long-term portion of contingent liabilities | 477 | 153 |
| Capital lease obligations | 133 | 233 |
| Other long-term liabilities | 194 | 214 |
| *Total non-current liabilities* | 10,141 | 3,975 |
| Total liabilities | 23,240 | 15,142 |
| SHAREHOLDERS' EQUITY | | |
| Cumulative preferred stock, par value $.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at April 30, 2015 and July 31, 2014, respectively | — | — |
| Junior preferred stock, par value $.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at April 30, 2015 and July 31, 2014, respectively | — | — |
| Common stock, par value $.001 per share, 25,000,000 shares authorized; 15,149,055 and 13,506,316 shares issued and outstanding at April 30, 2015 and July 31, 2014, respectively | 15 | 14 |
| Additional paid-in capital | 109,356 | 106,077 |
| Accumulated deficit | (88,161) | (88,864) |
| Other accumulated comprehensive income (loss) | 23 | (21) |
| Total shareholders' equity | 21,233 | 17,206 |
| Total liabilities and shareholders' equity | $ 44,473 | $ 32,348 |

*See accompanying notes*

**ARI Network Services, Inc.**
**Consolidated Statements of Operations**
**(Dollars in Thousands, Except per Share Data)**
**(Unaudited)**

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net revenue | $ 10,280 | $ 8,176 | $ 29,531 | $ 24,471 |
| Cost of revenue | 1,780 | 1,560 | 5,391 | 4,806 |
| Gross profit | 8,500 | 6,616 | 24,140 | 19,665 |
| Operating expenses: | | | | |
| Sales and marketing | 2,718 | 2,291 | 7,928 | 7,190 |
| Customer operations and support | 1,831 | 1,638 | 5,392 | 5,029 |
| Software development and technical support (net of capitalized software product costs) | 1,102 | 679 | 3,046 | 2,016 |
| General and administrative | 1,709 | 1,289 | 4,901 | 4,490 |
| Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue) | 465 | 354 | 1,245 | 1,014 |
| Net operating expenses | 7,825 | 6,251 | 22,512 | 19,739 |
| Operating income (loss) | 675 | 365 | 1,628 | (74) |
| Other income (expense): | | | | |
| Interest expense | (123) | (68) | (352) | (216) |
| Loss on change in fair value of stock warrants | — | 4 | — | (28) |
| Gain on change in fair value of estimated contingent liabilities | — | — | — | 26 |
| Gain on change in fair value of contingent assets | 28 | — | 28 | — |
| Other, net | 2 | 12 | 5 | 27 |
| Total other income (expense) | (93) | (52) | (319) | (191) |
| Income (loss) before provision for income tax | 582 | 313 | 1,309 | (265) |
| Income tax benefit (expense) | (243) | (153) | (606) | (11) |
| Net income (loss) | $ 339 | $ 160 | $ 703 | $ (276) |
| Weighted average common shares outstanding: | | | | |
| Basic | 14,362 | 13,394 | 14,100 | 13,235 |
| Diluted | 14,786 | 13,790 | 14,536 | 13,235 |
| Net income (loss) per common share: | | | | |
| Basic | $ 0.02 | $ 0.01 | $ 0.05 | $ (0.02) |
| Diluted | $ 0.02 | $ 0.01 | $ 0.05 | $ (0.02) |

*See accompanying notes*

**Consolidated Statements of Comprehensive Income**
**(Dollars in Thousands)**
**(Unaudited)**

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income (loss) | $ 339 | $ 160 | $ 703 | $ (276) |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign currency translation adjustments | 6 | (8) | 44 | (15) |
| Total other comprehensive income (loss) | 6 | (8) | 44 | (15) |
| Comprehensive income (loss) | $ 345 | $ 152 | $ 747 | $ (291) |

*See accompanying notes*

**ARI Network Services, Inc.**
**Consolidated Statements of Cash Flows**
**(Dollars in Thousands)**
**(Unaudited)**

| | Nine months ended April 30 | |
|---|---|---|
| | **2015** | **2014** |
| *Operating activities:* | | |
| Net income | $ 703 | $ (276) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of software products | 1,560 | 1,494 |
| Amortization of discount related to present value of earn-out | (10) | (12) |
| Amortization of bank loan fees | 28 | 32 |
| Interest expense related to earn-out payable | 37 | 58 |
| Depreciation and other amortization | 1,245 | 1,014 |
| Gain on change in fair value of earn-out receivable | (28) | - |
| Loss on change in fair value of stock warrants | - | 28 |
| Gain on change in fair value of earn-out payable | - | (26) |
| Provision for bad debt allowance | 131 | 176 |
| Deferred income taxes | 531 | (3) |
| Stock based compensation | 198 | 197 |
| Stock based director fees | 107 | 132 |
| Net change in assets and liabilities: | | |
| Trade receivables | (594) | (1,068) |
| Work in process | 125 | (7) |
| Prepaid expenses and other | (141) | (29) |
| Other long-term assets | (139) | (56) |
| Accounts payable | 69 | (157) |
| Deferred revenue | 142 | (722) |
| Accrued payroll and related liabilities | 349 | 110 |
| Accrued sales, use and income taxes | 5 | (15) |
| Other accrued liabilities | 277 | 172 |
| Net cash provided by operating activities | $ 4,595 | $ 1,042 |
| *Investing activities:* | | |
| Purchase of equipment, software and leasehold improvements | (469) | (592) |
| Cash received on earn-out from disposition of a component of the business | 111 | 101 |
| Cash paid for contingent liabilities related to acquisitions | (250) | (250) |
| Cash paid for net assets related to acquisitions | (5,950) | (200) |
| Software developed for internal use | - | (29) |
| Software development costs capitalized | (1,000) | (1,391) |
| Net cash used in investing activities | $ (7,558) | $ (2,361) |
| *Financing activities:* | | |
| Borrowings under line of credit, net | $ 1,750 | $ - |
| Payments on long-term debt | (470) | (337) |
| Borrowings under long-term debt | 2,168 | - |
| Proceeds from capital lease obligations incurred | - | 312 |
| Payments of capital lease obligations | (184) | (44) |
| Proceeds from issuance of common stock | 75 | 237 |
| *Net cash provided by financing activities* | $ 3,339 | $ 168 |
| Effect of foreign currency exchange rate changes on cash | (23) | (10) |
| Net change in cash and cash equivalents | 353 | (1,161) |
| Cash and cash equivalents at beginning of period | 1,808 | 2,195 |
| Cash and cash equivalents at end of period | $ 2,161 | $ 1,034 |
| *Cash paid for interest* | $ 256 | $ 222 |
| *Cash paid for income taxes* | $ 25 | $ 70 |
| | | |
| *Non-cash investing and financing activities* | | |
| Issuance of common stock in connection with acquisitions | $ 2,780 | $ 131 |
| Debt issued in connection with acquisition | 2,933 | - |
| Capital leases acquired in connection with acquisitions | 105 | - |
| Issuance of common stock related to payment of contingent liabilities | 42 | 33 |
| Tax benefit of stock options exercised | 55 | - |
| Contingent liabilities incurred in connection with acquisition | 911 | - |

*See accompanying notes*

*ARI Network Services, Inc.*
**Notes to Consolidated Financial Statements**

## 1. Description of the Business and Significant Accounting Policies

*Description of the Business*

ARI Network Services, Inc. ("ARI" or "the Company") creates software-as-a-service ("SaaS"), data-as-a-service ("DaaS") and other solutions that help equipment manufacturers, distributors and dealers in selected vertical markets to Sell More Stuff!™ – online and in-store. We remove the complexity of selling and servicing new and used inventory, parts, garments, and accessories ("PG&A") for customers in the outdoor power equipment ("OPE"), powersports, automotive tire and wheel ("ATW"), home medical equipment ("HME"), marine, recreational vehicle ("RV") and appliances industries. Our innovative products are powered by a proprietary library of enriched original equipment and aftermarket content that spans more than 750,000 equipment models from over 1,500 manufacturers. More than 23,500 equipment dealers, 195 distributors and 3,360 brands worldwide leverage our web and eCatalog platforms to Sell More Stuff!

We were incorporated in Wisconsin in 1981. Our principal executive office and headquarters is located in Milwaukee, Wisconsin. The office address is 10850 West Park Place, Suite 1200, Milwaukee, WI 53224, and our telephone number at that location is (414) 973-4300. Our principal website address is www.arinet.com. ARI also maintains operations in Duluth, Minnesota; Cypress, California; Floyds Knobs, Indiana; Cookeville, Tennessee; Salt Lake City, Utah; Wexford, Pennsylvania and Leiden, The Netherlands.

*Basis of Presentation*

These consolidated financial statements include the consolidated financial statements of ARI and its wholly-owned subsidiary, ARI Europe B.V. and have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). We eliminated all significant intercompany balances and transactions in consolidation. All adjustments that, in the opinion of management, are necessary for a fair presentation for the periods presented have been reflected as required by Regulation S-X, Rule 10-01.

*Fiscal Year*

Our fiscal year ends on July 31. References to fiscal 2015, for example, refer to the fiscal year ended July 31, 2015, and references to fiscal 2014 refer to the fiscal year ended July 31, 2014.

*Revenue Recognition*

Revenues from subscription fees for use of our software, access to our catalog content, and software maintenance and support fees are all recognized ratably over the contractual term of the arrangement. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

For software license arrangements that do not require significant modification or customization of the underlying software, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

Revenues for professional services to customize complex features and functionality in a product's base software code or develop complex interfaces within a customer's environment are recognized as the services are performed if they are determined to have standalone value to the customer or if all of following conditions are met i) the customer has a contractual right to take possession of the software; ii) the customer will not incur significant penalty if it exercises this right; and iii) it is feasible for the customer to either run the software on its own hardware or contract with another unrelated party to host the software. When the current estimates of total contract revenue for professional services and the total related costs indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined. Professional service revenues for set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of the arrangement, are amortized over the term of the contract.

Revenue for variable transaction fees, primarily for use of the shopping cart feature of our websites, is recognized as it is earned.

Amounts received for shipping and handling fees are reflected in revenue. Costs incurred for shipping and handling are reported in cost of revenue.

Amounts invoiced to customers prior to recognition as revenue, as discussed above, are reflected in the accompanying balance sheets as deferred revenue.

No single customer accounted for 10% or more of ARI's revenue during the three or nine months ended April 30, 2015 or 2014.

*Trade Receivables, Credit Policy and Allowance for Doubtful Accounts*

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within thirty (30) days from the invoice date. Payments of trade receivables are allocated to the specific invoices identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of trade receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews receivable balances that exceed ninety (90) days from the invoice date and, based on an assessment of current creditworthiness, estimates the portion of the balance that will not be collected. The allowance for potential doubtful accounts is reflected as an offset to trade receivables in the accompanying balance sheets.

*Capitalized and Purchased Software Product Costs*

Certain software development and acquisition costs are capitalized when incurred. Capitalization of these costs begins upon the establishment of technological feasibility. The establishment of technological feasibility and the on-going assessment of recoverability of software costs require considerable judgment by management with respect to certain external factors, including, but not limited to, the determination of technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technologies.

The amortization of software products is computed using the straight-line method over the estimated economic life of the product which currently runs from two to nine years. Amortization starts when the product is available for general release to customers. The Company capitalizes software enhancements on an on-going basis and all other software development and support expenditures are charged to expense in the period incurred.

*Deferred Loan Fees and Debt Discounts*

Fees associated with securing debt are capitalized and included in prepaid expense and other and other long term assets on the consolidated balance sheet. Common stock issued in connection with securing debt is recorded to debt discount, reducing the carrying amount of the debt on the consolidated balance sheet. Deferred loan fees and debt discounts are amortized to interest expense over the life of the debt using the effective interest method.

*Deferred Income Taxes*

The tax effect of the temporary differences between the book and tax bases of assets and liabilities and the estimated tax benefit from tax net operating losses is reported as deferred tax assets and liabilities in the consolidated balance sheets. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed at each reporting date or when events or changes in circumstances indicate that there may be a change in the valuation allowance. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as a valuation allowance is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the consolidated statements of operations.

*Legal Provisions*

ARI is periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable and reasonably estimable, in accordance with GAAP. We had no provisions for legal proceedings during the three or nine months ended April 30, 2015 or 2014.

## 2. Basic and Diluted Net Income per Common Share

Basic net income per common share is computed by dividing net income by the basic weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and reflects the potential dilution that could occur if all of ARI's outstanding stock options and warrants that are in the money were exercised (calculated using the treasury stock method).

The following table is a reconciliation of basic and diluted net income per common share (in thousands, except per share data):

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income (loss) | $ 339 | $ 160 | $ 703 | $ (276) |
| Weighted-average common shares outstanding | 14,362 | 13,394 | 14,100 | 13,235 |
| Effect of dilutive stock options and warrants | 424 | 396 | 436 | - |
| Diluted weighted-average common shares outstanding | 14,786 | 13,790 | 14,536 | 13,235 |
| Net income (loss) per share | | | | |
| Basic | $ 0.02 | $ 0.01 | $ 0.05 | $ (0.02) |
| Diluted | $ 0.02 | $ 0.01 | $ 0.05 | $ (0.02) |
| Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive | 10 | 200 | 10 | 1,520 |

## 3. 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.

On September 30, 2014, in connection with the Company's acquisition of Tire Company Solutions, LLC ("TCS"), the Company entered into the First Loan Modification Agreement (the "Modification Agreement") with SVB, which contained substantial amendments to the terms of the Agreement.

The Modification Agreement includes credit facilities consisting of a $3,000,000 revolving credit facility with a maturity date of September 30, 2016 and a $6,050,000 term loan with a maturity date of September 30, 2019. This term loan is an amendment to the existing $4,500,000 term loan with an original maturity date of April 26, 2018.

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to the Prime rate plus the Applicable Margin for Prime Rate Loans set forth in the chart below determined based on the Total Leverage Ratio, as defined in the Modification Agreement. The Company had $1,750,000 outstanding on the revolving credit facility and the effective interest rate was 3.75% at April 30, 2015.

| **Total Leverage Ratio** | **Applicable Margin for Prime Rate Loans** | |
|---|---|---|
| >= 2.50 to 1.0: | 1.50 | % |
| > 1.75 to 1.00 but <2.50 to 1.00: | 1.00 | % |
| <= 1.75 to 1.00: | 0.50 | % |

Principal in respect of any loans made under the revolving facility is required to be paid in its entirety on or before September 30, 2016. 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: $151,250 commenced on November 1, 2014 through August 1, 2016; $226,875 commencing on November 1, 2016 through August 1, 2017; and $302,500 commencing on November 1, 2017 through August 1, 2019. All remaining principal in respect of the term loan is due and payable on September 30, 2019. The Company is permitted to prepay all of, but not less than all of, the outstanding principal amount of the term loan upon notice to SVB and, in certain circumstances, the payment of a prepayment penalty of up to $121,000. Following July 31, 2015, the Modification Agreement requires the Company to make additional payments in the amount of 25% of excess cash flow, as defined in the agreement, until the Company's Total Leverage Ratio is less than 2.00 to 1.00.

The Modification 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 Total Leverage Ratio equal to or less than 3.00 to 1.00 and the maintenance of a Fixed Charge Coverage Ratio (as defined in the Modification Agreement) equal to or greater than 1.25 to 1.00. The Modification Agreement also contains customary events of default that, if triggered, could result in an acceleration of the Company's obligations under the Modification Agreement. The loans are secured by a first priority security interest in substantially all assets of the Company.

*TCS Promissory Notes*

In connection with the acquisition of TCS, on September 30, 2014, the Company issued two promissory notes (the "Notes") in the aggregate principal amount of $3,000,000 to the former owners of TCS. In February 2015, the principal amount of the Notes was reduced by $66,575 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The Notes initially accrue interest on the outstanding unpaid principal balance at a rate per annum equal to 5.0%; however, if any amount payable under a Note is not paid when due, such overdue amount will bear interest at the default rate of 7.5% from the date of such non-payment until such amount is paid in full. Accrued interest on the Notes will be due and payable quarterly commencing on December 29, 2014 and continuing on each 90th calendar day thereafter, until September 30, 2018, at which time all accrued interest and outstanding principal balance will be due and payable in full. The first four payments due and payable under the Notes will be interest only payments, and payments of principal and interest shall not commence until the payment due on December 29, 2015. The payments are subject to acceleration upon certain Events of Default, as defined in the Notes.

The following table sets forth certain information related to the Company's long-term debt as of April 30, 2015 and July 31, 2014 (in thousands):

| | | **April 30 2015** | | **July 31 2014** |
|---|---|---|---|---|
| Notes payable principal | $ | 8,681 | $ | 4,050 |
| Less current maturities | | (1,094) | | (675) |
| Notes payable - non-current | $ | 7,587 | $ | 3,375 |

Minimum principal payments due on the SVB Term Note and the TCS Notes are as follows for the fiscal years ending (in thousands):

| | SVB Term Note | TCS Notes | Total Notes Payable |
|---|---|---|---|
| 2015 | $ 151 | $ — | $ 151 |
| 2016 | 605 | 733 | 1,338 |
| 2017 | 832 | 978 | 1,810 |
| 2018 | 1,134 | 978 | 2,112 |
| 2019 | 1,210 | 244 | 1,454 |
| 2020 | 1,816 | — | 1,816 |
| | $ 5,748 | $ 2,933 | $ 8,681 |

**4. Business Combinations**

On April 27, 2015, the Company acquired substantially all of the assets of TASCO Corporation and its affiliated company Signal Extraprise Corporation (collectively "TASCO"), a leading provider of business management software designed exclusively for the automotive tire and wheel aftermarket industry. Consideration for the acquisition included: (1) a cash payment at the closing of the transaction equal to $1,750,000, which was funded through a borrowing on the Company's revolving credit facility; (2) 242,424 shares of the Company's common stock; and (3) a $200,000 holdback payable on April 27, 2016. The Company determined that the TASCO assets acquired did not constitute a business that is "significant" as defined in the applicable SEC regulations.

The following tables show the preliminary allocation of the purchase price (in thousands):

| | Preliminary Purchase Price |
|---|---|
| Cash | $ 1,750 |
| Issuance of common stock | 800 |
| Contingent holdback | 200 |
| Purchase price | $ 2,750 |

| | Preliminary Purchase Allocation |
|---|---|
| Software product costs | $ 233 |
| Intangible assets | 1,158 |
| Goodwill | 1,359 |
| Purchase price allocation | $ 2,750 |

The final purchase price, as well as the purchase price allocation, is subject to the completion of the final valuation of the net assets acquired and the calculation of the holdback payment, which is subject to set-off and a working capital adjustment as set forth in the asset purchase agreement. The final valuation is expected to be completed as soon as is practicable but no later than April 27, 2016 and could have a material impact on the preliminary purchase price allocation disclosed above.

On September 30, 2014, the Company acquired substantially all of the assets of TCS, a leading provider of software, websites and digital marketing services designed exclusively for dealers, wholesalers, retreaders and manufacturers within the automotive tire and wheel industries. Consideration for the acquisition included (1) a cash payment equal to $4,200,000; (2) 618,744 shares of the Company's common stock; (3) the issuance of two promissory notes in aggregate principal amount of $2,933,000 (as adjusted) to the former owners of TCS; and (4) a contingent earn-out purchase price contingent upon the attainment of specific revenue goals over the first three years following the acquisition.

The TCS acquisition increased the Company's portfolio of automotive tire and wheel dealer websites by more than 30%. The acquisition is expected to accelerate ARI's opportunity to drive organic growth through the cross-selling of new products. It also provides solutions for the entire automotive tire and wheel supply chain, including wholesalers, retreaders and manufacturers. The TCS business offers a business management solution for tire and wheel dealers as well as for auto repair shops. The combined customer benefits and operational efficiencies are expected to result in a stronger organization that can create more value for our customers, shareholders and employees.

The acquisition was funded from cash on hand, an increase in our SVB Term Loan, funds available on our revolving credit facility seller financing and the Company's common stock. The following tables show the allocation of the purchase price (in thousands):

| | Purchase Price |
|---|---|
| Cash | $ 4,200 |
| Financed by note payable | 2,933 |
| Issuance of common stock | 1,980 |
| Contingent earn-out | 711 |
| Purchase price | $ 9,824 |

| | Purchase Allocation |
|---|---|
| Trade receivables | $ 606 |
| Prepaid expense and other | 33 |
| Assumed liabilities | (623) |
| Furniture and equipment | 117 |
| Software product costs | 820 |
| Intangible assets | 4,080 |
| Goodwill | 4,791 |
| Purchase price allocation | $ 9,824 |

Intangible assets include the fair value of tradenames, customer relationships, and non-competition agreements. Estimated goodwill represents the additional benefits provided to the Company by the acquisition of TCS operational synergies. The Company cannot determine revenue and expenses specifically related to the TCS operation since the date of acquisition, as we have begun integration of the businesses. The Company acquired approximately $5,200,000 of tax deductible goodwill related to the TCS acquisition.

The following unaudited pro forma combined financial information presents the Company's results as if the Company had acquired TCS on August 1, 2013. The unaudited pro forma information has been prepared with the following considerations:

i. The unaudited pro forma condensed consolidated financial information has been prepared using the acquisition method of accounting under existing GAAP. The Company is the acquirer for accounting purposes.

ii. The pro forma combined financial information does not reflect any operating cost synergy savings that the combined company may achieve as a result of the acquisition, the costs necessary to achieve these operating synergy savings or additional charges necessary as a result of the acquisition.

The unaudited pro forma financial information presented is for information purposes only and does not purport to represent what the Company's and TCS's financial position or results of operations would have been had the acquisition in fact occurred on such date or at the beginning of the period indicated, nor does it project the Company's and TCS's financial position or results of operation for any future date or period.

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue | $ 10,280 | $ 9,526 | $ 30,447 | $ 28,062 |
| Net income | $ 339 | $ 177 | $ 842 | $ (260) |
| Net income per common share: | | | | |
| Basic | $ 0.02 | $ 0.01 | $ 0.06 | $ (0.02) |
| Diluted | $ 0.02 | $ 0.01 | $ 0.06 | $ (0.02) |

Pro forma adjustments to net income include amortization costs related to the acquired intangible assets, acquisition-related professional fees, interest expense on the debt incurred to acquire the assets of TCS, and the tax effect of the historical TCS results of operations and the pro forma adjustments at an estimated tax rate of 40% as follows:

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Amortization of intangible assets | - | 81 | 54 | 242 |
| Acquisition-related professional fees | - | - | (210) | - |
| Interest expense | - | 67 | 45 | 202 |
| Income tax benefit (expense ) | - | 12 | 92 | 10 |

On November 1, 2013, the Company acquired substantially all of the assets of DUO Web Solutions ("DUO") pursuant to an Asset Purchase Agreement dated November 1, 2013. DUO was a leading provider of social media and online marketing services for the powersports industry, which is in line with the Company's strategy to grow the digital marketing services side of the business. The Company determined that the DUO assets acquired did not constitute a business that is "significant" as defined in the applicable SEC regulations, nor did it have a material impact on the Company's financial statements.

On August 17, 2012, the Company acquired substantially all of the assets of Ready2Ride, Incorporated ("Ready2Ride") pursuant to the terms of an Asset Purchase Agreement dated August 17, 2012. Ready2Ride markets aftermarket fitment data to the powersports industry, which furthers ARI's differentiated content strategy and expands ARI's product offerings into aftermarket PG&A.

Consideration for the Ready2Ride acquisition included $500,000 in cash, 100,000 shares of the Company's common stock and assumed liabilities totaling approximately $419,000, a contingent hold-back purchase price of up to $250,000 and a contingent earn-out purchase price ranging from, in aggregate, $0 to $1,500,000.

On October 22, 2013, the Company amended the Ready2Ride Asset Purchase Agreement in relation to the earn-out payments as follows: (i) the first earn-out payment was composed of $125,000 paid in October 2013 and 10,000 shares of common stock issued in November 2013; (ii) the second earn-out payment of $125,000, was paid in September 2014 and 15,000 shares of common stock were issued in September 2014; and (iii) the third earn-out payment is composed of $125,000 and 15,000 shares of common stock payable in September 2015.

The contingent holdback and earn-out payable was initially measured at fair value on a recurring basis calculated using the present value of future estimated revenue over the next three years, which was originally estimated at $750,000. Prior to the amendment, because the contingent earn-out payable had no comparable market data or significant observable inputs to determine fair value, it was classified as a Level 3 measurement. Because the amended Asset Purchase Agreement defines the future payments based on cash and Company stock actively traded, and the payments are no longer contingent on future events, the earn-out is now classified as a Level 1 fair value measurement. Unrealized gains and losses for changes in fair value are recognized in earnings.

The Company recorded a gain on change in fair value of the estimated contingent earn-out payable of approximately $26,000 or $0.00 per basic and diluted share as a result of the amendment in the first quarter of fiscal 2014.

The remaining contingent earn-out and holdback payments due as of April 30, 2015 related to the Ready2Ride, TCS and TASCO acquisitions are as follows (in thousands):

| | | |
|---|---|---|
| 2016 | $ | 754 |
| 2017 | | 268 |
| 2018 | | 114 |
| 2019 | | 22 |
| Total estimated payments | | 1,158 |
| Less imputed interest | | (54) |
| Present value of contingent liabilities | $ | 1,104 |

The following table shows changes in the holdback and earn-out payable related to the Ready2Ride, TCS and TASCO acquisitions (in thousands):

| | Nine months ended April 30 | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| Beginning balance | $ | 448 | $ | 721 |
| Additions (TCS) | | 711 | | - |
| Additions (Tasco) | | 200 | | - |
| Payments | | (292) | | (283) |
| Imputed interest recognized | | 37 | | 60 |
| Gain on change in fair value of earn-out | | - | | (26) |
| Ending balance | $ | 1,104 | $ | 472 |
| Less current portion | $ | (627) | $ | (301) |
| Ending balance, long-term | $ | 477 | $ | 171 |

## 5. Disposition of a Component of an Entity

On March 1, 2011, the Company entered into an Asset Purchase Agreement (the "Agreement") with Globalrange Corporation ("Globalrange"). Under the terms of the Agreement, the Company sold to Globalrange certain rights and assets relating to our electronic data interchange business for the agricultural chemicals industry (the "AgChem EDI Business"). Because the AgChem EDI Business was not a separate entity or reportable segment, the transaction was recorded as a disposition of a component of an entity.

As part of the purchase price for the AgChem EDI Business, Globalrange agreed to assume certain liabilities of ARI relating to the AgChem EDI Business, primarily consisting of unearned revenue (as defined in the Agreement). Globalrange made earn-out quarterly payments to ARI over a four-year period following the closing date. The amounts of such earn-out payments were determined based on collections received by Globalrange relating to the AgChem EDI Business during such period.

The amount of the earn-out receivable was originally estimated at $580,000 less an imputed discount of $97,000, based on the present value of the estimated earn-out payments (the "earn-out receivable"), discounted at 14%, which was the prevailing rate of interest charged on the Company's debt at the time of the sale. The discount was amortized to interest income, which is included in other income on the consolidated statements of income, over the life of the earn-out. The earn-out was paid in full in April 2015.

The following table shows changes in the earn-out receivable (in thousands):

| | Nine months ended April 30 | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| Beginning balance | $ | 73 | $ | 160 |
| Net receipts | | (111) | | (102) |
| Imputed interest recognized | | 10 | | 12 |
| Change in estimate | | 28 | | - |
| Ending balance | $ | - | $ | 70 |

## 6. Other Intangible Assets

Amortizable intangible assets include customer relationships and other intangibles including trade names and non-compete agreements. We acquired $4,080,000 of intangible assets from the TCS acquisition in the first quarter of fiscal 2015 and a preliminary estimate of $1,158,000 of intangible assets from the TASCO acquisition in the third quarter of fiscal 2015. The TASCO intangible assets are included in customer relationships and may change as a result of the final valuation. Amortizable intangible assets are composed of the following at April 30, 2015 and 2014 (in thousands):

| | Nine months ended April 30, 2014 | | | *Wtd. avg.* |
|---|---|---|---|---|
| Customer relationships | **Cost Basis** | **Accumulated Amortization** | **Net Value** | ***remaining life*** |
| Beginning balance | $ 7,064 | $ (3,090) | $ 3,974 | |
| Activity | 110 | (378) | (268) | |
| Ending balance | $ 7,174 | $ (3,468) | $ 3,706 | *11.05* |
| Other intangibles | | | | |
| Beginning balance | $ 383 | $ (258) | $ 125 | |
| Activity | - | (87) | (87) | |
| Ending balance | $ 383 | $ (345) | $ 38 | *0.48* |
| Total intangibles | | | | |
| Beginning balance | $ 7,447 | $ (3,348) | $ 4,099 | |
| Activity | 110 | (465) | (355) | |
| Ending balance | $ 7,557 | $ (3,813) | $ 3,744 | *10.87* |

| | Nine months ended April 30, 2015 | | | *Wtd. avg.* |
|---|---|---|---|---|
| Customer relationships | **Cost Basis** | **Accumulated Amortization** | **Net Value** | ***remaining life*** |
| Beginning balance | $ 7,174 | $ (3,584) | $ 3,590 | |
| Activity | 3,838 | (598) | 3,240 | |
| Ending balance | $ 11,012 | $ (4,182) | $ 6,830 | *11.46* |
| Other intangibles | | | | |
| Beginning balance | $ 383 | $ (361) | $ 22 | |
| Activity | 1,399 | (159) | 1,240 | |
| Ending balance | $ 1,782 | $ (520) | $ 1,262 | *1.66* |
| Total intangibles | | | | |
| Beginning balance | $ 7,557 | $ (3,945) | $ 3,612 | |
| Activity | 5,237 | (757) | 4,480 | |
| Ending balance | $ 12,794 | $ (4,702) | $ 8,092 | *11.07* |

## 7. Stock-based Compensation Plans

The Company uses the Black-Scholes model to value stock options granted. Volatility is calculated as managements' estimate of future volatility over the expected term of the option based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the United States Treasury yields in effect at the time of grant.

Stock options granted to employees under the Company's stock option plan typically vest 25% on the first anniversary of the grant and 25% on the one year anniversary of each of the three following years. Stock options granted to non-employee directors under the Company's stock option plan typically vest 50% on the first anniversary of the grant and 50% on the next one year anniversary. The Company recognizes stock option expense over the vesting period for each vesting tranche.

As recognizing stock-based compensation expense is based on awards ultimately expected to vest, the amount of recognized expense has been reduced for estimated forfeitures based on the Company's historical experience. Total stock option compensation expense recognized by the Company was approximately $41,000 and $63,000 during the three month periods ended April 30, 2015 and 2014, respectively, and approximately $110,000 and $112,000 during the nine month periods ended April 30, 2015 and 2014, respectively. There was approximately $193,000 and $389,000 of total unrecognized compensation costs related to non-vested options granted under the Company's stock option plans as of April 30, 2015 and 2014, respectively. Total unrecognized compensation cost will be adjusted for any future changes in estimated and actual forfeitures. There were no capitalized stock-based compensation costs during the periods presented.

The following table shows the weighted average assumptions used to estimate the fair value of options granted:

| | Nine months ended April 30 | |
|---|---|---|
| | 2015 | 2014 |
| Expected life (years) | 5.0 | 5.1 |
| Risk-free interest rate | 1.7 % | 1.4 % |
| Expected volatility | 63.6 % | 72.0 % |
| Expected forfeiture rate | 9.1 % | 14.2 % |
| Expected dividend yield | - | - |
| Weighted-average estimated fair value of options granted during the year | $ 1.77 | $ 1.96 |
| Cash received from the exercise of stock options | $ 83,000 | $ 245,000 |

*2000 Stock Option Plan*

The Company's 2000 Stock Option Plan (the "2000 Plan") had 1,950,000 shares of common stock authorized for issuance. Each incentive stock option that was granted under the 2000 Plan is exercisable for a period of not more than ten years from the date of grant (five years in the case of a participant who is a 10% shareholder of the Company, unless the stock options are nonqualified), or such shorter period as determined by the Compensation Committee, and shall lapse upon the expiration of said period, or earlier upon termination of the participant's employment with the Company. The 2000 Plan expired on December 13, 2010, at which time it was terminated except for outstanding options. While options previously granted under the 2000 Plan will continue to be effective through the remainder of their terms or until exercised, no new options may be granted under the 2000 Plan.

Changes in option shares under the 2000 Plan during the nine months ended April 30, 2015 were as follows:

| | Number of Options | | Wtd. Avg. Exercise Price | Wtd. Avg. Remaining Contractual Period (Years) | | Aggregate Intrinsic Value |
|---|---|---|---|---|---|---|
| Outstanding at 7/31/14 | 611,300 | $ | 1.60 | 3.18 | $ | 834,752 |
| Granted | - | | n/a | n/a | | n/a |
| Exercised | (137,350) | | 1.89 | n/a | | n/a |
| Forfeited | (950) | | 1.26 | n/a | | n/a |
| Outstanding at 4/30/15 | 473,000 | $ | 1.52 | 2.98 | $ | 812,868 |
| Exercisable at 4/30/15 | 473,000 | $ | 1.52 | 2.98 | $ | 812,868 |

The range of exercise prices for options outstanding under the 2000 Plan was $0.49 to $2.74 at April 30, 2015.

*2010 Equity Incentive Plan*

The Board of Directors adopted the ARI Network Services, Inc. 2010 Equity Incentive Plan (as amended, the "2010 Plan") on November 9, 2010. The plan was approved by the Company's shareholders in December 2010, and amendments to the 2010 Plan were approved by the Company's shareholders in January 2014. The 2010 Plan is the successor to the Company's 2000 Plan. There are 1,850,000 shares of Company common stock authorized for issuance under the 2010 Plan. Potential awards under the 2010 Plan include incentive stock options and non-statutory stock options, shares of restricted stock or restricted stock units, stock appreciation rights ("SARs), and shares of common stock. Up to 1,525,000 of the shares authorized for issuance under the 2010 Plan may be used for common stock, restricted stock or restricted stock unit awards.

The exercise price for options and SARs under the 2010 Plan cannot be less than 100% of the fair market value of the Company's common stock on the date of grant, and the exercise prices for options and SARs cannot be repriced without shareholder approval, except to reflect changes to the capital structure of the Company as described in the 2010 Plan. The maximum term of options and SARs under the 2010 Plan is 10 years. The 2010 Plan does not have liberal share counting provisions (such as provisions that would permit shares withheld for payment of taxes or the exercise price of stock options to be re-granted under the plan).

Changes in option shares under the 2010 Plan during the nine months ended April 30, 2015 were as follows:

| | Number of Options | | Wtd. Avg. Exercise Price | Wtd. Avg. Remaining Contractual Period (Years) | | Aggregate Intrinsic Value |
|---|---|---|---|---|---|---|
| Outstanding at 7/31/14 | 482,542 | $ | 2.16 | 8.56 | $ | 453,057 |
| Granted | 55,000 | | 3.28 | n/a | | n/a |
| Exercised | (50,875) | | 1.53 | n/a | | n/a |
| Forfeited | (46,916) | | 2.59 | n/a | | n/a |
| Outstanding at 4/30/15 | 439,751 | $ | 2.33 | 8.08 | $ | 411,599 |
| Exercisable at 4/30/15 | 185,502 | $ | 1.75 | 7.43 | $ | 278,155 |

The range of exercise prices for options outstanding under the 2010 Plan was $0.58 to $3.61 at April 30, 2015.

Changes in the 2010 Plan's non-vested option shares included in the outstanding shares above during the nine months ended April 30, 2015 were as follows:

| | Number of Options | | Wtd. Avg. Exercise Price |
|---|---|---|---|
| Non-vested at 7/31/14 | 227,499 | $ | 2.60 |
| Granted | 55,000 | | 3.28 |
| Vested | - | | - |
| Forfeited | (28,250) | | 2.58 |
| Non-vested at 4/30/15 | 254,249 | $ | 2.75 |

The weighted average remaining vesting period was 2.47 years at April 30, 2015.

*Employee Stock Purchase Plan*

The Company's 2000 Employee Stock Purchase Plan, as amended, ("ESPP") has 575,000 shares of common stock reserved for issuance, of which 263,974 and 224,955 of the shares have been issued as of April 30, 2015 and 2014, respectively. All employees with at least nine months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.

*Restricted Stock*

Up to 1,525,000 of the shares authorized for issuance under the 2010 Plan may be granted in the form of shares of common stock, restricted stock or restricted stock units. The Company grants restricted stock to its directors as an annual retainer, its officers under the LTEB and from time to time to directors, officers or employees as incentive compensation or as discretionary compensation in place of cash. The Company recognized compensation expense of $54,000 and $104,000 during the three months ended April 30, 2015 and 2014, respectively, and $195,000 and $217,000 during the nine months ended April 30, 2015 and 2014, respectively, related to restricted stock expensed over the vesting period. The remaining balance of unrecognized compensation expense related to restricted stock was $526,000 at April 30, 2015.

Changes in unvested restricted shares of common stock under the 2010 Plan during the nine months ended April 30, 2015 and 2014 were as follows:

| | Nine months ended April 30 | |
|---|---|---|
| | 2015 | 2014 |
| Beginning balance unvested restricted stock | 93,704 | 85,500 |
| Granted | 621,471 | 129,548 |
| Vested | (28,610) | (76,500) |
| Ending balance unvested restricted stock | 686,565 | 138,548 |

The Compensation Committee adopted the Long-Term Executive Bonus Plan ("LTEB") for eligible executive officers of the Company effective beginning in fiscal 2013. In March 2015, the Compensation Committee issued 550,000 shares of restricted stock under the LTEB, which will vest according to the following schedule:

- 30% when the volume weighted average price of the Company's common stock for the previous 30 trading day period (the "30-day VWAP") equals or exceeds trades at or above $6.00
- 20% when the 30-day VWAP equals or exceeds $7.00
- 20% when the 30-day VWAP equals or exceeds $8.00
- 30% when the 30-day VWAP equals or exceeds $9.00

Under the plan described above, a target price must be reached within a four-year period starting on the date of grant for any restricted stock to vest. All unvested restricted stock will be forfeited when the four-year period expires. The initial value of the common stock granted under the LTEB was approximately $350,000, valued using a Monte Carlo Simulation with a 46% volatility rate and a 1.34% risk free interest rate, and is expensed over the vesting period. The remaining balance of unrecognized compensation expense related to the fiscal 2015 LTEB is $333,000.

## 8. Income Taxes

The unaudited provision for income taxes for the three and nine months ended April 30, 2015 and 2014 is composed of the following (in thousands):

| | Three months ended April 30 | | Nine months ended April 30 | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Current: | | | | |
| Federal | $ (18) | $ — | $ (28) | $ — |
| State | (11) | (8) | (47) | (14) |
| Change in valuation allowance | — | - | 17 | 32 |
| Deferred, net | (214) | (145) | (548) | (29) |
| Income tax benefit (expense) | $ (243) | $ (153) | $ (606) | $ (11) |

The provision for income taxes is based on taxes payable under currently enacted tax laws and an analysis of temporary differences between the book and tax bases of the Company's assets and liabilities, including various accruals, allowances, depreciation and amortization, and does not represent current taxes due. The tax effect of these temporary differences and the estimated benefit from tax net operating losses are reported as deferred tax assets and liabilities in the consolidated balance sheet. We have unused net operating loss carry forwards ("NOLs") for federal income tax purposes, and as a result, we generally only pay alternative minimum taxes at the federal level. We have unused NOLs for state income tax purposes of $3,231,000, most of which have a valuation allowance as they expire at the end of fiscal 2015.

The Company also has NOLs related to tax losses incurred by its Netherlands operation. Under tax laws in the Netherlands, NOLs are able to be carried forward for a period of nine years. The Company has determined that, consistent with prior periods, it is not likely that the net operating losses will be utilized by the Company. This conclusion was primarily based on the negative evidence of a history of losses and expired NOLs related to this entity. In the opinion of the management of the Company, there is not enough positive evidence to overcome this negative evidence. Therefore, a full valuation allowance is recorded, resulting in $0 net deferred tax assets related to the Netherlands operation at April 30, 2015 and 2014.

As of April 30, 2015, the Company had accumulated NOLs for federal, state and international tax purposes of approximately $4,821,000, $3,231,000 and $3,095,000, respectively.

We perform an evaluation of uncertain tax positions as a component of income tax expense on an annual basis. We determined that ARI did not have any significant risk related to income tax expense and therefore no amounts were reserved for uncertain tax positions as of April 30, 2015 and 2014. We will accrue and recognize interest and penalties related to uncertain tax positions as a component of income tax expense if it becomes necessary. Fiscal years subsequent to 2010 remain open and subject to examination by state tax jurisdictions and the United States federal tax authorities.

## 9. Subsequent Events

On May 12, 2015, the Company completed an underwritten offering pursuant to which it sold 1,760,000 shares of its common stock at a price to the public of $3.00 per share. The Company received net proceeds of approximately $4,700,000 from the sale, after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company.

## 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 and nine months ended April 30, 2015 and 2014, 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, 2014, 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. offers an award-winning suite of data-driven software tools and marketing services to help dealers, equipment manufacturers and distributors in selected vertical markets Sell More Stuff!™ – online and in-store. Our innovative products are powered by a proprietary data repository of enriched original equipment and aftermarket electronic content spanning more than 17 million active part and accessory SKUs and 750,000 equipment models. Business is complicated, but we believe our customers' technology tools don't have to be. We remove the complexity of selling and servicing new and used vehicle inventory, parts, garments and accessories ("PG&A") for customers in the automotive tire and wheel aftermarket ("ATW"), powersports, outdoor power equipment ("OPE"), marine, home medical equipment ("HME"), recreational vehicles ("RV") and appliance industries. More than 23,500 equipment dealers, 195 distributors and 3,360 brands worldwide leverage our web and eCatalog platforms to Sell More Stuff!™

### Our Solutions

Our SaaS, DaaS and other solutions, designed to help our customers sell more stuff, both in-store and online, include: (i) eCommerce-enabled websites, which provide a web presence for dealers and serve as a platform for driving leads and eCommerce sales; (ii) eCatalog content, which drives sales of inventory and PG&A both online and within the dealership; (iii) fully integrated business management software for the ATW market; (iv) lead management software designed to increase sales for dealers through more efficient management and improved closure of leads; and (v) digital marketing solutions designed to generate leads and drive traffic both on-line and in store for our dealer customers. 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, DaaS and other solutions are sold through our internal sales force and are composed primarily of annual recurring license and subscriptions and, in the case of business management software, perpetual license and maintenance contracts. Customers typically sign annual, auto-renewing contracts. Today, approximately 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 primary offerings in order to help our customers Sell More Stuff!™

*Web Platform Solutions*

Our eCommerce-enabled website solutions provide consumers with information about a dealership and its product lines through our extensive library of electronic catalog content and allow consumers to obtain information on whole goods and purchase PG&A via 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 are 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 may charge a nominal, one-time set-up fee to develop a new dealer website. Additional fees will include monthly recurring subscription fees and, under certain circumstances, variable transaction fees. Our website solutions are typically sold under one year, renewable contracts with monthly payment terms. We currently host and maintain more than 7,000 websites for dealers in all of our vertical markets.

*eCatalog Platform Solutions*

Our eCatalog solutions, which encompass our PartSmart®, PartSmart Web™, PartStream™, and AccessorySmart™ 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, online accessible, 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 is designed to allow 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. in August 2012.

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 Solution*

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.

*Digital Marketing Solution*

Our digital marketing solutions provide lead generation tools through search engine optimization, social media marketing and website enhancements, which serve to drive on-line sales and increase traffic at dealerships. Digital marketing services is a relatively new service offering by ARI and in the third quarter of fiscal 2014, we went to market with a more robust offering in the space as a result of our continued integration of the DUO acquisition.

*Other Solutions*

We also offer a suite of complementary solutions, which include software and website customization services and hosting services. Through the recent acquisitions of Tire Company Solutions, LLC (“TCS”) and TASCO Corporation (“TASCO”), we acquired a fully integrated suite of business management software solutions for the ATW market. These solutions, TirePower and Tireworks HD for tire retailers, ePower for tire wholesalers and TreadTracks for tire retreaders, are designed to streamline every aspect of a dealer’s operations to allow them to provide improved customer service. These products are sold through our dedicated internal sales team, and fees charged include a perpetual one-time license or installation fee, maintenance and other fees.

**Our Growth Strategy**

ARI’s goal is to become the leading provider of SaaS, Daas and other 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 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, customers and employees.

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 software access fees, data content fees, maintenance and support fees and hosting fees, and we define churn as the percentage of RR that does not renew. During the nine months ended April 30, 2015, our RR increased 15.6% over the same period last year while the percentage of our total revenues that were RR decreased to 90.3% for the nine months ended April 30, 2015 from 94.2% for the same period in fiscal 2014, primarily due to TCS having a lower percentage of RR than our historical RR.

- *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 products. 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. This fiscal year, we released a number of new features, upgrades and products including the following:

  *Web Platform*

  - We developed an all new whole goods shopping experience, delivering the most advanced unit inventory browsing experience in the market, which includes convenient search and filtering capabilities that rival the leading independent shopping portals.
  - We released the first smartphone and tablet application for iOS and Android in the market that enables dealers to manage all of their unit inventory directly from the app, including adding units, taking photos, managing promotions, and pushing inventory to third party channels such as CycleTrader and Craigslist.
  - We released a new auto-quote response feature for tire and wheel products, as well as major units that automatically emails interested consumers with current pricing information upon submitting a quote request.
  - We partnered with a third party vendor to release ARI Inventory, an add-on feature to our website that enables dealers to automatically push inventory listings from their website to third party channels such as Craigslist and eBay Motors, as well as to their social media channels.
  - We developed and released an all new tire shopping experience, which presents consumers with targeted tire recommendations for their unique vehicle based on various key decision criteria, such as expert recommendations,

best warranty, best promotion, lowest price, and more, as well as significantly reducing the number of steps required to submit a quote, which resulted in a 48% increase in leads to our dealers.

- We developed additional integrations to leading credit card processors, as well as additional integration points for 3rd parties to integrate with our software to streamline order processing.

*eCatalog*

- We developed a major update to our PartSmart Web platform, delivering a series of market-driven enhancements and innovations, including a streamlined user experience, dynamic diagram thumbnail previews, and fast moving parts tracking and display by unit.
- We released an expanded DataSmart product offering that provides key product data extract access, in addition to on-demand API access, to offer additional flexibility for implementation with various e-commerce software and SEO customization capabilities.
- We developed a new Search Engine Optimization plugin for our AccessoryStream product, helping to bolster the search engine ranking of parts, garments, and apparel products on website running on the PHP framework. This release compliments a previous release of the same tool for the .NET framework.
- We completed a partnership and integration of our DaaS offering with Channel Advisor, the leader in multi-channel e-commerce, to help dealers utilize our data to automatically place product sales listings on Amazon and eBay.

These product enhancements were designed to automate and enhance the marketing, sales and servicing activities for our customers, in order to help them sell and service more parts, garments, accessories and whole goods.

- *Differentiate our content.* We believe we have the largest library of replacement part, major unit, and PG&A content in the vertical markets we serve. This fiscal year, we authored 5 new OEM parts catalogs and we added 7 new product catalogs to our library, encompassing more than 40,000 new items. 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. This fiscal year, our enrichment activities included the addition of over 230,000 new part-to-unit fitments and 115,000 new product attributes. Additionally, we substantially expanded the level of enrichment of our tire product information with the addition of 11 new performance and quality classifications to better aid the shopping experience, such as dry handling, wet handling, snow traction, and braking. We have also continued integrating analytic tools into several of our products, offering value-added feedback to our customers and channel partners to help them "Sell More Stuff!"

- *Enter new markets.* ARI currently maintains a significant share in our core vertical markets of OPE, powersports, marine, RV and appliances. Accordingly, we anticipate low single-digit growth in these markets.

  - 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. Including the acquisition of TCS, ARI currently has more than 3,000 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. We are one of the first website providers to service the HME market. We estimate that this market comprises nearly 25,000 service providers, 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.

  - Our acquisition of TCS not only cemented our position as the largest supplier of e-commerce solutions in the ATW market, it also included a new business management software product for retailers, wholesalers and retreaders in the ATW market.

  - Our recent acquisition of TASCO has extended our position as a Business Management System leader in the ATW market, including expanded software dedicated to solving the unique needs of large, multi-location franchised businesses.

- *Expand geographically*. Although we maintain relationships with dealers throughout the world, we have 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 14 new catalog content offerings in the international OPE market and 3 catalogs within the other vertical markets we serve. We have continued 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 high single-digit to low 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 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 12 month basis, customer churn was 14.5% for the period ended April 30, 2015. 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.

*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 thirteen acquisitions. A summary of some of our most recent acquisitions is as follows:

| Acquisition | Date | Strategy |
|---|---|---|
| TASCO Corporation and affiliated Signal Extraprise Corporation | April 2015 | ▪ Extend business management software platform in the ATW market |
| Tire Company Solutions, LLC | September 2014 | ▪ Consolidate position and add new business management software in the ATW market |
| DUO Web Solutions | November 2013 | ▪ A leading provider of social media and online marketing services in the powersports industry |
| 50 Below Sales & Marketing, Inc. (Retail Division) | November 2012 | ▪ A market leader in the powersports industry<br>▪ Entrance into ATW and DME industries<br>▪ New award-winning website platform |
| Ready2Ride, Inc. | August 2012 | ▪ First of its kind aftermarket fitment data for the powersports industry |

**Summary of Operating Results**

Total revenue increased 25.7% or $2,104,000 for the three months ended April 30, 2015 compared to the same period last year. Year to date revenue increased 20.7% or $5,060,000. Recurring revenue constituted 90.5% and 90.3% of our total revenue for the three and nine months ended April 30, 2015 respectively, compared to 93.3% and 94.2% for the same periods last year. Recurring revenue increased 21.9% and 15.6% during the three and nine months ended April 30, 2015, compared to the same periods last year. The growth in year over year total revenue was attributable to incremental revenue from the TCS business acquired in September 2014, as well as organic growth in revenue from ARI's historical products.

Operating income increased 84.9% or $310,000, from $365,000 for the three months ended April 30, 2014 to $675,000 for the same period this year, and increased $1,702,000 from a loss of $74,000 for the nine months ended April 30, 2014 to income of $1,628,000 for the same period this year. Net operating expenses increased 25.2% or $1,574,000 and 14.0% or $2,773,000 during the three and nine month periods ended April 30, 2015, compared to the same periods last year, primarily due to the additional costs of the TCS operation and transaction fees related to the TCS acquisition. The year to date difference was partially offset by $234,000 in severance and related costs incurred in January 2014 as a result of the workforce reduction.

Net income was $339,000, or $0.02 per share, for the three months ended April 30, 2015, compared to $160,000, or $0.01 per share, for the same period last year. Net income for the nine months ended April 30, 2015 was $703,000, or $0.05 per share, compared to a net loss of $276,000, or $0.02 per share, for the same period last year.

Cash provided by operations was $4,595,000 for the nine months ended April 30, 2015 compared to $1,042,000 for the same period last year, primarily as a result of revenue growth, operational efficiencies and the workforce reduction made in January 2014.

**Revenue**

The following table summarizes our product revenue and RR and non-recurring revenue for the three and nine months ended April 30 (in thousands):

| | Three months ended April 30 | | | | | Nine months ended April 30 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015 | % of Total | 2014 | % of Total | % Change | 2015 | % of Total | 2014 | Total | % Change |
| Website | $ 5,426 | 52.8% | $ 4,181 | 51.1% | 29.8% | $ 15,120 | 51.2% | $ 12,464 | 50.9% | 21.3% |
| eCatalog | 3,376 | 32.8% | 3,466 | 42.4% | (2.6)% | 10,300 | 34.9% | 10,572 | 43.2% | (2.6)% |
| Lead management | 288 | 2.8% | 241 | 2.9% | 19.5% | 880 | 3.0% | 699 | 2.9% | 25.9% |
| Digital marketing | 325 | 3.2% | 127 | 1.6% | 155.7% | 896 | 3.0 % | 293 | 1.2% | 205.7% |
| Other | 865 | 8.4% | 161 | 2.0% | 437.4% | 2,335 | 7.9% | 443 | 1.8% | 427.1% |
| Total revenue | $ 10,280 | 100.0 % | $ 8,176 | 100.0 % | 25.7% | $ 29,531 | 100.0 % | $ 24,471 | 100.0 % | 20.7% |
| | | | | | | | | | | |
| Recurring revenue | 9,302 | 90.5 | 7,631 | 93.3 | 21.9% | 26,654 | 90.3 | 23,060 | 94.2 | 15.6% |
| Non-recurring revenue | 978 | 9.5 | 545 | 6.7 | 79.4% | 2,877 | 9.7 | 1,411 | 5.8 | 103.9% |
| Total revenue | $ 10,280 | 100.0 % | $ 8,176 | 100.0 % | 25.7% | $ 29,531 | 100.0 % | $ 24,471 | 100.0 % | 20.7% |

Total revenue increased 25.7% or $2,104,000 and 20.7% or $5,060,000 for the three and nine months ended April 30, 2015, compared to the same periods last year. RR increased 21.9% or $1,671,000 and 15.6% or 3,594,000 for the three and nine months ended April 30, 2015, compared to the same periods last year. RR represented 90.3% of total revenues in the first nine months of fiscal 2015 versus 94.2% in the first nine months of fiscal 2014. The decline in RR as a percentage of total revenue for the nine months ended April 30, 2015, was related to the mix in revenue related to the TCS business which, due to some of its perpetually licensed software, has a lower percentage of RR than our historical business, as well as the mix in revenue related to non-recurring professional services in the period.

*Website Revenue*

Our Website solutions generate revenue from one-time set-up and customization fees to develop new dealer websites, which is recognized ratably over the term of the contract, monthly recurring subscription fees and variable transaction fees. Our website solutions are typically sold as one year, renewable contracts with monthly payment terms. Websites have become ARI's largest source of revenue and accounted for 52.8% and 51.2% of total revenue during the three and nine months ended April 30, 2015 respectively. Website revenue increased 29.8% to $5,426,000 and 21.3% to $15,120,000 for the three and nine months ended April 30, 2015, compared to the same period last year. The growth in Website revenue was the result of both organic growth and our acquisition of TCS in September 2014. We anticipate that our web platforms will continue to be the Company's largest source of growth, with much of this growth coming in the ATW market, which is the primary market serviced by the TCS operation.

*eCatalog Revenue*

Our eCatalog solutions generate revenue from renewable subscription fees for our software, data content, software maintenance and support fees and software customization fees. eCatalog is our second largest source of RR, representing 32.8% and 34.9% of total revenue during the three and nine months ended April 30, 2015. eCatalog revenue decreased 2.6% or $90,000 and 2.6% or $272,000 during the three and nine months ended April 30, 2015, compared to the same periods last year, due to a decrease in RR.

The catalog content provided in our eCatalog solutions helps to drive sales growth in our Website and Lead Management solutions as well, so while eCatalog revenue has declined to date this fiscal year, it continues to drive growth in other areas of the business.

*Lead Management Revenue*

Lead management revenue is primarily generated from renewable subscription fees and variable transaction fees for the use of our Footsteps™ products. Lead management revenue increased 19.5% to $288,000 and 25.9% to $880,000 during the three and nine months ended April 30, 2015 compared to the same periods last year, as a result of growth in both recurring subscriptions and non-recurring set-up fees.

*Digital Marketing Revenue*

Revenues from our digital marketing solutions are generated from set-up fees and subscription fees for our lead generation tools through search engine optimization, social media marketing and website enhancements. In addition to this, the recently acquired the TCS business provides recurring digital marketing services to its customers. Total digital marketing revenue increased 155.7% to $325,000 and 205.7% to $896,000 during the three and nine months ended April 30, 2015 compared to the same periods last year. We expect digital marketing revenue to continue to increase over the prior year as we continue to grow this business.

*Other Revenue*

We also offer a suite of complementary solutions, which include software and website customization services, perpetually licensed software and hosting services. Other revenue increased 437.4% to $865,000 and 427.1% to $2,335,000 during the three and nine months ended April 30, 2015 compared to the same periods last year. The increase in other revenue is due to the sale of business management software licenses and services associated with the TCS acquisition. In addition to this, other revenue increased due to an increase in our professional services revenue, related to a service contract with one of our major manufacturers.

*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 product 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 product churn, which is the percentage of RR that does 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 primary product categories from annual license, subscription, maintenance and support fees. RR increased 21.9% or $1,671,000 and 15.6% or $3,594,000 for the three and nine months ended April 30, 2015, compared to the same periods last year. The growth in RR was primarily attributable to both the addition of RR from our TCS acquisition and organic growth in our historic Website products. We expect Website RR to continue to be our largest contributor to RR growth in fiscal 2015.

*Non-recurring Revenue*

Non-recurring revenue is generated from certain offerings within the Company’s business management and digital marketing services, professional services related to software customization and data conversion, usage fees charged on our RR products, perpetual license revenue and other complementary products and services. Total non-recurring revenues were $978,000 and $2,877,000 for the three and nine months ended April 30, 2015, versus $545,000 and $1,411,000 for the same periods last year, increases of 79.4% and 103.9%, respectively, primarily due to an increase in professional service revenue and perpetual license revenue related to TCS. As a percentage of total revenues, non-recurring revenues were 9.7% for the nine months ended April 30, 2015, versus 5.8% for the same period in fiscal 2014.

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. Revenue from the TCS operation has a lower percentage of RR than our historical revenue due to a portion of its revenue being derived from perpetual licenses, however, these offerings carry similar margins to our historical RR and often are sold with a recurring revenue maintenance fee component.

**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 for the three and nine months ended April 30 (in thousands):

| | Three months ended April 30 | | | | Nine months ended April 30 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | % of Revenue | 2014 | % of Revenue | 2015 | % of Revenue | 2014 | % of Revenue | % Change |
| Net revenues | $ 10,280 | | $ 8,176 | | $ 29,531 | | $ 24,471 | | 20.7 % |
| Cost of revenues: | | | | | | | | | |
| Amortization of capitalized software costs | 458 | 4.5% | 532 | 6.5% | 1,560 | 5.3 % | 1,494 | 6.1 % | 4.4 % |
| Direct labor | 613 | 6.0% | 474 | 5.8% | 1,612 | 5.5 % | 1,723 | 7.0 % | (6.4) % |
| Other direct costs | 709 | 6.9% | 554 | 6.8% | 2,219 | 7.5 % | 1,589 | 6.5 % | 39.6 % |
| Total cost of revenues | 1,780 | 17.3% | 1,560 | 19.1% | 5,391 | 18.3 % | 4,806 | 19.6 % | 12.2 % |
| Gross profit | $ 8,500 | 82.7% | $ 6,616 | 80.9% | $ 24,140 | 81.7 % | $ 19,665 | 80.4 % | 22.8 % |

Gross profit was $8,500,000 or 82.7% of revenue for the three months ended April 30, 2015, compared to $6,616,000 or 80.9% of revenue for the same period last year and $24,140,000 or 81.7% of revenue for the nine months ended April 30, 2015, compared to $19,665,000 or 80.4% of revenue for the same period last year. Amortization of capitalized software costs as a percentage of revenue decreased for the nine months ended April 30, 2015, compared to the same period last year, primarily due to revenue increasing at a faster rate than software capitalization costs. Direct labor costs as a percentage of revenue decreased for the nine months ended April 30, 2015, compared to the same period last year primarily due to operational efficiencies in our catalog production and website implementation operations. Other direct costs increased as a percentage of revenue for the three and nine months ended April 30, 2015, compared to the same periods last year, due to an increase in royalty expense as we expanded our website offerings, as well as subcontracted labor that was used for a portion of our professional services work in the current year periods. 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 computer 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, internal software, and telecommunications. These costs are generally allocated based on headcount, unless circumstances dictate otherwise. 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 for the three and nine months ended April 30 (in thousands):

| | Three months ended April 30 | | | | | Nine months ended April 30 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015 | % of Revenue | 2014 | % of Revenue | % Change | 2015 | % of Revenue | 2014 | % of Revenue | % Change |
| Sales and marketing | $ 2,718 | 26.4 % | $ 2,291 | 28.0 % | 18.6 % | $ 7,928 | 26.8 % | $ 7,190 | 29.4 % | 10.3 % |
| Customer operations and support | 1,831 | 17.8 % | 1,638 | 20.0 % | 11.8 % | 5,392 | 18.3 % | 5,029 | 20.6 % | 7.2 % |
| Software development and technical support | 1,102 | 10.7 % | 679 | 8.3 % | 62.3 % | 3,046 | 10.3 % | 2,016 | 8.2 % | 51.1 % |
| General and administrative | 1,709 | 16.6 % | 1,289 | 15.8 % | 32.6 % | 4,901 | 16.6 % | 4,490 | 18.3 % | 9.2 % |
| Depreciation and amortization (1) | 465 | 4.5 % | 354 | 4.3 % | 31.4 % | 1,245 | 4.2 % | 1,014 | 4.1 % | 22.8 % |
| Net operating expenses | $ 7,825 | 76.1 % | $ 6,251 | 76.5 % | 25.2 % | $ 22,512 | 76.2 % | $ 19,739 | 80.7 % | 14.0 % |

(1) Exclusive of amortization of software products of $553, $518, $1,102 and $962 for the three and nine months ended April 30, 2015 and 2014, respectively, which are included in cost of revenue.

Net operating expenses increased 25.2% or $1,574,000 and 14.0% or $2,773,000 for the three and nine months ended April 30, 2015, compared to the same periods last year. The Company acquired the net assets of TCS in September 2014 and the net assets of TASCO in April 2015. The increase in net operating expenses was largely due to the TCS operating costs during fiscal 2015 and transaction fees for the TCS and TASCO acquisitions. Management expects net operating expenses to continue to decline as a percentage of total revenue, as the Company continues to integrate the TCS and TASCO operations and, to the extent the Company can leverage growth in its core RR products, as incremental costs related to these products decrease for every dollar of new revenue.

*Sales and Marketing*

Sales and marketing expense increased 18.6% or $427,000 and 10.3% or $738,000 during the three and nine months ended April 30, 2015, compared to the same periods last year. The increase was primarily a result of the expenses associated with the TCS operations. Sales and marketing expense as a percentage of revenue decreased from 29.4% of revenue for the nine months ended April 30, 2014 to 26.8% for the same period in fiscal 2015. Management expects sales and marketing expense as a percentage of revenue to fluctuate, based upon the timing of the Company's marketing events and trade show schedule and its decision to add additional sales and marketing resources to drive organic revenue growth.

*Customer Operations and Support*

Customer operations and support expense increased 11.8% or $193,000 and 7.2% or $363,000 during the three and nine months ended April 30, 2015, compared to the same periods last year. The increase was primarily a result of the expense associated with the TCS operations. Customer operations and support expense as a percentage of revenue decreased from 20.6% of revenue for the nine months ended April 30, 2014 to 18.3% during the first nine months of fiscal 2015. To the extent RR continues to grow, management expects customer operations and support expenses to continue to decline as a percentage of total revenues over time, as we realize anticipated cost savings related to the efficiencies implemented in the catalog conversion and customer implementation and support areas.

*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 capitalized as software product costs and amortized over the estimated useful lives of the product; (ii) costs for 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.

Software development and technical support costs increased 62.3% or $423,000 and 51.1% or $1,030,000 during the three and nine months ended April 30, 2015 versus the same periods last year. The increase was primarily a result of the additional TCS software development and technical support costs, partially offset by the workforce reduction in January 2014.

During the three and nine months ended April 30, 2015, we capitalized $248,000 and $761,000 of software development labor and overhead, versus $334,000 and $1,171,000 during the same periods last year. In addition to internal capitalized software costs, we had outsourced capitalized development costs of $32,000 and $234,000 during the three and nine months ended April 30, 2015 and $81,000 and $249,000 during the same periods last year. During the nine months ended April 30, 2015, we devoted resources to several enhancements to our website products and a major new upgrade to our web eCatalog product, but have largely completed our work on AccessorySmart and PartStream products, which contributed to the higher capitalization rate in the same period last year.

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.

*General and Administrative*

General and administrative expense increased 32.6% or $420,000 and 9.2% or $411,000 during the three and nine months ended April 30, 2015, compared to the same periods last year. The quarter to date increase was primarily a result of transaction costs related to the TASCO acquisition and TCS operating expenses. The year to date increase was primarily a result of transaction costs for both the TCS and TASCO acquisitions and TCS operating expenses. General and administrative expense as a percentage of revenue decreased from 18.3% of revenue for the nine months ended April 30, 2014 to 16.6% for the same period in fiscal 2015. Management expects general and administrative expense as a percentage of revenue to decrease over time as we continue to scale the business, although additional acquisitions or other transactions could result in elevated general and administrative expense in future periods.

**Other Income and Expense**

The table below summarizes the components of other income and expenses for the three and nine months ended April 30 (in thousands):

| | Three months ended April 30 | | | Nine months ended April 30 | | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | % Change | 2015 | 2014 | % Change |
| Interest expense | $ (123) | $ (68) | 80.9 % | $ (352) | $ (216) | 63.0 % |
| Loss on change in fair value of stock warrants | — | 4 | (100.0)% | — | (28) | (100.0)% |
| Gain on change in fair value of contingent liabilities | — | — | —% | — | 26 | (100.0)% |
| Gain on change in fair value of contingent assets | 28 | — | 100.0 % | 28 | — | 100.0 % |
| Other, net | 2 | 12 | (83.3)% | 5 | 27 | (81.5)% |
| Total other income (expense) | $ (93) | $ (52) | 78.8 % | $ (319) | $ (191) | 67.0 % |

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 and earn-out payables. Interest expense increased 80.9% or $55,000 and 63.0% or $136,000 during the three and nine months ended April 30, 2015, compared to the same periods last year. The increase in interest expense is primarily a result of additional debt to partially fund the TCS acquisition.

**Acquisitions**

On April 27, 2015, the Company acquired substantially all of the assets of TASCO, a leading provider of business management software designed exclusively for the automotive tire and wheel aftermarket industry. Consideration for the acquisition included: (1) a cash payment at the closing of the transaction equal to $1,750,000; (2) 242,424 shares of the Company's common stock; and (3) a $200,000 holdback payable on April 27, 2016.

On September 30, 2014, we completed the acquisition of TCS, a leading provider of software, websites and marketing services designed exclusively for the automotive tire and wheel vertical. Consideration for the acquisition included, (1) a cash payment equal to $4,200,000; (2) 618,744 shares of the Company's common stock; (3) the issuance of two promissory notes initially in aggregate principal amount of $3,000,000 to the former owners of TCS. The principal amount of the Notes was reduced by $67,000 to $2,933,000 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement; and (4) a contingent earn-out purchase price payable in three potential payments and contingent upon the attainment of specific revenue goals. The earn-out does not have an upper range, however, the payout at 100% per the asset purchase agreement is $933,000 and the estimated fair value is $711,000.

The Company's strategy is to integrate these acquisitions as quickly as possible in order to realize the cost savings of operational synergies. As a result of this, we do not track revenues and costs specific to the individual acquired businesses.

**Income Taxes**

The Company has net deferred tax assets of $ 5,686,000 as of April 30, 2015, 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 income tax expense of $243,000 and $606,000 during the three and nine months ended April 30, 2015, compared to income tax expense of $153,000 and $11,000 during the same periods last year, primarily due to the increase in income before taxes. We paid income taxes of $25,000 and $70,000 during the nine months ended April 30, 2015 and 2014, 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.

We also have NOLs related to tax losses incurred by our Netherlands operation. We have determined that, consistent with prior periods, it is not likely that the net operating losses will be utilized and therefore, a full valuation allowance is recorded, resulting in $0 net deferred tax assets related to the Netherlands operation at April 30, 2015 and 2014.

**Liquidity and Capital Resources**

The following table sets forth certain cash flow information derived from our unaudited financial statements for the nine months ended April 30 (in thousands):

| | Nine months ended April 30 | | |
|---|---|---|---|
| | 2015 | 2014 | Change |
| Net cash provided by operating activities | $ 4,595 | $ 1,042 | $ 3,553 |
| Net cash used in investing activities | (7,558) | (2,361) | (5,197) |
| Net cash provided by financing activities | 3,339 | 168 | 3,171 |
| Effect of foreign currency exchange rate changes on cash | (23) | (10) | (13) |
| Net change in cash | $ 353 | $ (1,161) | $ 1,514 |
| Cash at end of period | $ 2,161 | $ 1,034 | $ 1,127 |

We generated $353,000 of net cash during the nine months ended April 30, 2015, compared to the utilization of $1,161,000 during the same period last year. We generated net cash provided by operating activities of $4,595,000 during the nine months ended April 30, 2015 compared to $1,042,000 during the same period last year. This increase in cash generated from operations was primarily due to increased pre-tax profitability as a result cost reductions and increased revenues and an increase in revenue from cash collected in the period rather than from deferred revenue, which is collected in prior periods.

Cash used in investing activities increased $5,197,000 for the nine months ended April 30, 2015, compared to the same period last year. We paid cash of $4,200,000 as consideration for the TCS acquisition, paid cash of $1,750,000 as consideration for the TASCO acquisition, paid $250,000 for a cash earn-out and holdback related to our August 2012 acquisition of the assets of Ready2Ride, Incorporated, capitalized $1,000,000 of software development costs, acquired technology and equipment of $469,000 and received $111,000 from an earn-out receivable, during the nine months ended April 30, 2015. We paid cash of $200,000 as consideration for the DUO acquisition, paid $250,000 related to the Ready2Ride cash earn-out and holdback, capitalized $1,420,000 of software development costs, acquired technology and equipment of $592,000, and received $101,000 from an earn-out receivable during the same period last year. We will continue to invest cash in the business to further our growth strategies previously discussed.

Net cash provided from financing activities was $3,339,000 during the nine months ended April 30, 2015, as the Company increased its senior debt, as described below, to partially fund the TCS acquisition in September 2014, and drew $1,750,000 on the line of credit to fund the TASCO acquisition in April 2015. Net cash provided by financing activities was $168,000 in the nine months ended April 30, 2014.

Management believes that current cash balances and its ability to generate cash from operations are sufficient to fund our needs over the next twelve 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.

On May 12, 2015, the Company completed an underwritten offering pursuant to which it sold 1,760,000 shares of its common stock at a price to the public of $3.00 per share. The Company received net proceeds of approximately $4,686,300 from the sale, after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company. The Company used a portion of the net proceeds to repay its outstanding line of credit balance of $1,750,000 incurred in connection with its April 2015 acquisition of TASCO (thus making the line of credit fully available for future transactions), and intends to use the balance of the net proceeds to invest in or to acquire, from time to time, businesses that align with its core acquisition strategy (although there were no commitments or agreements with respect to any acquisitions as of the date of the offering), and for general corporate purposes, which may include working capital and/or capital expenditures.

**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.

On September 30, 2014, in connection with the Company's acquisition of TCS, the Company entered into the First Loan Modification Agreement (the "Modification Agreement") with SVB, which contained substantial amendments to the terms of the Agreement.

The Modification Agreement includes credit facilities consisting of a $3,000,000 revolving credit facility with a maturity date of September 30, 2016 and a $6,050,000 term loan with a maturity date of September 30, 2019. This term loan is an amendment to the existing $4,500,000 term loan with an original maturity date of April 26, 2018.

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to the Prime rate plus the Applicable Margin for Prime Rate Loans based on the Total Leverage Ratio. The Company had $1,750,000 outstanding on the revolving credit facility, which was primarily used to fund the TASCO acquisition, and an effective interest rate of 3.75% at April 30, 2015.

The Modification 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 Total Leverage Ratio equal to or less than 3.25 to 1.00 through the period ending October 31, 2014 and 3.00 to 1.00 thereafter, 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 as of April 30, 2015.

*TCS Promissory Notes*

In connection with the acquisition of TCS, on September 30, 2014, the Company issued two promissory notes with an original aggregate value of $3,000,000 to the former owners of TCS. The principal amount of the Notes was subsequently reduced by $66,575 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The notes initially are accruing interest on the outstanding unpaid principal balance at a rate per annum equal to 5%; however, if any amount payable under a note is not paid when due, such overdue amount will bear interest at the default rate of 7.5% from the date of such non-payment until such amount is paid in full.

**Off-Balance Sheet Arrangements**

The Company has no 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.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

Not Applicable.

**Item 4. *Controls and Procedures***

The Company has established disclosure controls and procedures to ensure that material information relating to it, including its consolidated subsidiaries, is made known on a timely basis to the officers who certify our financial reports and to other members of senior management and the Board of Directors.

The Company's management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, the Company's disclosure controls and procedures are effective (1) in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act and (2) to ensure that information required to be disclosed in the reports it files or submits under the Exchange Act is accumulated and communicated to its management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There have not been any changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the quarter ended April 30, 2015 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. *Legal Proceedings***

From time to time, the Company may be involved in litigation relating to claims arising out of its operations in the usual course of business. No material legal proceedings to which the Company is a party exist at April 30, 2015.

***Item 1A. Risk Factors***

The Company's risks and uncertainties are described in Part I, Item 1A of the Company's annual report on Form 10-K for the fiscal year ended July 31, 2014. There have been no significant changes to the risks described in our Form 10-K.

**Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds***

In connection with the April 27, 2015 acquisition of substantially all of the assets of TASCO, the Company issued 242,424 shares of its common stock to Aidan J. McKenna, the sole shareholder of TASCO, as a portion of the consideration paid for the assets. The Company believes that this transaction was exempt from registration requirements pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended. The recipient of these securities represented his intention to acquire the securities for investment only and not with a view toward their distribution, and appropriate legends were affixed to the share certificates.

**Item 3. *Defaults upon Senior Securities***

None.

**Item 4. *Mine Safety Disclosures***

Not applicable.

**Item 5. *Other Information***

Not applicable.

**Item 6. *Exhibits***

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 Section 1350 Certification of Chief Executive Officer.

32.2 Section 1350 Certification of Chief Financial Officer.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 15th day of June, 2015.

ARI NETWORK SERVICES, INC.
*(Registrant)*

By: /s/ Roy W. Olivier
Roy W. Olivier
President and Chief Executive Officer

By: /s/ William A. Nurthen
William A. Nurthen
Vice President of Finance and Chief Financial Officer