

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

**FORM 10-K**

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

For the fiscal year ended July 31, 2011

( ) TRANSITION REPORT UNDER 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.**

(Name of small business issuer in its charter)

WISCONSIN  
(State or other jurisdiction of  
incorporation or organization)

39- 1388360  
(IRS Employer Identification No.)

10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224  
(Address of principal executive office)

Issuer's telephone number (414) 973-4300

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, par value \$0.001 per share  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act  
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.  
Yes No

Indicate by check mark whether the registrant (1) 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 checkmark 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (S229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

Smaller reporting company

(Do not check if a 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

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price of the registrant's common stock on January 31, 2011 as reported on the OTC bulletin board, was \$4.1 million.

As of October 19, 2011, there were 7,987,944 shares of the registrant's shares outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Definitive Proxy Statement, to be filed with the Securities and Exchange Commission no later than 120 days after July 31, 2011, for the 2011 Annual Meeting of Shareholders are incorporated by reference in Part III hereof.

**ARI Network Services, Inc.**  
FORM 10-K  
FOR THE FISCAL YEAR ENDED JULY 31, 2011  
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*This Annual Report on Form 10-K, including the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, 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 below under "Item 1A. Risk Factors" 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.*

## **PART I**

### **Item 1. Business**

#### **Overview**

ARI Network Services, Inc. ("ARI") is a leader in creating, marketing, and supporting solutions that enhance revenue and reduce costs for our customers. Our innovative, technology-enabled solutions connect the community of consumers, dealers, distributors, and manufacturers to help them efficiently service and sell more whole goods, parts, garments, and accessories ("PG&A") worldwide in selected vertical markets that include power sports, outdoor power equipment, marine, and appliances. We estimate that approximately 18,000 equipment dealers, 125 manufacturers, and 150 distributors worldwide leverage our technology to drive revenue, gain efficiencies and increase customer satisfaction.

Our suite of software and SaaS solutions are designed to facilitate our customers' operations, increasing sales through additional foot and website traffic, more effective lead management, and greater conversion rates on those leads. To achieve this, our solutions allow our customers to: (i) efficiently market to their customers and prospects in order to drive increased traffic to their location and website; (ii) manage and nurture customers and prospects; (iii) increase revenues by selling PG&A online; (iv) increase revenues by generating leads for whole goods; and (v) increase revenues and reduce costs of our dealer customers by enhancing the productivity of our customers' support operations, specifically with respect to the sale of manufacturers' parts.

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](http://www.arinet.com).

#### **Our Solutions**

Today, we generate revenue from three primary categories of technology-enabled solutions: (i) electronic catalogs for publishing, viewing and interacting with PG&A information from OEMs and distributors; (ii) lead generation and management products and services designed to help dealers generate sales of whole goods, PG&A through efficient marketing of their products; and (iii) websites with eCommerce capabilities designed to generate leads for whole goods and sales of PG&A through the sites and provide information to consumers in the dealers' local areas.

##### *Electronic Catalogs*

Our electronic catalog solutions, which encompass our PartSmart<sup>®</sup>, PartSmart Web<sup>™</sup> and PartStream<sup>™</sup> products, contain enhanced data relating to manufacturers' whole goods, and PG&A. The solutions allow distributors and dealers to view and interact with this information to efficiently support the sales and service of equipment. We believe that we have the broadest library of available content in the vertical markets we serve, and our multi-line electronic catalog solution is the fastest and most efficient in the marketplace. We derived 59% of our revenues from subscriptions to, and support for, our electronic catalog services in fiscal 2011.

*PartSmart*®, our CD-based electronic parts catalog, is used by dealers worldwide in the outdoor power, power sports, marine, and agricultural equipment industries to increase productivity by significantly reducing parts lookup time. Our *PartSmart*® software allows multi-line dealers to look up parts and service information for all manufacturer product lines that the dealer carries, and integrates with more than 85 of the leading dealer business management systems. We also provide a version of our *PartSmart*® product to the appliance industry, known as *PartSmart*® IPL.

*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 website platforms 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.

#### *Lead Generation and Management Products and Services*

Our award-winning lead generation and management solutions, which encompass our *Footsteps*™ product and *SearchEngineSmart*™ service, are designed to increase traffic to dealers' stores and websites and more efficiently manage and nurture generated leads, increasing conversion rates and ultimately revenues. We derived 9.3% of our revenues from lead generation and management services in fiscal 2011.

*Footsteps*™, a SaaS solution, connects the equipment manufacturers with their dealer channel through lead consolidation and distribution, and allows 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.

Our *SearchEngineSmart*™ service generates additional traffic to dealers' stores and websites through optimization of the dealers' paid search engine marketing campaigns, including organic optimization for local results.

#### *Website Solutions*

Our website solutions, which are tailored to the vertical markets we serve and are eCommerce enabled, provide consumers with information about the dealer and its product lines and allow consumers to purchase PG&A through the dealers' website 24 hours a day, 7 days a week. Our website solutions include *WebSiteSmart Pro*®, *eXceleratePro*™ and *eXceleratePro*™ 2, and *LeadStorm*™. We also offer a mobile solution that allows dealers' websites to be fully functional on smart mobile phones. Website services accounted for 24% of revenues in fiscal 2011.

#### *Other Services*

We also offer a suite of complementary technology-enabled solutions, which include professional services for the customization of software and website solutions; website hosting; and document transfer and communication services to customers in the manufactured equipment industry. On a combined basis, these other services accounted for 7.9% of fiscal 2011 revenues.

#### **Our Strategy**

We believe the following strategic foundations will allow us to continue to provide our community with the innovative solutions and world class customer service they have come to expect and drive the growth and profitability our shareholders deserve.

#### *Nurture and retain existing customers through world class customer service and product feature upgrades*

We believe there is a significant opportunity to leverage our relationships with existing customers and, accordingly, we place a high degree of focus on reducing the level of customer "churn". In order to retain our existing customers over time, we must keep them satisfied and continuously improve upon the value the customer receives. To this end we have made significant investments in our customer support operations, publishing, product development, and technology infrastructure during the past several years. Additionally, we realigned internal resources to designate a team that is proactively focused on customer satisfaction and renewing customers' subscriptions before they are set to expire. We will continue to invest in this area as well as identify new product features designed to enhance our customers' user experience and value.

*Drive organic growth through innovative new service offerings, differentiated content and geographic expansion*

As a subscription-based, recurring revenue business, the most important drivers of future growth are: (i) increasing the level of our monthly recurring revenue (“MRR”); (ii) increasing MRR as a percentage of total revenue; and (iii) reducing the rate of our customer churn. We discussed above our strategy for reducing our customer churn rates, and we have already seen significant improvement in these rates in fiscal 2011 and expect to see these rates continue to improve in fiscal 2012 and beyond.

The strategy we will utilize to drive increased MRR includes the following: (i) rapidly expand our base of customers and users through new innovative solutions, (ii) sell more to our existing customer base by developing and deploying “must have” new product features and upgrades; (iii) develop and deploy basic versions of our existing and new products (we refer to these as “freemium” versions), which we believe will allow us to quickly ramp up the number of users and allow us to upsell premium versions and additional features into these customers; and (iv) expand into new geographic markets.

The first three components of our organic growth strategy essentially allows us to very rapidly expand our customer and user base, and then leverage these customers and users through upsells of new innovative solutions and value-added upgrades and features of our existing solutions. 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. We have made, and expect to continue to make, significant investments in our product management and development teams. In fiscal 2011 we realigned these teams with resources assigned to each of our core products. The teams will continue to research and develop new features and functionality in our existing products. Additionally, we recently implemented an internal “Innovation Factory”, a team that will be solely dedicated to rapidly deploying enhancements to current products and the creation of new value-added solutions.

We believe that a significant opportunity exists to expand our services into international markets as our manufacturing customers do the same. Currently, only a small percentage of our revenues are generated from our international operations. One of our initiatives for fiscal 2012 is to align internal business development resources to drive additional relationships with European manufacturers and distributors. We will also upgrade our product roadmaps to allow us to rapidly deploy those products internationally, with a focus on the “BRIC” countries of Brazil, Russia, India, and China.

Lastly, we will continue to expand and enrich what we believe to be the broadest library of available content in the vertical markets we serve. We must continue to enhance our value proposition through enrichment of our content or this competitive advantage will begin to lose its distinction. 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 manufacturer customers, and creating new forms of content that further our customers’ ability to efficiently service and sell more whole goods, PG&A.

*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 the systems. We currently have integration capabilities with over 85 DMS’s and we continue to seek other strategic alliances that can be integrated with our product and service offerings. In fiscal 2012 we plan to build a dedicated integration team to expand on the capabilities of our interface and to connect, invasively if necessary, with the top DMS providers in the vertical markets we serve.

*Successfully execute acquisitions that align with our core strategy*

Historically, acquisitions have been a significant driver of ARI’s growth. Since 2007, the Company has successfully closed four strategic acquisitions while reviewing, and ultimately deciding not to pursue, a multitude of others. Our 2009 acquisition of Channel Blade Technologies (“Channel Blade”) and our 2008 acquisition of the electronic parts catalog and eCommerce assets of Info Access expanded not only our product offerings but the number of markets we serve. As a result of those acquisitions, ARI is the market leader in the marine, RV and appliance markets. Although we believe organic growth will be the primary driver of our business for the foreseeable future, we will continue to evaluate acquisitions that are in alignment with our core strategy.

## **Sales, Marketing and Support Teams**

We organize our sales and marketing programs into three distinct sales channels and two geographic regions, including North America and Europe.

### *Sales Channels*

We go to market utilizing three distinct sales teams, determined through a combination of customer, product, and geographic market. Our field sales personnel focus on building relationships with manufacturers and distributors, while our inside, telephone-based sales team focuses on selling to dealers. The dealer sales team is further divided by product (catalog sales versus other products and services) and an international sales team in The Netherlands. We are also in the process of enhancing our core products to allow for customer self-service sales capabilities.

### *Marketing*

Our marketing strategy is designed to drive knowledge of our value proposition into the markets we serve. We use a variety of marketing programs to target and build relationships with our prospective and current customers and partners. Our primary marketing activities include:

- participation in dealer meetings, trade shows and industry events to create awareness, build our lead database and develop relationships;
- search engine marketing and online and print direct marketing to generate awareness and action;
- ongoing website development to educate prospects and provide product information, testimonials, live demonstrations and marketing collateral;
- email and phone campaigns used to capture leads;
- use of customer testimonials; and
- sales tool kits and field marketing training to enable our sales organization to more effectively develop leads and close transactions.

### *Customer Service and Support*

Customer support is a critical part of our strategy as it is essential to retaining our existing customer base and reducing the level of customer churn. We maintain customer support operations in each of the Company's four locations. Our support representatives are available via telephone or email. We also maintain a customer satisfaction and renewal team that focuses on proactively reaching out to customers to ensure that our customers are satisfied and are receiving the most value possible from their spend with ARI.

## **Our Competitive Strengths**

### *Market Leader in Core Verticals*

We believe that we are one of the leaders in each of our core vertical markets and also believe we are the market leader in the outdoor power, marine, and appliance markets. Our direct relationships with approximately 18,000 dealers, 125 manufacturers, and 150 distributors allow us to cost-effectively leverage our published catalog content into a large and diversified customer base and to launch new product enhancements and technology-enabled solutions to this customer base.

### *Breadth and Depth of Published Content*

The breadth and depth of our catalog content, as well as our ability to enhance and efficiently publish manufacturers' PG&A data as it becomes available, provides ARI with a critical competitive advantage. Our electronic catalog content enables multi-line dealers to easily access catalog content for multiple manufacturers using a single software platform. This advantage, which saves our customers significant time, provides "stickiness" to our catalog customer base that allows us to efficiently and cost effectively nurture our existing customers while devoting resources to develop new products and services, enabling us to grow our overall customer base.

### *Recurring Revenue Model*

Approximately 80% of our revenue is subscription-based and recurring revenue. The majority of our customers are on contracts of twelve months or longer, and these contracts typically auto-renew for additional twelve month terms. This provides us with advanced visibility into our future revenues. Our recurring revenue model also emphasizes the importance of maintaining a low rate of customer churn, one of the key drivers of any recurring revenue, subscription-based businesses. Historically, we measured customer renewal rates. Over the past year we began measuring customer churn rates. Although similar, we believe that customer churn is a better management tool as it allows us to focus on the reasons we may lose customers and take action actions on those reasons within our control in order to reduce churn rates in the future.

Our recurring revenue model, when combined with low rates of customer churn, significantly reduces the cost to maintain and nurture our customer base. This in turn frees up resources to enhance our existing products and work toward new product innovations. Additionally, a substantial portion of our electronic catalog business is focused on our customers' service and repair operations. This allows our revenues to remain strong even in a down economy, as consumers tend to repair, rather than buy new equipment during a challenging economy.

### *Suite of Products Covers Entire Sales and Service Cycle*

Our suite of dealer products and services and eCommerce capabilities enhance our customers' front office operations by covering the entire sales cycle, from lead generation and lead management to sales of PG&A to the consumer, both in-store and online, and our electronic catalog products allow dealers to efficiently service and repair equipment.

We believe that our competitive advantages will enable us to compete effectively and sustainably in our core markets, although given the current pace of technological change, it is possible that unidentified competitors could emerge, existing competitors could merge and/or obtain additional capital, thereby making them more formidable, or new technologies could come on-stream and potentially threaten our position.

### **Our Markets and the Challenges We Face**

Competition for our products and services varies by product and by vertical market. We believe that no single competitor today competes with us on every product and service in each of our industry verticals. In electronic catalogs, we compete primarily with Snap-on Business Solutions, which designs and delivers electronic parts catalogs, accessory sales tools, and manufacturer network development services, primarily to the automotive, power sports, outdoor power, construction, agriculture and mining markets. In addition, there is a variety of smaller companies focused on one or two specific industries.

In lead management, websites and eCommerce, our primary competitors are PowerSports Network, owned by Dominion Enterprises, and 50 Below. Competition for our website development services also comes from in-house information technology groups that may prefer to build their own web-based proprietary systems, rather than use our proven industry solutions. There are also large, general market eCommerce companies, such as IBM, which offer products and services that could address some of our customers' needs. These general eCommerce companies do not typically compete with us directly, but they could decide to do so in the future. We believe we maintain a competitive advantage in our core vertical markets given the integration of our published catalog content into our lead management and website products.

Several of the markets we serve, including power sports, marine, and RV, are closely aligned with the state of the economy, given the "luxury" nature of the products in those verticals. In fiscal 2010 we experienced an increase in customer churn in these markets due to manufacturer bankruptcies, dealer closures, and extreme cost reduction measures by our dealers. Our customer churn rates improved in these markets in fiscal 2011 as the effects of the economy began to ease off those markets. It is also important to note that the impacts of a difficult economic environment are somewhat softened by the consumers' willingness in a down economy to repair existing equipment rather than purchase new equipment, which serves to amplify the importance of our published parts content provided to customers via our catalog parts lookup products and our website products.

**Intellectual Property**

We rely on various intellectual property laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We also enter into confidentiality and proprietary rights agreements with our employees, consultants and other third parties and control access to software, documentation and other proprietary information. We have two registered trademarks in the U.S. and elsewhere: PartSmart and WebsiteSmart Pro. We also use numerous unregistered trademarks.

**Employees**

As of July 31, 2011, we had approximately 133 employees. Of these, 47 are involved in customer operations and support, 33 are in sales and marketing, 32 are engaged in maintaining or developing software and providing software customization services and 21 are involved in general and administration functions. None of these employees is represented by a union.

**Fiscal Year**

ARI's fiscal year ends on July 31<sup>st</sup>. Any references throughout this document to fiscal 2011 or fiscal 2010 refer to the fiscal years ended July 31, 2011 and 2010, respectively. Also note that the reference to the word "fiscal" has been removed from all tables throughout this document.

## Executive Officers of the Registrant

The table below sets forth the names of ARI's executive officers as of October 19, 2011. The officers serve at the discretion of the Board of Directors.

<u>Name</u>	<u>Age</u>	<u>Capacity Served</u>
Roy W. Olivier	52	President, Chief Executive Officer and Director
Darin R. Janecek	43	Vice President of Finance, Chief Financial Officer, Secretary and Treasurer
Jon M. Lintvet	35	Chief Marketing Officer

### *Roy W. Olivier*

Mr. Olivier was appointed President and Chief Executive Officer of the Company in May 2008, after having served in the capacity of Vice President of Global Sales and Marketing of the Company since September 2006. Prior to joining ARI in 2006, Mr. Olivier was a consultant to start-up, small and medium-sized businesses. Prior to that, he was Vice President of Sales and Marketing for ProQuest Media Solutions, a business he founded in 1993 and sold to ProQuest in 2000. Before that, Mr. Olivier held various sales and marketing executive and managerial positions with several other companies in the telecommunications and computer industries, including Multicom Publishing Inc., Tandy Corporation, BusinessLand and PacTel.

### *Darin R. Janecek*

Mr. Janecek was appointed Vice President of Finance and Chief financial Officer of ARI in December 2010, after having served as Vice President of Finance and Director of Finance since joining the Company in May 2009. Mr. Janecek also serves as Treasurer and Corporate Secretary. Prior to joining ARI, Mr. Janecek served in various mergers and acquisitions, corporate strategy and analysis roles at Johnson Controls, Inc. in Milwaukee, Wisconsin, and Crowe Horwath LLP, FTI Consulting, and CNA Insurance in Chicago, Illinois. Prior to that, he served in several corporate accounting roles in the manufacturing and health care industries. Mr. Janecek began his career in 1991 as an auditor with Deloitte & Touche LLP. Mr. Janecek is a certified public accountant and earned a Master of Business Administration from Loyola University, Chicago, and a Bachelor of Accounting from the University of Wisconsin - Milwaukee.

### *Jon M. Lintvet*

Mr. Lintvet was appointed Chief Marketing Officer of ARI in October 2011. As Chief Marketing Officer, Mr. Lintvet leads all product management, innovation and strategic marketing initiatives for ARI. Mr. Lintvet was Chief Executive Officer of Channel Blade prior to ARI's acquisition of the company in 2009. Following the acquisition, Mr. Lintvet was named ARI's Director of Business Development. In November 2010 Mr. Lintvet was promoted to Vice President of Product. Prior to Channel Blade Mr. Lintvet served in various product development roles at Capital One. Mr. Lintvet earned a Bachelor of Science from Ithaca College in Ithaca, New York.

## Available Information

You can obtain copies of our 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and other filings with the SEC, and all amendments to these filings, free of charge from our website at [www.arinet.com](http://www.arinet.com) as soon as reasonably practical following our filing of any of these reports with the SEC. You can also obtain copies free of charge by contacting us at our office address listed above.

## Item 1A. Risk Factors

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.

*Continued unfavorable economic conditions or reduced investments in technology spending may harm our business.*

Our business depends on the overall demand for technology services spending, and on the economic health and general willingness of our current and prospective customers to make capital commitments. If the conditions in the U.S. and global economic environment remain uncertain or continue to be volatile, or if they deteriorate further, our business, operating results and financial condition may be adversely affected. Our customers sell capital goods, some of which are considered "luxury" in nature, which are highly dependent on the disposable income of end consumers. Continued weak or volatile economic conditions, or a reduction in consumer spending may weaken our customers' demand for electronic catalogs, websites, lead management or other technology-enabled services, or their general information technology spending, which would likely harm our business and operating results in a number of ways, including longer sales cycles, potential lower prices for our services, reduced sales, and reduced subscription renewal rates.

*We may become liable to our customers and lose customers if we have defects or disruptions in our service or if we provide poor service.*

Because we deliver some of our technology as a service, errors or defects in the software applications underlying our service, or a failure of our hosting infrastructure, may make our services, in particular our eCommerce services, unavailable to our customers. Since our customers use our eCommerce services to facilitate their sales, any errors, defects, disruptions in service or other performance problems with our services, whether in connection with the day-to-day operation of our services, upgrades or otherwise, could damage our customers' businesses.

Despite the implementation of security measures, the core of our network infrastructure is vulnerable to unauthorized access, computer viruses, equipment failure and other disruptive problems, including the following:

- we and our users may experience interruptions in service as a result of the accidental or intentional actions of Internet users, current and former employees or others;
- unauthorized access may jeopardize the security of confidential information stored in our computer systems and our customers' computer systems, which may result in liability to our customers and also may deter potential customers;
- we may face liability for transmitting viruses to third parties that damage or impair their access to computer networks, programs, data or information;
- there may be a systemic failure of Internet communications, leading to claims associated with the general unavailability of some of our products; or
- eliminating computer viruses and alleviating other security or technical problems may require interruptions, delays or cessation of service to our customers.

If we have any errors, defects, disruptions in service or other performance problems with our services, customers could elect not to renew, or delay or withhold payment to us, we could lose future sales or customers may make claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or litigation costs.

*Our core markets and verticals are competitive, and if we do not compete effectively, our operating results may be harmed.*

The markets for electronic catalog, websites, lead management and other technology-enabled services targeted at the equipment industry are competitive, and the eCommerce area, specifically, is rapidly changing with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to remain intense. In addition, increased competition generally could result in reduced sales, reduced margin or the failure of our services to achieve or maintain more widespread market acceptance. Competition in our market is based principally upon service breadth and functionality; service performance, security and reliability; ability to tailor and customize services for a specific company, vertical market or industry; ease of use of the service; speed and ease of deployment, integration and configuration; total cost of ownership, including price and implementation and support costs; professional services implementation; strength of customer relationships; and financial resources of the vendor. To compete effectively, we also must be able to more frequently update our services to meet market demand.

Our principal competitors include Snap-on Business Solutions, 50 Below, and Powersports Network, owned by Dominion Enterprises. Some of our actual and potential competitors enjoy competitive advantages over us, such as greater name recognition within our target vertical markets, larger marketing budgets, as well as substantially greater financial, technical and other resources. If we are not able to compete effectively, our operating results will be harmed.

*The impact of negative factors on the business may not be immediately reflected in our financial results.*

Because we recognize subscription revenue over the term of the applicable agreement, the lack of subscription renewals or new service agreements may not be reflected immediately in our operating results. The majority of our revenue in any given period is attributable to service agreements entered into during previous periods. A decline in new or renewed service agreements in any one period will not be fully reflected in our revenue in that period but will harm our revenue in future periods. As a result, the effect of significant downturns in sales and market acceptance of our services in a particular period may not be fully reflected in our operating results until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, because revenue from new customers must be recognized over the applicable subscription term.

*Our operating results may fluctuate from quarter to quarter.*

We expect that a portion of our revenue in the future will be derived from non-recurring fee income, which consists primarily of revenues from professional services such as software customization and training, software sales and one-time network installation fees. The timing of receipt of this revenue is dependent upon several factors that we cannot predict. These factors include:

- the time required to close large license fee and development agreements, which can be delayed due to customer requirements and decision-making processes;
- the seasonality of certain sectors of the equipment industry in which we operate;
- delays in the introduction of new products or services and their acceptance by customers; and
- delays in delivering customized software to our customers.

Our costs are not entirely predictable and may vary from quarter-to-quarter due to acquisitions or non-recurring expenditures. Cash flows may also vary from quarter to quarter, depending on the timing of disbursements and customer payments, which exhibit considerable seasonality. These fluctuations may make period-to-period comparisons of our results of operations more complex.

*Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and harm our operating results.*

A change in accounting standards or practices could harm our operating results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may harm our operating results or the way we conduct our business and may increase our compliance costs.

*Our business could suffer if we are unable to protect our intellectual property rights or are liable for infringing the intellectual property rights of others.*

We regard our trademarks, proprietary technology and similar intellectual property as critical to our success, and we rely upon trademark law, trade secret protection, and confidentiality and license agreements with our employees, strategic partners, and others to protect our proprietary rights, but these measures can have only limited effectiveness. Prevalent use of the Internet has also increased the ease with which third parties can distribute our intellectual property without our authorization.

We intend to pursue the registration of our material trademarks as necessary. We may not be entitled to the benefits of any such registration until such registration takes effect. In addition, effective protection may not be available in every country in which our products are available. Further, we may be subject to claims in the ordinary course of our business, including claims of alleged infringement of the trademarks, copyrights and other intellectual property rights of third parties by us and our licensees.

Other parties may assert claims of infringement of intellectual property or other proprietary rights against us. These claims, even if without merit, could require us to expend significant financial and managerial resources. Furthermore, if claims like this were successful, we might be required to change our trademarks, alter our content, products or services, or pay financial damages, any of which could substantially increase our operating expenses. We also may be required to obtain licenses from others to refine, develop, market and deliver new services. We may be unable to obtain any needed license on commercially reasonable terms or at all, and rights granted under any licenses may not be valid and enforceable. In the future we could be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of trademarks and other intellectual property rights of third parties by us and our licensees. Any such claims could have a material adverse effect on our business, financial condition and operating results.



*We are dependent on our management and employees.*

We are dependent on the services of our executive officers and other key employees. There can be no assurance, however, that we can obtain executives of comparable expertise and commitment in the event of death, disability, or voluntary departure of one of our executive officers or other key employees, or that our business would not suffer material adverse effects as the result of the death, disability, or voluntary departure. Further, the loss of the services of any one or more of these employees could have an adverse effect on our business. In addition, we will also need to attract and retain other highly skilled technical and managerial personnel for whom competition is intense. If we are unable to do so, our business, results of operations and financial condition could be materially adversely affected.

*Our common stock has a very limited trading market.*

Our common stock is traded on the OTC bulletin board, which typically provides less liquidity than the NASDAQ or any other national securities exchange. In addition, trading in our common stock has historically been extremely limited. Because of the thinness of the market for our stock, the price of our common stock may be subject to manipulation. This limited trading may adversely affect the liquidity of our common stock, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us. As a result, there could be a larger spread between the bid and the ask prices of our common stock and an investor may not be able to sell shares of our common stock when or at prices you desire.

*Our shareholder rights plan may permit our board to block a takeover attempt and adversely affect the value of our common stock.*

Our board of directors adopted a shareholder rights plan and declared a dividend of an associated right, which together are expected to have the effect of deterring any takeover of the Company that is not preceded by board approval of the proposed transaction. The existence of such shareholder rights plan may deter potential tender offers for our common stock or other acquisition offers and may have the effect of delaying or preventing a change of control.

*We may not be able to identify, acquire and successfully integrate acquisitions.*

A key component of our growth strategy has been and will continue to be acquisitions and other business development opportunities that solidify or accelerate our market position in our core offerings and vertical markets. The successful implementation of this strategy depends upon our ability to identify suitable acquisition candidates, acquire such businesses on acceptable terms, finance the acquisition and integrate their operations successfully into ARI. There can be no assurance that such candidates will be available or, if such candidates are available, that the price will be attractive or that we will be able to identify, acquire, finance or integrate such businesses successfully. In addition, in pursuing such acquisition opportunities, we may compete with other entities with similar growth strategies; these competitors may be larger and have greater financial and other resources than ARI. Competition for these acquisition targets could also result in increased prices of acquisition targets and/or a diminished pool of companies available for acquisition.

The successful integration of these acquisitions also may involve a number of additional risks, including: (i) the inability to retain the clients of the acquired business; (ii) the lingering effects of poor client relations or service performance by the acquired business, which also may taint our existing business; (iii) the inability to retain the desirable management, key personnel and other employees of the acquired business; (iv) the inability to fully realize the desired efficiencies and economies of scale; (v) the inability to establish, implement or police ARI's existing standards, controls, procedures and policies on the acquired business; (vi) diversion of management attention; and (vii) exposure to client, employee and other legal claims for activities of the acquired business prior to acquisition. In addition, any acquired business could perform significantly worse than expected.

The inability to identify, acquire, finance and successfully integrate acquisitions could have a material adverse effect on ARI or its estimated or desired business, income, growth or other condition and results.

*Future acquisitions may result in dilution to existing shareholders.*

The timing, size and success of acquisition efforts and any associated capital commitments cannot be readily predicted. Future acquisitions may be financed by issuing shares of common stock, cash, or a combination thereof. To the extent our common stock is used for all or a portion of the consideration to be paid for future acquisitions, dilution may be experienced by existing stockholders.

*We face risks with our international strategy.*

Our business strategy includes increasing our presence in the non-U.S. equipment markets. This strategy presents a number of special risks, including:

- managing more geographically diverse operations;
- dealing with currency fluctuations;
- the increased costs of operation;
- only having a small number of employees in these markets;
- our dependence on value-added resellers and contractors to sell and service our products;
- a much smaller and more concentrated current customer base; and
- the assumption that U.S. international policy will remain favorable towards the countries in which we sell our products and services.

*Our historical losses have resulted in our weak balance sheet.*

While we have been profitable in recent years, we have experienced net losses in numerous fiscal years since our organization in 1981, resulting in an accumulated deficit of \$89.1 million at July 31, 2011. We may not be able to maintain profitability or increase profitability in the future. As a result of our historical losses, our financial position has been weakened, and our ability to finance our growth is constrained.

*We will require a significant amount of cash to service our indebtedness. Our ability to generate cash depends on certain factors beyond our control.*

Our ability to make principal and interest payments on our indebtedness and to fund planned capital expenditures and product development efforts will depend on our ability to generate cash in the future. Our future operating performance and financial results will be subject, in part, to factors beyond our control, including dealer bankruptcies in the vertical markets we serve, and general economic, financial and business conditions. We cannot assure that our business will generate sufficient cash flow from operations or that future financing facilities will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs.

If we are unable to generate sufficient cash flow to service our debt, we may be required to:

- refinance all or a portion of our debt or obtain additional financing, neither of which can be assured;
- sell some of our assets or operations;
- reduce or delay capital expenditures, research and development efforts and acquisitions; or
- revise or delay our strategic plans.

If we are required to take any of these actions, it could have a material adverse effect on our business, financial condition and results of operations. In addition, we cannot assure that we would be able to take any of these actions, that these actions would enable us to continue to satisfy our capital requirements or that these actions would be permitted under the terms of our various debt instruments.

**Item 2. Properties**

The table below summarizes ARI's current facilities. Management believes that the Company's current facilities are suitable and sufficient to support present operations.

<b>Description of Use</b>	<b>Location</b>	<b>Square Footage</b>	<b>Lease Expiration</b>	<b>Operating Segment</b>
Corporate headquarters	Milwaukee, WI	16,300	July 2021	North America
Product development and professional services team	Cypress, CA	6,000	July 2013	North America
Marine and RV sales and support	Virginia Beach, VA	9,800	April 2014	North America
European sales and support	Leiden, The Netherlands	200 m <sup>2</sup>	April 2015	Netherlands

**Item 3. Legal Proceedings**

None.

**Item 4. [Removed and Reserved for Future Use]**

## PART II

### Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

ARI's common stock is currently quoted on the OTC bulletin board under the symbol ARIS. The following table sets forth the high and low sales price for the periods indicated. OTC bulletin board quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

<b>Fiscal</b>				
<b>Quarter Ended:</b>	<b>High</b>		<b>Low</b>	
10/31/2009	\$	1.07	\$	0.55
1/31/2010	\$	1.10	\$	0.63
4/30/2010	\$	1.00	\$	0.70
7/31/2010	\$	0.84	\$	0.61
10/31/2010	\$	0.75	\$	0.31
1/31/2011	\$	0.75	\$	0.45
4/30/2011	\$	0.80	\$	0.47
7/31/2011	\$	0.99	\$	0.48

As of October 19, 2011, there were approximately 671 holders of record of ARI common stock. We have not paid cash dividends to date and have no current intention to pay cash dividends.

During fiscal 2011, the Company did not repurchase any of its equity securities.

## Item 6. Selected Financial Data

The following tables set forth certain financial information with respect to the Company for each of the previous five fiscal years, which includes information derived from ARI's audited financial statements and notes thereto for fiscal 2011 and fiscal 2010. The reports, thereon, of Wipfli LLP are included elsewhere in this report. The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the aforementioned Financial Statements and Notes. All amounts are in thousands, except per share data.

### Statement of Income

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net revenue	\$ 21,334	\$ 21,484	\$ 17,560	\$ 16,917	\$ 15,435
Gross profit	16,927	17,131	14,160	14,046	12,716
Gross margin	79.3%	79.7%	80.6%	83.0%	82.4%
Net operating expenses	<u>15,194</u>	<u>16,626</u>	<u>13,051</u>	<u>13,225</u>	<u>12,551</u>
Operating income	1,733	505	1,109	821	165
Other expense	<u>(332)</u>	<u>(630)</u>	<u>(221)</u>	<u>(28)</u>	<u>(60)</u>
Income (loss) from continuing operations before provision for income taxes	1,401	(125)	888	793	105
Income tax benefit (expense)	<u>1,017</u>	<u>1,294</u>	<u>(123)</u>	<u>590</u>	<u>(4)</u>
Income from continuing operations	2,418	1,169	765	1,383	101
Discontinued operations	<u>25</u>	<u>(392)</u>	<u>(341)</u>	<u>-</u>	<u>-</u>
Net income	<u>\$ 2,443</u>	<u>\$ 777</u>	<u>\$ 424</u>	<u>\$ 1,383</u>	<u>\$ 101</u>

### Earnings per share:

#### Income from continuing operations:

Basic	\$ 0.31	\$ 0.15	\$ 0.11	\$ 0.21	\$ 0.02
Diluted	\$ 0.31	\$ 0.15	\$ 0.11	\$ 0.20	\$ 0.02

#### Net income:

Basic	\$ 0.31	\$ 0.10	\$ 0.06	\$ 0.21	\$ 0.02
Diluted	\$ 0.31	\$ 0.10	\$ 0.06	\$ 0.20	\$ 0.02

### Other Financial Data

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Amortization of capitalized software products	\$ 1,127	\$ 1,054	\$ 876	\$ 764	\$ 800
Depreciation and amortization	1,688	1,640	1,054	727	631
Capital expenditures	670	541	636	119	639
Software development costs capitalized	1,741	1,340	759	524	358

**Balance Sheet Data**

	As of July 31 <sup>st</sup>				
	2011	2010	2009	2008	2007
Cash and cash equivalents	\$ 1,134	\$ 938	\$ 650	\$ 1,086	\$ 1,050
Working capital deficit	(2,998)	(3,692)	(4,246)	(5,475)	(5,221)
Net capitalized software product costs	2,815	2,395	2,397	1,596	1,606
Total assets	21,099	19,777	18,607	12,193	9,927
Current portion of debt and lease obligations	1,289	1,217	726	1,471	1,031
Long term debt and lease obligations	4,293	5,338	5,115	349	484
Total shareholders' equity	7,831	5,219	4,187	2,896	718

**Cash flow Data**

	2011	2010	2009	2008	2007
Net cash provided by (used for):					
Operating activities	\$ 3,471	\$ 1,624	\$ 2,745	\$ 2,027	\$ 1,144
Investing activities	(2,293)	(1,891)	(2,219)	(1,651)	(2,174)
Financing activities	(977)	550	(968)	(353)	(1,491)

**Item 7. 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 audited consolidated financial statements for fiscal 2011 and fiscal 2010, including the notes thereto, which appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which as previously identified are subject to the safe harbors created under the Securities Act and Exchange Act.

**Overview**

Our fiscal 2011 financial results were some of the best in the Company's history. We more than tripled our operating income and net income; more than doubled our cash generated from operations; paid down nearly \$1 million of debt; and increased our investment in product development. We believe these results are the culmination of various critical initiatives of the past several years. In April 2009 we acquired Channel Blade and fiscal 2011 was the first full year we experienced the efficiencies that resulted from that acquisition. At the end of fiscal 2010 we underwent a workforce reduction and business improvement initiative designed to help the Company streamline its operations and focus on our core offerings of electronic catalogs, lead generation and management, and eCommerce websites. As part of this initiative in July 2010 we divested ARI F&I Services LLC ("AFIS"), our non-strategic dealer outsourced finance and insurance operation, and in March 2011 we divested our non-strategic electronic data interchange business devoted to the agricultural chemicals industry ("AgChem EDI").

We generated net income of \$2,443,000, or \$0.31 per share in fiscal 2011, compared to net income of \$777,000, or \$0.10 per share, in fiscal 2010. The significant improvement in earnings is attributable to several factors, including:

- (i) Operating expenses declined by \$1,432,000, or 8.6%, in fiscal 2011, resulting from our fiscal 2010 fourth quarter workforce reduction and business improvement initiative, for which we incurred a \$437,000 charge in the fiscal 2010 fourth quarter, and from our continuing efforts to reduce costs and achieve operational efficiencies throughout the organization.
- (ii) In fiscal 2010 we incurred losses from our discontinued AFIS operation, net of tax benefits, of \$392,000. These losses did not reoccur in fiscal 2011.
- (iii) We recorded a gain on the sale of our AgChem EDI business of \$433,000.

These factors were partially offset by both an increase in interest expense in fiscal 2011 and a reduction in the amount of tax benefit realized, each of which will be discussed below.

Despite a slight decline in revenue and gross profit, operating income increased to \$1,733,000 in fiscal 2011 from \$505,000, driven solely by the reduction in operating expenses discussed above.

At July 31, 2011, we had cash balances of \$1,134,000, versus \$938,000 at July 31, 2010. Furthermore, our total outstanding debt, which includes amounts due under our line of credit, capital lease obligations, and term note, was \$5,582,000 at July 31, 2011, nearly a \$1,000,000 decline from the \$6,555,000 outstanding at July 31, 2010. These favorable results were due to significant growth in cash generated from operations, which resulted from our strategy of focusing on growing our core recurring revenue base and generating technological and operating efficiencies throughout our business.

### Net Revenues and Gross Margins

The table below summarizes the Company's net revenues, gross profit and gross margin by major product category for fiscal 2011 and fiscal 2010.

	<u>2011</u>	<u>2010</u>	<u>Percent Change</u>
<i>Catalog</i>			
Revenue	\$ 12,649	\$ 12,474	1.4%
Cost of revenue	1,546	1,621	-4.6%
Gross profit	11,103	10,853	2.3%
Gross margin percentage	87.8%	87.0%	
<i>Website</i>			
Revenue	5,025	5,305	-5.3%
Cost of revenue	1,120	1,012	10.7%
Gross profit	3,905	4,293	-9.0%
Gross margin percentage	77.7%	80.9%	
<i>Lead generation and management</i>			
Revenue	1,982	2,044	-3.0%
Cost of revenue	1,078	983	9.7%
Gross profit	904	1,061	-14.8%
Gross margin percentage	45.6%	51.9%	
<i>Other</i>			
Revenue	1,678	1,661	1.0%
Cost of revenue	663	737	-10.0%
Gross profit	1,015	924	9.8%
Gross margin percentage	60.5%	55.6%	
<i>Total</i>			
Revenue	21,334	21,484	-0.7%
Cost of revenue	4,407	4,353	1.2%
Gross profit	<u>\$ 16,927</u>	<u>\$ 17,131</u>	<u>-1.2%</u>
Gross margin percentage	79.3%	79.7%	

Total revenues for the fiscal year ended July 31, 2011 were \$21,334,000 compared to \$21,484,000 for the same period last year, a decline of 0.7%. Our fiscal 2011 revenues were negatively affected by the loss of non-cash deferred revenues related to the Channel Blade acquisition and the loss of revenues from our divested AgChem EDI business. Excluding the impact of these items, we experienced revenue growth of 4.0% for fiscal 2011, as shown in the table below (in thousands).

	<u>2011</u>	<u>2010</u>	<u>Percent Change</u>
Revenue as reported	\$ 21,334	\$ 21,484	-0.7%
Non-cash deferred revenue	(49)	(801)	-93.9%
AgChem EDI revenue	(275)	(481)	-42.8%
<b>Revenue, adjusted</b>	<u><u>\$ 21,010</u></u>	<u><u>\$ 20,202</u></u>	<u><u>4.0%</u></u>

The non-cash deferred revenues represent the amortization of a deferred revenue liability recorded at the time we acquired Channel Blade. As of July 31, 2011, this liability was fully amortized and these revenues will not recur in the future. As previously discussed, we divested our AgChem EDI business in March 2011. We recognized \$275,000 of revenues related to this business in fiscal 2011 prior to the divestiture, compared to revenues of \$481,000 for the full fiscal year 2010.

New sales, although down from fiscal 2010, remain strong and in fiscal 2011 we realized a significant improvement in our customer churn rates, both of which served to increase our MRR year over year by more than 30%. Given that a substantial portion of our revenues are subscription-based, MRR and churn are two performance indicators we closely monitor, as they represent the most significant drivers of future revenue growth.

#### *Catalog*

Catalog revenues are generated from software license fees, license renewal fees, software maintenance and support fees, catalog subscription fees, and professional services related to data conversion. Catalog revenues increased 1.4% in fiscal 2011, compared to fiscal 2010, resulting from improvements in our customer churn rates and new catalog sales. Management expects catalog subscriptions to remain the Company's most significant source of revenues and anticipates modest growth in this category for the foreseeable future.

#### *Website*

Website revenues are generated from set-up and recurring subscription fees on our website products, as well as transaction fees from our customers' online sales generated via the websites. Website revenues decreased 5.3% in fiscal 2011, compared to fiscal 2010. This decrease in revenue was due to the decline in non-cash deferred revenues previously discussed. All of these revenues were recorded in the website category. Excluding the recognition of these non-cash revenues, revenues from our website products increased 10.5%. Furthermore, the non-cash, non-recurring revenues in fiscal 2010 were replaced with cash-generating MRR in fiscal 2011. We expect to see continued sales growth in fiscal 2012 from our website products and for these products to be a long-term source of growth for the Company.

#### *Lead Generation and Management*

Lead generation revenues are realized from the sale of our SearchEngineSmart™ product, while lead management revenues are generated from set-up and subscription fees for the use of the Company's Footsteps™ product. Lead generation and management revenues decreased 3.0% in fiscal 2011, when compared to fiscal 2010. As previously discussed, the marine market was hard hit by the economy and we experienced an increase in customer churn rates on our Footsteps™ product in the latter half of fiscal 2010 due to the bankruptcies of several large marine manufacturers. This churn had a negative impact on fiscal 2011 revenues. Management expects our Footsteps™ product to be a significant driver of future growth for the Company, and anticipates the launch of a new platform of this product in fiscal 2012.

#### *Other Revenues*

Other revenues primarily consist of professional services related to software customization and website hosting fees, but also include revenues generated from other products that are ancillary to our three core offerings. Revenues from our divested AgChem EDI business were also included within this category. Other revenues increased 1.0% in fiscal 2011 compared to fiscal 2010. The main driver of this increase was a contracted website customization project with a large manufacturer in the power sports industry, offset in part by the loss of revenues related to our divested Agchem EDI business. Management anticipates that other revenues will fluctuate based on the timing of professional fees related to software customization, which tend to be opportunistic in nature.

#### *Cost of Revenues, Gross Profit and Gross Margin*

We classify as cost of revenues those costs that are directly attributable to the provision of services to our customers. These costs include:

*Software amortization*, which represents the periodic amortization of costs for internally developed or purchased software sold to our customers;

*Direct labor*, used in the provision of catalog and marketing professional services; and

*Other direct costs*, which represent amounts paid to third party vendors directly attributable to the services we provide our customers.

The table below breaks out fiscal 2011 and fiscal 2010 cost of revenues into each of these three expense categories (in thousands):

	<u>2011</u>	<u>Percent of Revenue</u>	<u>2010</u>	<u>Percent of Revenue</u>
Net revenues	\$ 21,334		\$ 21,484	
Cost of revenues:				
Amortization of capitalized software costs	1,127	5.3%	1,054	4.9%
Direct labor	1,272	6.0%	1,395	6.5%
Other direct costs	2,008	9.4%	1,904	8.9%
Total cost of revenues	<u>4,407</u>	<u>20.7%</u>	<u>4,353</u>	<u>20.3%</u>
<b>Gross profit</b>	<b><u>\$ 16,927</u></b>	<b><u>79.3%</u></b>	<b><u>\$ 17,131</u></b>	<b><u>79.7%</u></b>

Overall gross profit was \$16,927,000, or 79.3 % of revenue, in fiscal 2011, versus \$17,131,000, or 79.7% of revenue, in fiscal 2010. There was an increase in software amortization costs, as we began to amortize several new releases of our core products in fiscal 2011. We also experienced an increase in other direct costs related to royalties for the rights to sell certain catalog content. Overall gross margin was 79.3% in fiscal 2011, which was less than half of one percentage point lower than fiscal 2010. Management expects to see improvements in gross margin over time as we grow our subscription-based recurring revenues, which typically have a higher margin than our other products and services.

### Operating Expenses

The table below summarizes the Company's operating expenses by expense category for fiscal 2011 and fiscal 2010 (in thousands):

	<u>2011</u>	<u>Percent of Revenue</u>	<u>2010</u>	<u>Percent of Revenue</u>	<u>Percent Change</u>
Sales and marketing	\$ 4,272	20.0%	\$ 4,786	22.3%	-10.7%
Customer operations and support (1)	3,439	16.1%	3,469	16.1%	-0.9%
Software development and technical support (2)	1,543	7.2%	1,415	6.6%	9.0%
General and administrative	4,252	19.9%	4,879	22.7%	-12.9%
Restructuring	-	0.0%	437	2.0%	n/a
Depreciation and amortization (3)	1,688	7.9%	1,640	7.6%	2.9%
<b>Net operating expenses</b>	<b><u>\$ 15,194</u></b>	<b><u>71.2%</u></b>	<b><u>\$ 16,626</u></b>	<b><u>77.4%</u></b>	<b><u>-8.6%</u></b>

(1) Net of capitalized software development costs of \$191 and \$81 in fiscal 2011 and fiscal 2010, respectively.

(2) Net of capitalized software development costs of \$1,474 and \$1,247 in fiscal 2011 and fiscal 2010, respectively.

(3) Exclusive of amortization of software products of \$1,127 and \$1,054 in fiscal 2011 and fiscal 2010, respectively, which are included in cost of revenue.

Net operating expenses were \$15,194,000 in fiscal 2011, a decrease of \$1,432,000, or 8.6%, from fiscal 2010. As part of our strategy to streamline the business and focus on our three core offerings, we undertook a workforce reduction and business improvement initiative, which included the divestiture of AFIS, the write off of certain assets related to non-core operations, and a small headcount reduction in July 2010. We incurred a charge of \$437,000 in fiscal 2010 related to this initiative. This initiative, coupled with the economies realized from the Channel Blade acquisition and a continued focus on cost reduction and operational efficiencies, is reflected in the decrease in net operating expenses in fiscal 2011.

### *Sales and Marketing Expenses*

Sales and marketing expenses consist primarily of personnel and related costs, including sales commissions, for our sales and marketing employees, and also include the cost of marketing programs and trade show attendance. Marketing programs consist of lead generation and direct marketing, advertising, events and meeting costs, public relations, brand building and product management activities. Sales and marketing expenses decreased 10.7% in fiscal 2011, when compared to fiscal 2010. As a percentage of revenue, sales and marketing expenses declined from 22.3% in fiscal 2010 to 20.0% in fiscal 2011, driven in part by a reduction in commission expense that resulted from the previously-mentioned sales decline.

We measure the returns realized through our sales teams with the customer acquisition cost (“CAC”) ratio, one of Bessemer Venture Partners’ “6C’s of Cloud Finance.” We experienced an improvement in our CAC ratios during fiscal 2011, compared to the same period last year, which means that we are generating more margin for each sales and marketing dollar spent. These improvements in CAC were achieved by refining our sales incentive programs to better align them with our core strategy of MRR growth, as well as achieving operating efficiencies and close management of discretionary sales and marketing spending. Sales and marketing will continue to be one of our largest expenses, as we intend to continue to invest in sales and marketing to grow our customer base and expand relationships with our existing customers. However, management expects sales and marketing costs to gradually decline as a percentage of revenues over time.

### *Customer Operations and Support*

Customer operations and support expenses are composed of server room operations, software maintenance agreements for our core network, and personnel and related costs for our operations and support employees. Customer operations and support costs remained relatively the same in fiscal 2011, compared to last year. Management expects customer operations and support costs to decline as a percentage of revenue in future years as we continue to consolidate our data centers into one centralized facility, while retaining the appropriate backup facilities.

### *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 are typically capitalized as software product costs and amortized over the estimated useful lives of the product; (ii) professional services performed for customers related to software customization projects are classified as cost of revenues; and (iii) all other activities are considered operating expenses and included within the software development and technical support operating expense category.

The table below summarizes the breakdown of our total software development and technical support spending (in thousands):

	<u>2011</u>	<u>2010</u>	<u>Percent Change</u>
Total software development and technical support costs	\$ 4,480	\$ 4,138	8.26%
Less: amount capitalized as software development	(1,665)	(1,328)	25.38%
Less: direct labor classified as cost of revenues	<u>(1,272)</u>	<u>(1,395)</u>	<u>-8.82%</u>
<b>Net software development and technical support costs classified as operating expenses</b>	<b><u>\$ 1,543</u></b>	<b><u>\$ 1,415</u></b>	<b><u>9.05%</u></b>

We increased our total software development and technical support costs by \$330,000, or 7.95%, in fiscal 2011, compared to the same period last year, which is consistent with our strategy to release new products and enhancements to existing products. We expect fluctuations in the amount of software development and technical support costs classified as operating expenses from period to period, as the mix of development and customization activities will change based on customer requirements, even if total software development and technical support departmental costs remain relatively constant.

During fiscal 2011, we capitalized \$1,665,000 of software development labor and overhead, versus \$1,340,000 last year. As discussed earlier, we completed several significant product upgrades and enhancements during fiscal 2011 and are working on several new enhancements expected to be released in the upcoming quarter, which we anticipate will increase future revenues for the Company.

Management expects total spending for software development and technical support to continue to increase in fiscal 2012 as we continue to focus on our core strategy of product enhancement and innovation.

#### *General and Administrative*

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. General and administrative costs declined \$627,000, or 12.9%, in fiscal 2011. As a percentage of revenue, general and administrative expenses declined from 22.7% in fiscal 2010 to 19.9% in fiscal 2011.

This improvement can be attributed to the various cost reduction and business improvement initiatives implemented over the last several years as well as efficiencies realized from the integration of the Channel Blade operations. Management expects general and administrative expenses to remain relatively flat in fiscal 2012 and to continue to decline, as a percentage of revenues, in fiscal 2012 and beyond as the business continues to grow and the Company leverages its reduced cost structure.

#### *Depreciation and Amortization*

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 assets are a component of cost of revenues. Depreciation and amortization expense remained relatively flat in fiscal 2011.

#### *Restructuring*

As discussed previously, in July 2010 the Company undertook a workforce reduction and business improvement initiative, which included the divestiture of AFIS, the write off of certain assets related to non-core operations, and a headcount reduction. The Company incurred restructuring charges of \$437,000 related to this initiative. The results of operations of AFIS were reclassified as a discontinued operation in the Company's consolidated financial statements. All remaining payment obligations related to severance and net future lease costs were paid in fiscal 2011.

#### **Interest Expense**

Interest expense was \$790,000 in fiscal 2011, versus \$649,000 in fiscal 2010. On April 27, 2010, the interest rate on our term note, which resulted from the April 2009 acquisition of Channel Blade, increased from 10% to 14%. Management expects a significant reduction in interest expense beginning in fiscal 2012. On July 27, 2011 we entered into a Loan and Security Agreement (described in Note 4 to the consolidated financial statements) with Fifth Third Bank ("Fifth Third"), the proceeds of which were used to pay off the Channel Blade note in full. The note bears interest at a rate based on the one, two, three or six month LIBOR (as selected by the Company on the last business day of each month) plus 4.0%, and matures on July 27, 2014. The effective interest rate on the note was 4.21% at July 31, 2011.

#### **Income Taxes**

As of July 31, 2011, we had unused net operating loss carryforwards ("NOLs") for federal income tax purposes of \$13,092,000 expiring between 2012 and 2030, and as such generally only incur alternative minimum taxes.

We performed an assessment as of July 31, 2011 of the likelihood that the remaining NOLs included in our net deferred tax assets will be realized from future taxable income. The assessment resulted in a change in estimate of \$1,967,000 less tax expense, or \$0.25 per basic and diluted common share. This change was due to an improvement in our forecasted U.S. net income before taxes and a change in our tax strategy related to the treatment of capitalized software product costs. Refer to Note 11 of the consolidated financial statements for further discussion.

## Discontinued Operations

On July 27, 2010 we sold AFIS, which offered dealer finance and insurance services, to F&I Smart LLC, recording a loss on the divestiture of \$1,000. The results of operations of AFIS have been reflected as a discontinued operation in our consolidated financial statements for all periods presented. The results of operations of AFIS were previously reported within the United States business segment. The following table summarizes the results of operations of AFIS, included in discontinued operations for the fiscal years ended July 31 (in thousands):

	<u>2011</u>	<u>2010</u>
Revenues	\$ -	\$ 136
Cost of sales	-	13
Operating expenses	-	776
Operating loss	-	(653)
Gain (loss) on sale	40	(1)
Income tax benefit (provision) (1)	(15)	262
<b>Net gain (loss)</b>	<b><u>\$ 25</u></b>	<b><u>\$ (392)</u></b>

(1) Net of recorded deferred income tax asset valuation allowance

## Liquidity and Capital Resources

The following table sets forth, for the periods indicated, certain cash flow information derived from the Company's financial statements (in thousands):

	<u>2011</u>	<u>2010</u>	<u>Percent Change</u>
Net cash provided by operating activities	\$ 3,471	\$ 1,624	113.7%
Net cash used in investing activities	(2,293)	(1,891)	21.3%
Net cash provided by (used in) financing activities	(977)	550	-277.6%
Effect of foreign currency exchange rate changes on cash	(5)	5	-200.0%
<b>Net change in cash</b>	<b><u>\$ 196</u></b>	<b><u>\$ 288</u></b>	<b><u>-31.9%</u></b>
<b>Cash at end of period</b>	<b><u>\$ 1,134</u></b>	<b><u>\$ 938</u></b>	<b><u>20.9%</u></b>

### Cash

At July 31, 2011, the Company had cash balances of \$1,134,000, compared to \$938,000 at July 31, 2010. Total cash flows declined from \$288,000 in fiscal 2010 to \$196,000 in fiscal 2011, as we used our increased cash flows from operations to pay down nearly \$1,000,000 in debt and continue to invest in product development.

Net cash provided by operations more than doubled in fiscal 2011, compared to fiscal 2010, due to several factors:

- (i) a greater portion of our revenues in fiscal 2011 resulted in cash collected, as the \$801,000 of revenues recognized in fiscal 2010 related to the amortization of the deferred revenue liability incurred with the acquisition of Channel Blade were non-cash revenues;
- (ii) our accounts receivable collections have improved as we expanded our efforts and made process improvements in this area;
- (iii) we sold the AFIS business, which generated pre-tax operating losses of \$654,000 in fiscal 2010;
- (iv) our operating expenses continued to decline as we focus on efficiencies throughout the organization; and
- (v) the Channel Blade acquisition has been fully integrated into the organization.

We invested more cash into the business in fiscal 2011 than we did in fiscal 2010. Fiscal 2011 cash used in investing activities was \$2,293,000, compared with \$1,891,000 in fiscal 2010. We continue to invest cash in the business, primarily for the development of new products and upgrades of existing products, as well as upgrading our technology infrastructure as part of our efforts to consolidate our data centers. These efforts will result in our primary data center being located in a Tier III (as defined by the Uptime Institute's tier classification system) hosted facility in Madison, Wisconsin with one internally-hosted backup data center. Although we will continue to invest in the business, management expects cash used in investing activities to fluctuate from period to period based on the level of software development activities as well as the timing of other capital expenditures.

We used cash for financing activities of \$977,000 in fiscal 2011; in fiscal 2010 we generated cash from financing activities of \$550,000. We used a significant portion of the cash generated from operating activities in fiscal 2011 to pay down outstanding debt.

Management believes that current cash balances and its ability to generate cash from operations, as well as the existing availability under the Company's line of credit with Fifth Third, are sufficient to fund the Company's needs over the next twelve months.

#### Debt

On July 9, 2004, we entered into a line of credit agreement with JPMorgan Chase, N.A. (the "Chase Line") which, as amended, permitted us to borrow an amount equal to 80% of the book value of all eligible accounts receivable plus 45% of the value of all eligible open renewal orders (provided the renewal rate was at least 85%) minus \$75,000, up to \$2,000,000. The agreement bore interest at 1% per annum above the prime rate plus an additional 3%, at the bank's option, upon the occurrence of any default under the note. There was \$1,025,000 outstanding on the Chase Line at July 31, 2010 and the line was paid in full and terminated on July 27, 2011.

On July 27, 2011, ARI entered into a Loan and Security Agreement (the "Agreement") with Fifth Third, filed as exhibit 10.1 on the Company's Form 8-K on July 28, 2011. Pursuant to the terms of the Agreement, Fifth Third extended to the Company credit facilities consisting of a \$1,500,000 revolving credit facility (the "Revolving Loan") and a \$5,000,000 three year term loan facility (the "Term Loan"). Each of the credit facilities bears interest at a rate based on the one, two, three or six month LIBOR (as selected by the Company on the last business day of each month) plus 4.0% (effective rate of 4.21% at July 31, 2011). In connection with this Agreement, the Chase Line and all other banking relationships between ARI and JP Morgan Chase, N.A. were terminated. There was \$245,000 outstanding on the Revolving Loan as of July 31, 2011.

The Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to incur new debt, create liens on its assets, make certain investments, enter into merger transactions, issue capital securities and make distributions to its shareholders. Financial covenants include a minimum fixed charge coverage ratio, as defined in the Agreement, of 1.2, and a senior leverage (maximum senior funded indebtedness to EBITDA) ratio, as defined in the Agreement, of 2.0. The Agreement also contains customary events of default which, if triggered, could result in an acceleration of the Company's obligations under the Agreement. The Credit Facilities are secured by a first priority security interest in substantially all assets of the Company and by a first priority pledge of all outstanding equity securities of each of the Company's domestic subsidiaries and 65% of outstanding equity securities of the Company's foreign subsidiary.

Long-term debt consisted of the following at July 31, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Notes payable:		
Channel Blade Technologies	\$ -	\$ 5,000
Fifth Third Bank	<u>5,000</u>	<u>-</u>
Total long-term debt	5,000	5,000
Less current maturities	<u>(917)</u>	<u>-</u>
<b>Long-term debt, non-current</b>	<b><u>\$ 4,083</u></b>	<b><u>\$ 5,000</u></b>

Principal and interest on the new Term Loan will be repaid in fixed monthly principal installments of \$83,333 plus accrued but unpaid interest on the unpaid principal balance commencing on September 1, 2011 through July 1, 2014, with a final balloon payment due July 27, 2014. Mandatory prepayments of the Credit Facilities will be required in the amount of 50% of the Company's excess cash flow for the six-month periods ending January 31, 2012 and July 31, 2012 and for each fiscal year thereafter. Excess cash flow is defined as the remainder of net income plus interest, taxes, depreciation and amortization expense for such period, minus cash taxes paid, capital expenditures incurred, capitalized software costs and scheduled payments of principal and interest charges.

## Acquisitions

Since 1995 the Company has had a formal corporate development program aimed at identifying, evaluating and closing acquisitions that augment and strengthen the Company's market position, product offerings, and personnel resources. Since the program's inception, nine business acquisitions and one software asset acquisition have been completed. All of these acquisitions have been fully integrated into the Company's operations.

On April 27, 2009, the Company acquired substantially all of the assets of Channel Blade Technologies, the leading provider of websites, lead management and marketing automation solutions in the marine and RV markets. Consideration for the acquisition included approximately \$500,000 in cash, 615,385 shares of the Company's common stock at a market price of \$0.75 per share, \$765,000 of assumed liabilities and a \$5,000,000 note payable. The Company included the results of operations of Channel Blade in its consolidated financial statements for all periods presented.

On April 17, 2009, AFIS acquired the assets of Powersports Outsourcing Group, valued at approximately \$85,000, in partial satisfaction of its debt to ARI of approximately \$185,000, \$149,000 of which we purchased from Keybank National Association on April 16, 2009. PSOG, located in Schenectady, NY and then led by Mark L. Taylor, had been offering outsourced F&I services to power sports, marine and RV customers in the Northeast United States since 1998. In connection with the acquisition, AFIS entered into a three year employment agreement with Mr. Taylor to serve as Director of F&I Business Development. Effective March 8, 2010, ARI and Mr. Taylor terminated the employment agreement and entered into an arrangement pursuant to which Mr. Taylor continued to provide any necessary transitional services to the Company for six months following the effective date. This agreement has expired.

On July 27, 2010, ARI sold all of the equity interests in AFIS to F&I Smart LLC (the "Subject Interests") in a membership interest sale agreement. The sales price of the Subject Interests is a contingent amount based on dealer revenue beginning July 28, 2010 and ending on August 28, 2013. We have not accrued for any future contingent proceeds as we are not able to estimate the amounts at this time. The Company recognized a \$1,000 loss on the sale of AFIS in the fourth quarter of fiscal 2010.

## Critical Accounting Judgments

The Company's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformance with GAAP requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified as the most critical accounting policies and judgments those addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, refer to Note 1 of the consolidated financial statements, which appear elsewhere within this report on Form 10-K. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information currently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

### *Revenue Recognition*

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential include customizing complex features and functionality in a product's base software code or developing complex interfaces within a customer's environment. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When professional services are considered essential, revenue under the arrangement is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined.

### *Allowance for Doubtful Accounts*

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company currently estimates a reserve for most amounts due over 90 days, unless there is reasonable assurance of collectability. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### *Impairment of Long-Lived Assets*

Equipment and leasehold improvements, capitalized software product costs and other identifiable assets are reviewed for impairment annually, or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. During fiscal 2011 and fiscal 2010, the Company disposed of equipment and leasehold improvements with a cost basis of \$371,000 and \$1,220,000, respectively and recorded a loss on disposal of \$0 and \$10,000, respectively.

In fiscal 2010, the Company incurred an impairment charge of \$48,000 on capitalized software, with a cost basis of \$208,000, which was disposed of, and an additional impairment charge of \$141,000 on assets that are still in use. These impairment charges are included in restructuring costs on the statement of operations. The Company did not incur any software impairment charges in fiscal 2011.

### *Deferred Income Taxes*

The tax effect of the temporary differences between the book and tax basis of assets and liabilities and the estimated tax benefit from tax net operating losses is reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed. 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 statement of income. We recognized a tax benefit of \$1,017,000 and \$1,294,000 from continuing operations in fiscal 2011 and fiscal 2010, respectively, both of which primarily resulted from a change in our estimated tax valuation allowance.

### *Stock-Based Compensation*

The Company uses the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. As stock-based compensation expense recognized in our results of operations is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures based on our historical experience. Management reviews the critical assumptions used in the Black-Scholes model each quarter and adjusts those assumptions when necessary.

### *Goodwill and Other Intangible Assets*

As fully described in note 1 to the Consolidated Financial Statements, we periodically review the carrying value of goodwill to determine whether an impairment may exist. We determined that there is a single reporting unit for the purpose of goodwill impairment tests. We estimate the fair value of the reporting unit using various valuation techniques, with our primary techniques being a discounted cash flow valuation and control premium adjusted market capitalization. There are many estimates and assumptions involved in preparing a discounted cash flow analysis, including estimating future operating results, selecting a weighted average cost of capital to discount estimated future cash flows, anticipated long-term growth rates, and future profit margins.

Estimating the fair value of a reporting unit is an inherently subjective process. Changes in assumptions, estimates, and other inputs could result in the indication of potential impairment of a portion of the recorded goodwill. Management believes the assumptions, estimates, and other inputs used reflect their best efforts and are appropriate for valuing the reporting unit. Our goodwill impairment test indicated that goodwill was not impaired in fiscal 2011 or fiscal 2010.

Impairment tests are also performed for those intangible assets with estimable useful lives if circumstances warrant a review. Due to the restructuring in the fourth quarter of fiscal 2010, the Company performed an impairment test on intangible assets with definite lives using estimated future cash flows from these assets for the remainder of their useful lives in fiscal 2010. There were no impairments to intangible assets with estimable useful lives as a result of this test. There were no circumstances to warrant a review of intangible assets with estimable useful lives in fiscal 2011.

### *Earn-out Receivable*

As part of the purchase price for the disposition of a component of the business, we recorded an earn-out receivable with anticipated payments to ARI annually over a four-year period following the closing date. The earn-out was recorded at fair value, which was the estimated future receipts less an imputed discount, based on the present value of the estimated earn-out payments, discounted at an

imputed interest rate at the time the note is issued and any subsequent changes in prevailing interest rates shall be ignored. Imputed interest is amortized to interest income over the life of the earn-out.

### Quarterly Financial Data

The following table sets forth the unaudited results of operations for each of the eight quarterly periods ended July 31, 2011, prepared on a basis consistent with the audited financial statements, reflecting all normal recurring adjustments that are considered necessary. The quarterly information is as follows (in thousands, except per share data):

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	2011	2010	2011	2010	2011	2010	2011	2010
Net revenues	\$ 5,324	\$ 5,437	\$ 5,238	\$ 5,334	\$ 5,354	\$ 5,352	\$ 5,418	\$ 5,361
Gross margin	4,157	4,486	4,152	4,361	4,259	4,232	4,359	4,052
Income from continuing operations	99	325	123	339	516	155	1,680	350
Discontinued operations	-	(163)	-	(163)	25	(129)	-	63
Net income (loss)	\$ 99	\$ 162	\$ 123	\$ 176	\$ 541	\$ 26	\$ 1,680	\$ 413
Basic and diluted income from continuing operations per common share:								
Basic	\$ 0.01	\$ 0.04	\$ 0.02	\$ 0.04	\$ 0.07	\$ 0.02	\$ 0.21	\$ 0.05
Diluted	\$ 0.01	\$ 0.04	\$ 0.02	\$ 0.04	\$ 0.07	\$ 0.02	\$ 0.21	\$ 0.05
Basic and diluted net income per common share:								
Basic	\$ 0.01	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.07	\$ 0.00	\$ 0.21	\$ 0.05
Diluted	\$ 0.01	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.07	\$ 0.00	\$ 0.21	\$ 0.06

### Off-Balance Sheet Arrangements

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

### Item 8. Financial Statements and Supplementary Data

Reference is made to the consolidated financial statements, the reports thereon and the notes thereto commencing after the signature page of this Report, which are incorporated herein by reference.

### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

### Item 9A. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, as amended, is recorded, processed, summarized, and reported within the required time periods and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, we have completed an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness and the design and operation of our disclosure controls and procedures as of July 31, 2011. Based upon this evaluation, our management, including the Chief Executive Officer and the Chief Financial Officer, has concluded that our disclosure controls and procedures were effective as of July 31, 2011.

#### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and the Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control over Financial Reporting – Guidance for Smaller Public Companies issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under this framework, our management concluded that our internal control over financial reporting was effective as of July 31, 2011.

This Annual Report on Form 10-K does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Internal control over financial reporting was not subject to attestation by our independent registered public accounting firm pursuant to the amendments to Rule 2-02(f) of Regulation S-X that exempt us from this attestation requirement based on our status as a non-accelerated filer. We are required to provide only management’s report in this Annual Report on Form 10-K.

#### *Changes in Internal Controls*

There were no changes to the Company’s internal control over financial reporting during the year ended July 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

#### *Limitations on Effectiveness of Controls and Procedures*

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include, but are not limited to, the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

## **PART III**

### **Item 10. *Directors, Executive Officers, and Corporate Governance***

Information required by Item 10 of Part III is included in our Proxy Statement relating to our 2011 Annual Meeting of Shareholders, and is incorporated herein by reference.

### **Item 11. *Executive Compensation***

Information required by Item 11 of Part III is included in our Proxy Statement relating to our 2011 Annual Meeting of Shareholders, and is incorporated herein by reference.

### **Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by Item 12 of Part III is included in our Proxy Statement relating to our 2011 Annual Meeting of Shareholders, and is incorporated herein by reference.

### **Item 13. *Certain Relationships and Related Transactions***

Information required by Item 13 of Part III is included in our Proxy Statement relating to our 2011 Annual Meeting of Shareholders, and is incorporated herein by reference.

### **Item 14. *Principal Accounting Fees and Services***

Information required by Item 14 of Part III is included in our Proxy Statement relating to our 2011 Annual Meeting of Shareholders, and is incorporated herein by reference.

## PART IV

### Item 15. Exhibits

2.1	Asset Purchase Agreement dated March 1, 2011 between ARI Network Services, Inc. and Globalrange Corporation, incorporated herein by reference to Exhibit 2.1 to the Form 8-K filed on March 4, 2011.
3.1	Articles of Incorporation of the Company, as amended, incorporated herein by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 1999.
3.2	Articles of Amendment of the Company, incorporated herein by reference to Exhibit 3.2 of Form 8-K filed on August 18, 2003.
3.3	By-laws of the Company incorporated herein by reference to Exhibit 3.1 of the Company's Registration Statement on Form S-1 (Reg. No. 33-43148).
4.2	The Company agrees to furnish to the Commission upon request copies of any agreements with respect to long term debt not exceeding 10% of the Company's consolidated assets.
10.1	Rights Agreement dated as of August 7, 2003, between the Company and American Stock Transfer & Trust Company, as Rights Agent, incorporated herein by reference to Exhibit 10.1 of Form 8-K filed on August 18, 2003.
10.2 *	Summary of Executive Bonus Arrangements (Fiscal 2011).
10.3	Credit Agreement dated July 9, 2004 between the Company and Bank One, NA, incorporated by reference to exhibit 10.14 of the Company's Form 10-K for the year ended July 31, 2004.
10.4	Amendment to Credit Agreement dated February 15, 2005, between the Company and JPMorgan Chase Bank, NA, successor by merger to Bank One, NA., incorporated herein by reference to Exhibit 10.14 of the Company's Form 10-KSB for the fiscal year ended July 31, 2005.
10.5	Continuing Security Agreement dated July 9, 2004, between the Company and JPMorgan Chase Bank, NA, successor by merger to Bank One, NA., incorporated by reference to Exhibit 10.15 of the Company's Form 10-KSB for the year ended July 31, 2004.
10.6	Line of credit note dated July 9, 2004 by the Company for \$500,000, incorporated by reference to exhibit 10.16 of the Company's Form 10-KSB for the year ended July 31, 2005.
10.7	Note Modification Agreement dated February 15, 2005 to the Line of Credit Note dated July 9, 2004 by the Company for \$500,000, incorporated herein by reference to Exhibit 10.17 of the Company's Form 10-KSB for the fiscal year ended July 31, 2005.
10.8	Note Modification Agreement dated October 26, 2006, to the Line of Credit Note dated July 9, 2004 by the Company for \$1,000,000, incorporated herein by reference to Exhibit 10.1 of the Company's Form 8-K filed on October 31, 2006.
10.9	Note Modification Agreement dated April 25, 2006 to the Line of Credit Note dated July 9, 2004 by the Company for \$500,000, incorporated herein by reference to Exhibit 10.16 of the Company's Form 10-KSB for the fiscal year ended July 31, 2006.
10.10	First Amendment to Rights Agreement dated November 10, 2005, between the Company and American Stock Transfer & Trust Company, as Rights Agent, incorporated by reference to Exhibit 10.1 of Form 8-K filed on November 14, 2005.
10.11	Amendment to Credit Agreement dated May 10, 2007, between the Company and JP Morgan Chase Bank, NA, successor by merger to Bank One, NA, incorporated by reference to the Company's Form 10-QSB for the quarter ended April 30, 2007.
10.12	Note Modification Agreement dated May 10, 2007, between the Company and JP Morgan Chase Bank, NA, successor by merger to Bank One, NA, incorporated by reference to the Company's Form 10-QSB for the quarter ended April 30, 2007.
10.13	Note Modification Agreement dated April 25, 2008, between the Company and JP Morgan Chase Bank, NA, successor by merger to Bank One, NA.
10.14	Credit Agreement Amendment dated April 6, 2009, incorporated by reference to Form 10-Q for the quarter ended April 30, 2009.
10.15	Credit Agreement Amendment dated April 8, 2010, between the Company and JP Morgan Chase Bank, NA, incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on June 18, 2010.
10.16*	Change of Control Agreement dated September 13, 2006 between the Company and Roy W. Olivier, incorporated by reference to Exhibit 10.3 of the Company's Form 10-QSB for the quarter ended October 31, 2007.

10.17*	Employment Agreement dated May 1, 2008 between the Company and Roy W. Olivier, incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed on May 2, 2008.
10.18*	Amendment to Change of Control Agreement dated May 2, 2008, by and between ARI Network Services, Inc. and Roy W. Olivier.
10.19*	Employment Agreement dated December 10, 2010 between Darin R. Janacek and the Company, incorporated herein by reference to Exhibit 10.1 to the Form 8-K filed on December 16, 2010.
10.20*	Change of Control Agreement dated December 10, 2010 between Darin R. Janacek and the Company, incorporated herein by reference to Exhibit 10.2 to the Form 8-K filed on December 16, 2010.
10.21*	ARI Network Services, Inc. 2010 Equity Incentive Plan, incorporated herein by reference to Exhibit 10.1 to the Form 8-K filed on December 22, 2010.
10.22*	ARI Network Services, Inc. 2000 Employee Stock Purchase Plan, as Amended and Restated November 4, 2010, incorporated herein by reference to Exhibit 10.2 to the Form 8-K filed on December 22, 2010.
10.23	Loan and Security Agreement dated as of July 27, 2011 by and between ARI Network Services, Inc. and Fifth Third Bank, incorporated herein by reference to Exhibit 10.1 to the Form 8-K filed on July 28, 2011.
10.24	Membership Interests Security Agreement dated as of July 27, 2011 by ARI Network Services, Inc. to and in favor of Fifth Third Bank, incorporated herein by reference to Exhibit 10.2 to the Form 8-K filed on July 28, 2011.
21.1	Subsidiaries of the Company.
23.1	Consent of Wipfli LLP.
24.1	Powers of Attorney appear on the signature page hereof.
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.

*\*Indicates Management Contract or Compensatory Plan or Agreement.*



**Report of Wipfli LLP,  
Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders  
ARI Network Services, Inc.

We have audited the accompanying consolidated balance sheets of ARI Network Services, Inc. and Subsidiaries (the Company) as of July 31, 2011 and 2010 and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 31, 2011 and 2010 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

/s/ Wipfli LLP  
Milwaukee, Wisconsin  
October 31, 2011

## **Consolidated Financial Statements**

ARI Network Services, Inc.

Years ended July 31, 2011 and 2010

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

	<u>July 31</u> <u>2011</u>	<u>July 31</u> <u>2010</u>
Current assets:		
Cash and cash equivalents	\$ 1,134	\$ 938
Trade receivables, less allowance for doubtful accounts of \$383 and \$565 at July 31, 2011 and 2010, respectively	1,179	1,359
Work in process	169	133
Prepaid expenses and other	802	481
Deferred income taxes	<u>2,693</u>	<u>2,600</u>
<i>Total current assets</i>	5,977	5,511
Equipment and leasehold improvements:		
Computer equipment and software for internal use	2,304	1,883
Leasehold improvements	558	506
Furniture and equipment	<u>2,000</u>	<u>1,970</u>
	4,862	4,359
Less accumulated depreciation and amortization	<u>2,988</u>	<u>2,433</u>
<i>Net equipment and leasehold improvements</i>	1,874	1,926
Capitalized software product costs:		
Amounts capitalized for software product costs	16,693	15,919
Less accumulated amortization	<u>13,878</u>	<u>13,524</u>
<i>Net capitalized software product costs</i>	2,815	2,395
Deferred income taxes	2,607	1,616
Other long term assets	346	63
Other intangible assets	2,041	2,827
Goodwill	<u>5,439</u>	<u>5,439</u>
<b>Total assets</b>	<b><u>\$ 21,099</u></b>	<b><u>\$ 19,777</u></b>

See accompanying notes

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

	<b>July 31 2011</b>	<b>July 31 2010</b>
Current liabilities:		
Current borrowings on line of credit	\$ 245	\$ 1,025
Current portion of long-term debt	917	-
Accounts payable	561	490
Deferred revenue	5,282	5,270
Accrued payroll and related liabilities	1,264	1,322
Accrued taxes	106	60
Other accrued liabilities	473	844
Current portion of capital lease obligations	127	192
<i>Total current liabilities</i>	8,975	9,203
Non-current liabilities:		
Long-term debt	4,083	5,000
Long-term portion of accrued compensation	-	17
Capital lease obligations	210	338
<i>Total non-current liabilities</i>	4,293	5,355
<b>Total liabilities</b>	<b>13,268</b>	<b>14,558</b>
Shareholders' equity:		
Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at July 31, 2011 and 2010, respectively	-	-
Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at July 31, 2011 and 2010, respectively	-	-
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 7,901,774 and 7,768,921 shares issued and outstanding at July 31, 2011 and 2010, respectively	8	8
Common stock warrants and options	1,092	983
Additional paid-in capital	95,834	95,748
Accumulated deficit	(89,064)	(91,507)
Other accumulated comprehensive loss	(39)	(13)
<b>Total shareholders' equity</b>	<b>7,831</b>	<b>5,219</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 21,099</b>	<b>\$ 19,777</b>

See accompanying notes

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

	<u>2011</u>	<u>2010</u>
Net revenue	\$ 21,334	\$ 21,484
Cost of revenue	<u>4,407</u>	<u>4,353</u>
Gross profit	16,927	17,131
Operating expenses:		
Sales and marketing	4,272	4,786
Customer operations and support	3,439	3,469
Software development and technical support (net of capitalized software product costs)	1,543	1,415
General and administrative	4,252	4,879
Restructuring	-	437
Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue)	<u>1,688</u>	<u>1,640</u>
Net operating expenses	<u>15,194</u>	<u>16,626</u>
Operating income	1,733	505
Other income (expense):		
Interest expense	(790)	(649)
Gain on sale of a component of the business	433	-
Other, net	<u>25</u>	<u>19</u>
Total other income (expense)	<u>(332)</u>	<u>(630)</u>
Income (loss) from continuing operations before provision for income tax	1,401	(125)
Income tax benefit (expense)	<u>1,017</u>	<u>1,294</u>
Income from continuing operations	2,418	1,169
Discontinued operations, net of tax	<u>25</u>	<u>(392)</u>
<b>Net income</b>	<b><u>\$ 2,443</u></b>	<b><u>\$ 777</u></b>
Income from continuing operations per common share:		
Basic	<u>\$ 0.31</u>	<u>\$ 0.15</u>
Diluted	<u>\$ 0.31</u>	<u>\$ 0.15</u>
Net income per common share:		
Basic	<u>\$ 0.31</u>	<u>\$ 0.10</u>
Diluted	<u>\$ 0.31</u>	<u>\$ 0.10</u>

See accompanying notes

**ARI Network Services, Inc.**  
**Consolidated Statements of Shareholders' Equity**  
(Dollars in Thousands)

	Common Stock			Paid-in Capital	Accumulated Deficit	Other Accumulated Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares Issued and Outstanding	Par Value	Warrants & Options				
<b>Balance July 31, 2009</b>	<b>7,693,510</b>	<b>\$ 8</b>	<b>\$ 816</b>	<b>\$ 95,681</b>	<b>\$ (92,284)</b>	<b>\$ (34)</b>	<b>\$ 4,187</b>
Stock-based compensation	-	-	167	-	-	-	167
Issuance of common stock under company 401(k) plan	58,332	-	-	52	-	-	52
Issuance of common stock under executive bonus plan	10,495	-	-	10	-	-	10
Issuance of common stock under stock purchase plan	6,584	-	-	5	-	-	5
Subtotal	<u>75,411</u>	<u>-</u>	<u>167</u>	<u>67</u>	<u>-</u>	<u>-</u>	<u>234</u>
Net Income					777		777
Foreign currency translation adjustments						21	21
Comprehensive income							798
<b>Balance July 31, 2010</b>	<b>7,768,921</b>	<b>\$ 8</b>	<b>\$ 983</b>	<b>\$ 95,748</b>	<b>\$ (91,507)</b>	<b>\$ (13)</b>	<b>\$ 5,219</b>
Stock-based compensation	-	-	109	-	-	-	109
Issuance of common stock under company 401(k) plan	86,739	-	-	60	-	-	60
Issuance of common stock under executive bonus plan	33,140	-	-	20	-	-	20
Issuance of common stock under stock purchase plan	12,174	-	-	5	-	-	5
Issuance of common stock from exercise of stock options	800	-	-	1	-	-	1
Subtotal	<u>132,853</u>	<u>-</u>	<u>109</u>	<u>86</u>	<u>-</u>	<u>-</u>	<u>195</u>
Net Income					2,443		2,443
Foreign currency translation adjustments						(26)	(26)
Comprehensive income							2,417
<b>Balance July 31, 2011</b>	<b>7,901,774</b>	<b>\$ 8</b>	<b>\$ 1,092</b>	<b>\$ 95,834</b>	<b>\$ (89,064)</b>	<b>\$ (39)</b>	<b>\$ 7,831</b>

Shareholders' Equity includes cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding for all periods presented.

Shareholders' Equity includes junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding for all periods presented.

See accompanying notes

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

	<u>2011</u>	<u>2010</u>
<b>Operating activities</b>		
Net income	\$ 2,443	\$ 777
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of software products	1,127	1,054
Impairment of software products	-	189
Amortization of interest income related to present value of earnout	(19)	-
Depreciation and other amortization	1,688	1,640
Loss on disposal of equipment	-	10
Gain on disposal of a component of the business	(433)	-
Loss on disposal of discontinued operations	-	1
Provision for bad debt allowance	73	287
Deferred income taxes	(1,084)	(1,562)
Stock based compensation related to stock options	109	167
Stock issued as contribution to 401(k) plan	60	52
Net change in assets and liabilities:		
Trade receivables	73	(301)
Work in process	(36)	10
Prepaid expenses and other	(131)	(160)
Other long term assets	(89)	(4)
Accounts payable	26	(288)
Deferred revenue	49	(253)
Accrued payroll and related liabilities	(59)	(87)
Accrued taxes	46	(22)
Other accrued liabilities	(372)	114
<i>Net cash provided by operating activities</i>	<u>3,471</u>	<u>1,624</u>
<b>Investing activities</b>		
Purchase of equipment, software and leasehold improvements	(670)	(541)
Cash received from disposition of a component of the business	118	-
Cash surrendered in disposal of discontinued operations	-	(10)
Software developed for internal use	(194)	(99)
Software development costs capitalized	(1,547)	(1,241)
<i>Net cash used in investing activities</i>	<u>(2,293)</u>	<u>(1,891)</u>
<b>Financing activities</b>		
Borrowings (repayments) under line of credit	(780)	525
Payments under long-term debt	(5,000)	(117)
Borrowings under long-term debt	5,000	-
Proceeds from capital lease obligations incurred	-	300
Payments of capital lease obligations	(203)	(163)
Proceeds from issuance of common stock	6	5
<i>Net cash provided by (used in) financing activities</i>	<u>(977)</u>	<u>550</u>
Effect of foreign currency exchange rate changes on cash	(5)	5
Net change in cash and cash equivalents	196	288
Cash and cash equivalents at beginning of period	938	650
<b>Cash and cash equivalents at end of period</b>	<u><b>\$ 1,134</b></u>	<u><b>\$ 938</b></u>
Cash paid for interest	<u>\$ 964</u>	<u>\$ 474</u>
Cash paid for income taxes	<u>\$ 10</u>	<u>\$ 89</u>
<b>Noncash investing and financing activities</b>		
Capital lease obligations incurred for computer equipment	\$ 10	\$ 170
Accrued earn-out receivable related to disposition of a component of the business	384	-
Net current liabilities related to disposition of a component of the business	50	-
Net current assets and liabilities surrendered in sale of discontinued operations	-	9
Issuance of common stock related to payment of executive compensation	20	10

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") provides technology-enabled solutions that help dealers, distributors and manufacturers worldwide increase revenue and reduce costs. Our suite of products and services include: (i) electronic catalogs for publishing, viewing and interacting with technical reference information about equipment; (ii) lead generation and management products and services designed to help dealers grow their businesses and increase profitability through efficient marketing of their products; and (iii) websites with eCommerce capabilities designed to generate sales through the sites and provide information to consumers in the dealers' local areas. We deliver our products and services to companies of all sizes across a dozen vertical markets, with a core emphasis on the outdoor power, power sports, marine, RV, and appliance sectors. We estimate that approximately 18,000 equipment dealers, 125 manufacturers, and 150 distributors worldwide leverage our technology to drive revenue, gain efficiencies and increase customer satisfaction.

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](http://www.arinet.com).

*Basis of Presentation*

These consolidated financial statements include the financial statements of ARI and its wholly-owned subsidiaries. We eliminated all significant intercompany balances and transactions in consolidation. Any adjustments deemed necessary by management for a fair presentation of all periods presented have been reflected as required by Regulation S-X, Rule 10-01, in the normal course of business.

In fiscal 2009, ARI F&I Services, LLC ("AFIS"), a wholly-owned subsidiary of ARI, acquired Powersports Outsourcing Group. AFIS was subsequently sold on July 27, 2010. The results of AFIS have been reported as a discontinued operation.

*Fiscal Year*

Our fiscal year ends on July 31. References to fiscal 2011, for example, refer to the fiscal year ending July 31, 2011, and references to fiscal 2010 refer to the fiscal year ending July 31, 2010.

*Foreign Currency Translation*

The functional currency of the Company's subsidiary in the Netherlands is the Euro; accordingly, monetary assets and liabilities are translated into U.S. dollars at the rate of exchange existing at the end of the period, and non-monetary assets and liabilities are translated into U.S. dollars at historical exchange rates. Income and expense amounts, except for those related to assets translated at historical rates, are translated at the weighted-average exchange rates during the period. Adjustments resulting from the re-measurement of the financial statements into the functional currency are charged or credited to comprehensive income (loss).

*Use of Estimates*

The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the U.S. ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The Company considers capitalization and amortization of software product costs, valuation of intangible assets, accruals for anticipated losses on projects, accruals for anticipated future earn-out receipts related to the disposition of a component of the business, and the deferred tax valuation allowance to be significant estimates that are subject to change in the near term.

*Changes in Accounting Estimates*

During fiscal 2011 and fiscal 2010, the Company had a change in its estimated valuation allowance related to deferred tax assets due to ongoing revisions and evaluations of the estimated future expected results of operations and tax planning strategies. The difference between the amounts previously recorded as a valuation allowance and the amount currently recorded was charged to income tax

expense, as more fully discussed in Note 11. The amount of this change in accounting estimate was income of \$1,967,000, or \$0.25 per basic and diluted common share in fiscal 2011, and \$1,402,000, or \$0.18 per basic and diluted common share, in fiscal 2010.

#### *Concentrations*

The Company had no cash deposits in excess of the insurance coverage provided by the Federal Deposit Insurance Corporation ("FDIC") as of July 31, 2011 that would be exposed to loss in the event of a nonperformance by the financial institution. The Company's policy is to maintain cash in European bank accounts only to the extent required to cover day-to-day operating activities. Any excess European cash balances are transferred to our U.S. accounts on a periodic basis.

No single customer accounted for 10% or more of ARI's revenue in fiscal 2011 or fiscal 2010.

#### *Revenue Recognition*

Revenue from software licenses, annual or periodic maintenance fees and catalog subscription fees, which are included in multiple element arrangements, are all recognized ratably over the contractual term of the arrangement, as vendor specific objective evidence does not exist for these elements. ARI considers all arrangements with payment terms extending beyond twelve months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

Revenue for use of the network and for information services is recognized on a straight-line basis over the period of the contract.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential to software license arrangements include customizing complex features and functionality in a product's base software code or developing complex interfaces within a customer's environment. When professional services are considered essential to software license arrangements, revenue under the arrangement is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. Professional services revenue for set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of this type of arrangement, is amortized over the term of the contract. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined.

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

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

In conjunction with our acquisition of Channel Blade Technologies ("Channel Blade"), we incurred a deferred revenue liability of approximately \$1,310,000 related to setup fees charged for hosted websites. The deferred revenue liability was amortized over the terms of the customer contracts, of which none is remaining as of July 31, 2011. Approximately \$49,000 and \$801,000 of the Channel Blade deferred revenue was recognized during fiscal 2011 and fiscal 2010, respectively.

Revenue received from shipping and handling fees is reflected in net revenue. Costs incurred for shipping and handling are reported in cost of revenue.

#### *Cash and Cash Equivalents*

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Our investment policy, as approved by the Board of Directors, is designed to provide preservation of capital, adequate liquidity to meet projected cash requirements, optimum yields in relationship to risk, market conditions and tax considerations and minimum risk of principal loss through diversified short and medium term investments. Eligible investments include direct obligations of the U.S. Treasury, obligations issued or guaranteed by the U.S. government, certain time deposits, certificates of deposits issued by commercial banks, money market mutual funds, asset backed securities and municipal bonds. Our current investments include money market mutual funds with terms not exceeding ninety days.

#### *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 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 all receivable balances that exceed 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.

#### *Sales Tax*

Taxes collected from customers and remitted to governmental authorities are presented on a net basis, excluding such amounts from revenue.

#### *Work in Process*

Work in process consists of billable professional services performed by the Company, for which revenue was recognized pursuant to contract accounting primarily using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred, which have not been invoiced as of the end of the reporting period.

#### *Equipment and Leasehold Improvements*

Equipment and leasehold improvements are stated at cost. The Company developed tools for internal use related to the publication of catalog data which is included in computer equipment and software for internal use of \$194,000 and \$99,000 during fiscal 2011 and 2010, respectively. Depreciation and amortization are computed under the straight-line method for financial reporting purposes and accelerated methods for income tax purposes. Depreciation and amortization have been provided over the estimated useful lives of the assets as follows:

Computer equipment	3 – 7 years
Leasehold improvements	2 – 7 years
Furniture and equipment	3 – 5 years

Leasehold improvements are amortized over the useful lives of the assets or the term of the related lease agreement, whichever is shorter. During fiscal 2011 and fiscal 2010, the Company disposed of equipment and leasehold improvements with a cost basis of \$371,000 and \$1,220,000, respectively and recorded a loss on disposal of \$0 and \$10,000, respectively.

#### *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 revenues, estimated economic life and changes in software and hardware technologies.

The annual amortization of software products is the greater of the amount computed using: (a) the ratio that current gross revenues for the network or a software product bear to the total of current and anticipated future gross revenues for the network or a software product, or (b) the straight-line method over the estimated economic life of the product which currently runs from three to five years. Amortization starts when the product is available for general release to customers. All other software development and support expenditures are charged to expense in the period incurred.

#### *Capitalized Interest Costs*

Capitalized interest costs were immaterial as a whole to the financial statements in fiscal 2011 and 2010.

### Capitalized Finance Costs

The Company had capitalized finance costs of approximately \$84,000 during fiscal 2011 for closing costs associated with the loan and security agreement between Fifth Third Bank and the Company, described in Notes 4 and 5. These amounts have been classified as other long-term assets on the Balance Sheet.

### Insurance Premiums Receivable

The Company is the beneficiary of the total premiums it paid on a split-dollar life insurance policy at the death of the policy holder. Insurance premiums receivable are recorded at present value based on the average life expectancy of the policy holder and are included in other long term assets. Insurance premiums receivable consisted of \$69,000 and \$63,000 at July 31, 2011 and 2010, respectively, which is the present value of future life insurance premiums receivable of approximately \$237,000 discounted at an average rate of 9% and averaged over 14 to 16 years.

### Impairment of Long-Lived Assets

In accordance with GAAP, long-lived assets, including capitalized software product costs, property and equipment, and amortized intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve judgment. We evaluated the ongoing value of our long-lived assets as of July 31, 2010 and incurred an impairment charge of \$48,000 on capitalized software, with a cost basis of \$208,000, which was disposed of, and an additional impairment charge of \$141,000 on assets that are still in use. These impairment charges are included in restructuring costs on the statement of income. We did not have any events or changes in circumstances to warrant an impairment evaluation in fiscal 2011.

### Fair Value Measurements

GAAP has established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions. The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

We had no financial instruments measured at fair value on a recurring basis during fiscal 2011 and 2010.

ARI measures non-financial instruments at fair value on a non-recurring basis as required by GAAP. Gains and losses on items which were measured at fair market value on a non-recurring basis were recognized in earnings. During fiscal 2011, we had no non-financial instruments measured at fair value on a non-recurring basis. In fiscal 2010, we incurred a loss of \$189,000 related to impairment of certain software products measured at fair value, based on the Company's projection of anticipated future gross revenues for the network or a software product, as follows (in thousands):

	2011	2010
Fair value measurements using:		
Level 1 inputs: quoted prices in active markets for identical assets	\$ -	\$ -
Level 2 inputs: significant other observable inputs	-	-
Level 3 inputs: significant unobservable inputs	-	2,395
<b>Total fair value</b>	<b>\$ -</b>	<b>\$ 2,395</b>
<b>Total loss recognized</b>	<b>\$ -</b>	<b>\$ 189</b>

### *Goodwill*

GAAP requires that we assess goodwill for impairment annually, or more frequently if circumstances warrant a review. Certain triggering events that may warrant a more frequent impairment test include a significant change in the business climate, legal factors, a decline in operating performance, competition, sale or disposition of a significant portion of the business, or other factors. We tested for goodwill impairment at July 31, 2011 and 2010.

We test goodwill for impairment using a two-step process, as prescribed by GAAP. The first step of the test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

We determined that there is a single reporting unit for the purpose of goodwill impairment tests. We estimate the fair value of the reporting unit using various valuation techniques, with the primary technique being a discounted cash flow analysis. There are many estimates and assumptions involved in preparing a discounted cash flow analysis, including most significantly the weighted average cost of capital ("WACC") used to discount future cash flows, anticipated long-term growth rates, and future profit margins. Management uses its best efforts to reasonably estimate all of these and other inputs in the cash flow models utilized. We estimated future cash flows using two forecast scenarios and management used its best judgment to assign a weighting to each scenario. Step 1 of the goodwill impairment test indicated that goodwill was not impaired in fiscal 2011 or fiscal 2010. As a result, step 2 of the test was not performed.

### *Deferred Income Taxes*

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

### *Stock-Based Compensation*

ARI uses the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. As stock-based compensation expense recognized in our results of operations is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures, which were estimated based on our historical experience.

### *Advertising Costs*

Advertising costs, which are included in sales and marketing expense on the statement of income, are expensed as incurred. Total advertising costs were \$77,000 and \$132,000 in fiscal 2011 and fiscal 2010, respectively.

### *Comprehensive Income (Loss)*

Comprehensive income is a more inclusive financial reporting method that includes disclosure of financial information that historically has not been recognized in the calculation of net income. We reported comprehensive income (loss), which includes net income and foreign currency translation adjustments, in the Consolidated Statements of Shareholders' Equity for fiscal 2011 and fiscal 2010.

### *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, in accordance with GAAP. We had no legal provisions in fiscal 2011 or fiscal 2010.

### Recently Adopted Accounting Standards

In October 2009, the Financial Accounting Standards Board (the "FASB") amended guidance related to revenue recognition for software with multiple elements that became effective for the Company beginning August 1, 2010. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB amended guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. The impact of adopting this new standard has not had a material impact on the Company's consolidated financial statements for fiscal 2011.

### New Accounting Pronouncements

Management has reviewed recently issued accounting pronouncements and believes there are no new pronouncements that would have a material impact on our present or future financial statements.

## 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 for fiscal 2011 and fiscal 2010 (in thousands, except per share data):

	<u>2011</u>	<u>2010</u>
Income from continuing operations	\$ 2,418	\$ 1,169
Income (loss) from discontinued operations	25	(392)
Net income	<u>\$ 2,443</u>	<u>\$ 777</u>
Weighted-average common shares outstanding	7,855	7,751
Effect of dilutive stock options and warrants	56	15
Diluted weighted-average common shares outstanding	<u>7,911</u>	<u>7,766</u>
Earnings per share - basic:		
Income from continuing operations	\$ 0.31	\$ 0.15
Income (loss) from discontinued operations	0.00	(0.05)
<b>Net income</b>	<u><b>\$ 0.31</b></u>	<u><b>\$ 0.10</b></u>
Earnings per share - diluted:		
Income from continuing operations	\$ 0.31	\$ 0.15
Income (loss) from discontinued operations	0.00	(0.05)
<b>Net income</b>	<u><b>\$ 0.31</b></u>	<u><b>\$ 0.10</b></u>
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	<u>923</u>	<u>1,504</u>

### 3. Capitalized and Purchased Software Product Costs

The balance of capitalized and purchased software product costs consisted of the following (in thousands):

	Software Product Costs	Accumulated Amortization	Net Value
Balance 7/31/09	\$ 14,886	\$ (12,489)	\$ 2,397
Capitalized costs	1,241	-	1,241
Disposals	(208)	208	-
Impairments	-	(189)	(189)
Amortization expense	-	(1,054)	(1,054)
Balance 7/31/10	15,919	(13,524)	2,395
Capitalized costs	1,547	-	1,547
Disposals	(773)	773	0
Amortization expense	-	(1,127)	(1,127)
Balance 7/31/11	<u>\$ 16,693</u>	<u>\$ (13,878)</u>	<u>\$ 2,815</u>

The estimated aggregate amortization expense for each of the five succeeding fiscal years related to capitalized and purchased software product costs consist of the following at July 31, 2011 (in thousands):

2012	\$ 1,240
2013	967
2014	411
2015	139
2016	58
	<u>\$ 2,815</u>

### 4. Line of Credit

On July 9, 2004, we entered into a line of credit agreement with JPMorgan Chase, N.A. (the "Chase Line") which, as amended, permitted us to borrow an amount equal to 80% of the book value of all eligible accounts receivable plus 45% of the value of all eligible open renewal orders (provided the renewal rate was at least 85%) minus \$75,000, up to \$2,000,000. The agreement bore interest at 1% per annum above the prime rate plus an additional 3%, at the bank's option, upon the occurrence of any default under the note. The interest rate was subject to a floor equal to the sum of (i) 2.5%; plus (ii) the quotient of: (a) the one month LIBOR rate divided by (b) one minus the maximum aggregate reserve requirement imposed under Regulation D of the Board of Governors of the Federal Reserve System. The agreement included a non-usage fee of 0.25% per annum on any unused portion of the line of credit and was secured by substantially all of the Company's assets. The line of credit limited repurchases of common stock, the payment of dividends, liens on assets and new indebtedness. It also contained a financial covenant requiring us to maintain a minimum debt service coverage ratio of 1.2 to 1.0. The Chase Line was terminated effective July 27, 2011.

On July 27, 2011, ARI entered into a Loan and Security Agreement (the "Agreement") with Fifth Third Bank ("Fifth Third"), filed as exhibit 10.1 on the Company's Form 8-K on July 28, 2011. Pursuant to the terms of the Agreement, Fifth Third extended to the Company credit facilities consisting of a \$1,500,000 revolving credit facility (the "Revolving Loan") and a \$5,000,000 term loan facility (the "Term Loan"). Each of the credit facilities bears interest at a rate based on the one, two, three or six month LIBOR (as selected by the Company on the last business day of each month) plus 4.0%, and matures on July 27, 2014. In connection with this Agreement, the Chase Line was terminated. There was \$245,000 outstanding and \$1,255,000 available on the Revolving Loan as of July 31, 2011.

The Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to incur new debt, create liens on its assets, make certain investments, enter into merger transactions, issue capital securities (other than employee and director options, employee benefit plans, and other compensation programs), and make distributions to its shareholders. Financial covenants include a minimum fixed charge coverage ratio, as defined in the Agreement, of 1.2, and a senior leverage (maximum senior funded indebtedness to EBITDA) ratio, as defined in the Agreement, of 2.0. The Agreement also contains customary events of default which, if triggered, could result in an acceleration of the Company's obligations under the Agreement. The Credit Facilities are secured by a first priority security interest in substantially all assets of the Company and by a first priority pledge of all

outstanding equity securities of each of the Company's domestic subsidiaries and 65% of outstanding equity securities of the Company's foreign subsidiaries.

## 5. Long-term Debt

On April 27, 2009, we issued a \$5,000,000 secured promissory note in connection with the acquisition of Channel Blade. The annual interest rate on the note was 10% for the first year and 14% thereafter. Accrued interest only was due quarterly commencing July 31, 2009 through April 30, 2011. Twenty equal quarterly payments of principal and interest were due, commencing August 1, 2011. On July 27, 2011 we entered into a Loan and Security Agreement (described in Note 4) with Fifth Third Bank, the proceeds of which were used to pay off the Channel Blade note in full on July 27, 2011.

Long-term debt consisted of the following at July 31, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Channel Blade Technologies	\$ -	\$ 5,000
Fifth Third Bank	<u>5,000</u>	<u>-</u>
Total long-term debt	5,000	5,000
Less current maturities	<u>(917)</u>	<u>-</u>
<b>Long-term debt, non-current</b>	<b><u>\$ 4,083</u></b>	<b><u>\$ 5,000</u></b>

Principal and interest on the new Term Loan will be repaid in fixed monthly principal installments of \$83,333 plus accrued but unpaid interest on the unpaid principal balance commencing on September 1, 2011 through July 1, 2014, with a final balloon payment due July 27, 2014. Mandatory prepayments of the Credit Facilities will be required in the amount of 50% of the Company's excess cash flow for the six-month periods ending January 31, 2012 and July 31, 2012 and for each fiscal year thereafter. Excess cash flow is defined as the remainder of net income plus interest, taxes, depreciation and amortization expense for such period, minus cash taxes paid, capital expenditures incurred, capitalized software costs and scheduled payments of principal and interest charges.

Minimum principal payments due on the Term Loan are as follows for the fiscal years ending (in thousands):

2012	\$ 917
2013	1,000
2014	<u>3,083</u>
	<b><u>\$ 5,000</u></b>

## 6. Acquisitions and Divestitures

On July 27, 2010 we sold AFIS, an outsourced F&I business located in Schenectady, NY, to F&I Smart LLC in a membership interest sale agreement (the "Subject Interests"). The sales price of the Subject Interests is a contingent amount based on dealer revenue beginning July 28, 2010 and ending on August 28, 2013. We have not accrued for any future contingent proceeds as we are not able to estimate the amounts and have not received any payments as of July 31, 2011. We recognized a \$1,000 loss on the sale of AFIS in the fourth quarter of fiscal 2010. Refer to Note 14 for further discussion of our discontinued operation.

On April 27, 2009, we acquired substantially all of the assets of Channel Blade, the leading provider of websites, lead management and marketing automation solutions in the marine and RV markets in an asset purchase agreement valued at approximately \$6,700,000, paid in cash, common stock, assumed net liabilities and a \$5,000,000 note payable. The purchase price of this acquisition was allocated to various assets and liabilities including \$918,000 of software products costs amortized over 4.1 years, \$2,712,000 of intangible assets, which are amortized over 5, 8 and 2 years and \$3,243,000 of goodwill related to Channel Blade's knowledge of and penetration into the marine and RV vertical markets. The Channel Blade operation has been fully integrated into our operations.

On March 1, 2011, we entered into an Asset Purchase Agreement (the "Agreement") with Globalrange Corporation ("Globalrange"). Under the terms of the Agreement, we 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 revenues (as defined in the Agreement). Globalrange will make earn-out payments to ARI annually over a four-year period following the closing date, with an initial pre-payment of \$80,000. The amounts of such earn-out payments will be determined based on collections received by Globalrange relating to the AgChem EDI Business during such period, and will be subject to a floor and cap, in accordance with the terms of the Agreement.

The earn-out was recorded at fair value, which was estimated at \$580,000 less an imputed discount of \$97,000, based on the present value of the estimated earn-out payments, discounted at 14%, which was the prevailing rate of interest charged on the Company's debt at the time of disposition. Imputed interest is amortized to interest income over the life of the earn-out. We recorded a gain on the disposition of the AgChem EDI Business of \$433,000 or \$0.05 per share before tax. The current portion of the earn-out is included in prepaid and other assets and the remaining balance of the estimated earn-out receivable, included in Other Long Term Assets, consisted of the following at July 31, 2011 (in thousands):

	<u>2011</u>
Earnout Receivable	\$ 384
Less current maturities	<u>(190)</u>
<b>Long Term Earnout Receivable</b>	<b><u>\$ 194</u></b>

Changes in the earn-out receivable during the fiscal year ended July 31, 2011 were as follows (in thousands):

Balance at March 1, 2011	\$ 483
Payments	(118)
Imputed interest recognized	<u>19</u>
<b>Balance at July 31, 2011</b>	<b><u>\$ 384</u></b>

The estimated receipts related to the earn-out receivable for the years subsequent to July 31, 2011 are as follows (in thousands):

<u>Year Ending July 31,</u>	
2012	\$ 190
2013	138
2014	85
2015	<u>49</u>
Total Estimated Payments	462
Less imputed interest	<u>(78)</u>
Present value of Earnout	<b><u>\$ 384</u></b>

## 7. Other Intangible Assets

Amortizable intangible assets include customer relationships, trade names and employee non-compete agreements. Amortizable intangible assets are composed of the following at July 31, 2011 and 2010 (in thousands):

	<u>Customer Relationships</u>	<u>Trade Names</u>	<u>Non-Compete Agreements</u>	<u>Total</u>
Net value 7/31/09	\$ 3,235	\$ 239	\$ 163	\$ 3,637
Amortization	<u>(667)</u>	<u>(50)</u>	<u>(93)</u>	<u>(810)</u>
Net value 7/31/10	2,568	189	70	2,827
Amortization	<u>(666)</u>	<u>(50)</u>	<u>(70)</u>	<u>(786)</u>
<b>Net value 7/31/11</b>	<b><u>\$ 1,902</u></b>	<b><u>\$ 139</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 2,041</u></b>
<i>Weighted average remaining useful life</i>	5.05	2.75	-	4.89

The estimated amortization expense related to intangible assets for the years subsequent to July 31, 2011 is as follows (in thousands):

2012	\$	602
2013		335
2014		322
2015		284
2016		284
2017		214
	\$	<u>2,041</u>

## 8. Capital and Operating Leases

The Company leases office space and certain office equipment under operating lease arrangements expiring through 2021. The Company is generally liable for its share of increases in the landlord's direct operating expenses and real estate taxes related to these leases. Total rental expense for the operating leases was \$602,000 in fiscal 2011 and \$738,000 in fiscal 2010, respectively. An additional \$99,000 and \$114,000 was paid in fiscal 2011 and 2010, respectively, which was included in accrued restructuring related to closed offices.

Where applicable, rent expense for leased offices is recognized on a straight-line basis over the lease terms, which differs from the pattern of payments required by the leases. Other accrued liabilities included \$310,000 and \$233,000 of deferred rent at July 31, 2011 and 2010, respectively. As more fully discussed in Note 13, we recorded a restructuring liability for estimated net future lease costs associated with closed offices. The remaining balance of this restructuring liability was \$0 and \$80,000 as of July 31, 2011 and 2010.

ARI leases approximately 16,300 square feet of office space located at 10850 West Park Place, Milwaukee, Wisconsin 53224, which commenced on July 17, 2009 and expires on July 17, 2021. Over the twelve year lease agreement, annual base rent of \$149,000 increases approximately 2.9% per year. Rent abatement was negotiated for the first fifteen months totaling approximately \$187,000. Annual projected operating costs and taxes, which are subject to change, are currently \$8.65 per square foot.

We have certain equipment and leasehold improvements with capital lease obligations of (in thousands):

Fiscal Year Ending July 31:	2011	2010
Equipment and leasehold improvements	\$ 812	\$ 803
Less: accumulated depreciation (1)	494	271
Total cost of equipment and leasehold improvements with outstanding capital lease obligations	<u>\$ 318</u>	<u>\$ 532</u>

(1) amortization of leased equipment and leasehold improvements is included in depreciation and other amortization

Minimum lease payments under remaining capital and operating leases are as follows (in thousands):

<b>Fiscal Year Ending July 31:</b>	<b>Capital Leases</b>	<b>Operating Leases</b>
2012	\$ 158	\$ 578
2013	164	612
2014	60	460
2015	-	352
2016	-	318
Thereafter	-	1,673
Total minimum lease payments	382	3,993
Less amounts related to interest	45	-
<b>Net minimum lease payments</b>	<u><b>\$ 337</b></u>	<u><b>\$ 3,993</b></u>

## 9. Shareholder Rights Plan

On August 7, 2003, we adopted a Shareholder Rights Plan designed to protect the interests of common shareholders from an inadequate or unfair takeover, but not affect a takeover proposal which the Board of Directors believes is fair to all shareholders. Under the Shareholder Rights Plan adopted by the Board of Directors, all shareholders of record on August 18, 2003 received one Preferred Share Purchase Right for each share of common stock they owned. These Rights trade in tandem with the common stock until and unless they are triggered. Should a person or group acquire more than 10% of ARI's common stock (or if an existing holder of 10% or more of the common stock were to increase its position by more than 1%), the Rights would become exercisable for every shareholder except the acquirer that triggered the exercise. The Rights, if triggered, would give the rest of the shareholders the ability to purchase additional stock of ARI at a substantial discount. The rights will expire on August 18, 2013, and can be redeemed by the Company for \$0.01 per Right at any time prior to a person or group becoming a 10% shareholder.

## 10. Stock-based Compensation Plans

### *Employee Stock Purchase Plan*

The Company's 2000 Employee Stock Purchase Plan, as amended, ("ESPP") has 225,000 shares of common stock reserved for issuance, and 177,439 of the shares have been issued as of July 31, 2011. All employees with 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.

### *Stock Option Plans*

Total stock compensation expense in fiscal 2011 and fiscal 2010 was approximately \$109,000 and \$167,000, respectively. As of July 31, 2011 and 2010, there was approximately \$87,000 and \$134,000, respectively, of total unrecognized compensation cost related to non-vested options granted under the plans.

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

	2011	2010
Expected life (years)	10 years	10 years
Risk-free interest rate	2.9%	3.6%
Expected volatility	104.3%	93.5%
Expected forfeiture rate	18.6%	16.0%
Expected dividend yield	0.0%	0.0%

### 1991 Stock Option Plan

Our 1991 Stock Option Plan ("1991 Plan") was terminated on August 14, 2001, except as to outstanding options. All options outstanding under the 1991 Plan expired as of September 7, 2010.

Changes in option shares under the 1991 Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding and exercisable at 7/31/09	35,500	\$ 2.43	1.09	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(500)	9.06	n/a	n/a
<b>Outstanding and exercisable at 7/31/10</b>	<b>35,000</b>	<b>\$ 2.33</b>	<b>0.10</b>	<b>\$ -</b>
Outstanding and exercisable at 7/31/10	35,000	\$ 2.33	0.10	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(35,000)	2.33	n/a	n/a
<b>Outstanding and exercisable at 7/31/11</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>

The range of exercise prices for options outstanding under the 1991 Plan at July 31, 2010 was \$2.06 to \$2.44.

### 1993 Director Stock Option Plan

The Company's 1993 Director Stock Option Plan ("1993 Plan") was terminated on August 14, 2001, except as to outstanding options. All options outstanding under the 1993 Plan expired as of September 11, 2010.

Changes in option shares under the Director Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding and exercisable at 7/31/09	1,313	\$ 2.65	0.97	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(563)	3.46	n/a	n/a
<b>Outstanding and exercisable at 7/31/10</b>	<b>750</b>	<b>\$ 2.05</b>	<b>0.08</b>	<b>\$ -</b>
Outstanding and exercisable at 7/31/10	750	\$ 2.05	0.08	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(750)	2.05	n/a	n/a
<b>Outstanding and exercisable at 7/31/11</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>

The range of exercise prices for options outstanding under the 1993 Plan at July 31, 2010 was \$2.00 to \$2.13.

### 2000 Stock Option Plan

The Company's 2000 Stock Option Plan ("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 Company's 2000 Stock Option 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, no new options may be granted under the 2000 Plan.

Changes in option shares under the 2000 Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/09	1,213,402	\$ 1.51	7.08	\$ 21,337
Granted	210,250	0.82	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(153,671)	1.35	n/a	n/a
<b>Outstanding at 7/31/10</b>	<b>1,269,981</b>	<b>\$ 1.41</b>	<b>6.48</b>	<b>\$ 13,319</b>
<b>Exercisable at 7/31/10</b>	<b>987,453</b>	<b>\$ 1.51</b>	<b>5.82</b>	<b>\$ 13,117</b>
Outstanding at 7/31/10	1,269,981	\$ 1.41	6.48	\$ 13,319
Granted	146,100	0.64	n/a	n/a
Exercised	(800)	0.33	n/a	n/a
Forfeited	(178,948)	1.15	n/a	n/a
<b>Outstanding at 7/31/11</b>	<b>1,236,333</b>	<b>\$ 1.36</b>	<b>6.10</b>	<b>\$ 34,041</b>
<b>Exercisable at 7/31/11</b>	<b>1,055,241</b>	<b>\$ 1.47</b>	<b>5.63</b>	<b>\$ 22,125</b>

The weighted average fair market price of options granted for the twelve months ended July 31, 2010 and 2011 was \$0.82 and \$0.64, respectively. The range of exercise prices for options outstanding under the 2000 Plan was \$0.15 to \$2.74 at July 31, 2011 and 2010, respectively.

Changes in non-vested option shares under the 2000 Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price
Non-vested at 7/31/09	341,776	\$ 1.40
Granted	210,250	0.82
Vested	(196,812)	1.27
Forfeited	(72,686)	1.23
<b>Non-vested at 7/31/10</b>	<b>282,528</b>	<b>\$ 1.09</b>
Non-vested at 7/31/10	282,528	\$ 1.09
Granted	146,100	0.64
Vested	(178,975)	1.13
Forfeited	(68,561)	0.93
<b>Non-vested at 7/31/11</b>	<b>181,092</b>	<b>\$ 0.75</b>

The weighted average remaining vesting period was 1.73 and 2.19 years at July 31, 2011 and 2010, respectively.

### 2010 Stock Option Plan

The Board of Directors adopted the ARI Network Services, Inc. 2010 Equity Incentive Plan (the "2010 Plan") on November 9, 2010, and it was approved by the Company's shareholders in December 2010. The 2010 Plan is the successor to the Company's 2000 Plan.

The 2010 Plan includes the following provisions:

- the aggregate number of shares of Common Stock subject to the 2010 Plan is 650,000 shares;
- the exercise price for options and stock appreciation rights cannot be less than 100% of the fair market value, as defined, of the Company's Common Stock on the date of grant;
- the exercise prices for options and stock appreciation rights cannot be repriced without shareholder approval, except to reflect changes to the capital structure of the Company as described in the 2010 Plan;
- a maximum term of ten years for options and stock appreciation rights;
- a maximum of 325,000 of the shares available for issuance under the 2010 Plan can be in the form of restricted shares or restricted stock units, and the 2010 Plan does not have liberal share counting provisions (such as provisions that would permit shares withheld for payment of taxes or the exercise price of stock options to be re-granted under the plan); and
- awards cannot be transferred to third parties, with the exception of certain estate planning transfers, which can be made if the committee that administers the 2010 Plan approves such transfers.

Changes in option shares under the 2010 Plan during fiscal 2011 are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/10	-	\$ -	-	\$ -
Granted	54,250	0.67	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	-	n/a	n/a	n/a
<b>Outstanding at 7/31/11</b>	<b>54,250</b>	<b>\$ 0.67</b>	<b>9.64</b>	<b>\$ 5,570</b>
<b>Exercisable at 7/31/11</b>	<b>21,313</b>	<b>\$ 0.66</b>	<b>9.61</b>	<b>\$ 2,221</b>

The weighted average fair market price of options granted for the twelve months ended July 31, 2011 was \$0.67. The range of exercise prices for options outstanding under the 2010 Plan at July 31, 2011 was \$0.575 to \$0.922.

	Number of Options	Wtd. Avg. Exercise Price
Non-vested at 7/31/10	-	\$ -
Granted	54,250	0.67
Vested	(21,313)	0.66
Forfeited	-	-
<b>Non-vested at 7/31/11</b>	<b>32,937</b>	<b>\$ 0.67</b>

The weighted average remaining vesting period was 1.53 years at July 31, 2011.

### Stock Warrants

On April 24, 2003, in exchange for previously outstanding securities, we issued to a group of investors warrants for 250,000 common shares, exercisable at \$1.00 per share that expired on December 21, 2010.

## 11. Income Taxes

The provision for income taxes is composed of the following (in thousands):

	<u>2011</u>	<u>2010</u>
Current:		
Federal	\$ (25)	\$ -
State	(39)	(6)
Change in the beginning deferred tax asset valuation allowance	1,967	1,402
Deferred, net	<u>(886)</u>	<u>(102)</u>
Income tax (benefit) expense from continuing operations	<u>\$ 1,017</u>	<u>\$ 1,294</u>
Income tax benefit from discontinued operations	<u>\$ (15)</u>	<u>\$ 262</u>

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 our assets and liabilities, including various accruals, allowances, depreciation and amortization. The tax effect of these temporary differences and the estimated tax benefit from tax net operating losses are reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed. To the extent that management believes it is more likely than not that some portion, or all, of the deferred tax asset will not be realized, a valuation allowance is established. This assessment is based on all available evidence, both positive and negative, in evaluating the likelihood of realizability. Issues considered in the assessment include future reversals of existing taxable temporary differences, estimates of future taxable income (exclusive of reversing temporary differences and carryforwards) and prudent tax planning strategies available in future periods. Because ultimately the realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as valuation allowances is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the statement of operations.

In fiscal 2010 we had a change in our estimated valuation allowance. This change resulted from an extension of the number of years used in the forecast to determine net operating loss utilization. Prior to fiscal 2010, in determining the amount of net operating loss carryforwards that would be utilized, we projected our taxable income for twelve quarters, with the assumption that any forecast beyond three years was not meaningful. In fiscal 2010, we determined that we were in a position to forecast taxable income for the remaining life of our current net operating loss carryforwards, which resulted in a gain of approximately \$1,402,000, or \$0.18 per basic and diluted common share, for the following reasons:

- We had experienced six consecutive profitable years of operations, while at the same time integrating four acquisitions. Although we incurred a taxable loss in fiscal 2010, those losses were primarily due to the results of our discontinued operation as well as one-time restructuring costs that were not expected to continue.
- We continued to grow both organically and through acquisitions and were at a stage where our operating structure and costs were more sustainable.
- We established a strategic plan to focus on our core offerings: electronic catalogs, websites and lead management services. This plan encompassed the discontinuation of several products and the sale of a non-strategic and underperforming subsidiary, thereby reducing our cost structure. This strategic plan has provided more stability going forward.

We performed an assessment of the likelihood that the remaining net operating loss carryforwards ("NOLs") included in our net deferred tax assets will be realized from future taxable income as of July 31, 2011, which resulted in a change in estimate of \$1,967,000, or \$0.25 per basic and diluted common share, for the following reasons:

- As a result of our strategic plan to focus on our core offerings and improve operating efficiencies throughout the organization, we experienced an improvement in our forecasted US net income before taxes.

- In fiscal 2011, we elected to do a change in accounting method related to the tax treatment of capitalized software product costs, which defers the expense over future periods, allowing us to have a higher US taxable income in earlier periods in order to utilize the NOLs that are due to expire over the next few years.
- In fiscal 2011, we elected to recognize the gain on the disposition of a portion of the business for tax purposes, versus amortizing the gain over future periods, allowing us to have a higher US taxable income in earlier periods in order to utilize the NOLs that are due to expire over the next few years.

Significant components of our deferred tax liabilities and assets as of July 31 were as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 5,278	\$ 6,808
Alternative minimum tax credit carryforwards	104	85
Deferred revenue	1,729	1,918
Software product costs	46	214
Intangible assets	345	233
R&D credit carryforward	-	-
Other	885	1,074
Total deferred tax assets	<u>8,387</u>	<u>10,332</u>
Valuation allowance for deferred tax assets	<u>(2,720)</u>	<u>(5,657)</u>
Net deferred tax assets	5,667	4,675
Deferred tax liabilities:		
Software product costs and other	(117)	(297)
Goodwill	<u>(250)</u>	<u>(162)</u>
<b>Net deferred taxes</b>	<b><u>\$ 5,300</u></b>	<b><u>\$ 4,216</u></b>

A reconciliation between income tax expense and income taxes computed by applying the statutory federal income tax rate of 34% and the state rate of approximately 3% to U.S. based income before income taxes is as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Computed income taxes at 37%	\$ (570)	\$ (14)
Permanent items	(78)	(91)
Change in estimated valuation allowance	1,967	1,402
Effective rate adjustment	(344)	-
Other	41	(3)
Income tax expense (benefit) from continuing operations	<u>\$ 1,017</u>	<u>\$ 1,294</u>
Income tax benefit from discontinued operations	<u>\$ (15)</u>	<u>\$ 262</u>

During fiscal 2011 and fiscal 2010, \$2,266,000 and \$4,231,000, respectively, of federal net operating loss carryforwards expired. These expired net operating loss carryforwards have been included in the calculation of the change in valuation allowance. As of July 31, 2011, we had accumulated net operating loss carryforwards for federal and state tax purposes of approximately \$14,246,000 and \$8,326,000, respectively, which expire as follows:

<u>Year ended July 31,</u>	<u>Federal</u>	<u>State</u>
2012	\$ 3,664	\$ 2,665
2013	2,746	1,841
2014	-	482
2015	-	3,258
2019	843	4
2020	6,043	-
2024	4	-
2025	-	75
2030	946	-
	<u>\$ 14,246</u>	<u>\$ 8,326</u>

Of these unused federal net operating loss carryforwards, \$2,038,000 expire between 2012 and 2014 and are limited to \$116,000 annually that can be utilized to offset taxable income. Use of these net operating loss carryforwards is restricted under Section 382 of the Code because of changes in ownership in 1997.

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 July 31, 2011 and 2010. 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 2007 remain open and subject to examination by state tax jurisdictions and the United States federal tax authorities.

## 12. Employee Benefit Plan

ARI has a qualified retirement savings plan (the "401(k) Plan") covering its employees. Each employee may elect to reduce his or her current compensation by up to 50%, up to a maximum of \$16,500 (\$22,000 over age 50) in both calendar years 2011 and 2010 (subject to adjustment in future years) and have the amount of the reduction contributed to the 401(k) Plan. Company contributions to the 401(k) Plan are at the discretion of the Board of Directors. During fiscal 2011 and fiscal 2010, we issued 86,739 and 58,332 shares of common stock, respectively, as a discretionary contribution to the 401(k) Plan. The amounts charged to expense for the 401(k) contributions, net of forfeitures, were \$60,000 and \$52,000 for the fiscal years 2011 and 2010, respectively.

## 13. Restructuring

In July 2008 ARI announced a restructuring that consolidated our data conversion operations in Virginia into our Wisconsin location and consolidated our software development operations in Colorado into our California location. Adjustments were made to the restructuring reserve during fiscal 2011 and fiscal 2010 to reflect changes to our assumptions regarding our ability to sublet the vacant office space in Colorado and the present value of the net future lease costs through March 2011. The following represents changes to the restructuring reserve, which is included in other accrued liabilities on the balance sheet (in thousands):

	<u>2011</u>	<u>2010</u>
Beginning Balance	\$ 80	\$ 93
Payments	(99)	(114)
Adjustments to restructuring charges	19	101
Ending Balance	<u>\$ -</u>	<u>\$ 80</u>

In July 2010, in an effort to focus on our core business, which includes electronic catalogs, websites, and lead management services, we undertook a workforce reduction and business improvement initiative, which included the divestiture of AFIS and the write off of certain

components of capitalized software related to products no longer in use or with limited future cash flows that are no longer considered a part of our core operation.

The following represents restructuring charges incurred in fiscal 2010 from continuing operations (in thousands):

Severance and related benefits	\$ 147
Software impairments	<u>189</u>
<b>Total restructuring costs</b>	<b><u>\$ 336</u></b>

The accrued severance and related restructuring reserve from continuing operations, which was included in accrued payroll and related liabilities on the balance sheet, was \$147,000 as of July 31, 2010 and was fully paid during fiscal 2011.

The following represents the restructuring charges incurred in fiscal 2010 with respect to the AFIS divestiture, which were included in discontinued operations (in thousands):

Severance and related benefits	\$ 27
Other accrued liabilities	<u>83</u>
<b>Total restructuring costs</b>	<b><u>\$ 110</u></b>

Changes to the accrued restructuring from discontinued operations, which was included in other accrued liabilities on the balance sheet, consisted of vendor payments and adjustments related to the settlement of estimated vendor and payroll related liabilities as follows (in thousands):

	<u>2011</u>
Beginning Balance	\$ 110
Payments	(51)
Adjustments to restructuring charges	<u>(59)</u>
Ending Balance	<u>\$ -</u>

#### 14. Discontinued Operations

On July 27, 2010, we divested AFIS, which offered dealer F&I services. The divestiture resulted in a loss from discontinued operations of \$1,000. During fiscal 2011, we recorded a gain of \$24,000 net of income tax related to the settlement of an accrued liability for vendor services. The results of operations of AFIS have been reflected as a discontinued operation in our consolidated financial statements for all periods presented. The results of operations of AFIS were previously reported within the United States business segment.

	<u>2011</u>	<u>2010</u>
Revenues	\$ -	\$ 136
Cost of sales	-	13
Operating expenses	<u>-</u>	<u>776</u>
Operating loss	-	(653)
Gain (loss) on sale	40	(1)
Income tax benefit (provision) (1)	<u>(15)</u>	<u>262</u>
<b>Net gain (loss)</b>	<b><u>\$ 25</u></b>	<b><u>\$ (392)</u></b>

(1) Net of recorded deferred income tax asset valuation allowance

## 15. Business Segments

Our business segments are internally organized by geographic location of the operating facilities. In accordance with GAAP regarding disclosures about business segments, we have segregated the Netherlands operation and the United States operations into separate reportable segments. Segment revenue for the Netherlands operation includes only revenue generated out of the Netherlands subsidiary and does not include revenue sold to foreign countries by the United States operation. We evaluate the performance of and allocate resources to each of the segments based on their operating results.

Information concerning our operating business segments for fiscal 2011 and fiscal 2010 is as follows (in thousands):

Revenue from continuing operations:	<b>2011</b>	<b>2010</b>
Netherlands	\$ 799	\$ 689
United States	20,535	20,795
Consolidated	<u>\$ 21,334</u>	<u>\$ 21,484</u>
Net income (loss) from continuing operations:	<b>2011</b>	<b>2010</b>
Netherlands	\$ (114)	\$ (159)
United States	2,532	1,328
Consolidated	<u>\$ 2,418</u>	<u>\$ 1,169</u>
Total Assets	<b>July 31</b>	<b>July 31</b>
Netherlands	<u>2011</u>	<u>2010</u>
Netherlands	\$ 342	\$ 328
United States	20,757	19,449
Consolidated	<u>\$ 21,099</u>	<u>\$ 19,777</u>

## 16. Related Party

Briggs & Stratton Corporation ("Briggs") is one of our customers and owns approximately 10% of ARI stock. Briggs has entered into customer contracts with us and has provided vendor services to us in the ordinary course of business. Generally, the customer contracts are for one to three years and renew annually thereafter unless either party elects otherwise. We invoiced Briggs approximately \$370,000 and \$371,000 for products and services provided during fiscal 2011 and fiscal 2010, respectively. Briggs had unpaid net trade receivables of \$18,000, or 1%, and \$15,000, or 1%, of total trade receivables outstanding as of July 31, 2011 and 2010, respectively, \$0 of which was over 90 days at July 31, 2011 or 2010.

The vendor services provided by Briggs are for printing of materials which are generally resold to customers and included in cost of sales. Briggs invoiced us approximately \$33,000 and \$55,000 for printing services during fiscal 2011 and fiscal 2010, respectively, \$0 and \$2,000 of which were unpaid as of July 31, 2011 and 2010.

Gordon J. Bridge serves on our board of directors. He was assigned by the board to be the lead Director of AFIS, for which he was paid \$57,050 in fiscal 2010. There were no unpaid expenses at July 31, 2011 or 2010.

## 17. Litigation

None.

## 18. Subsequent Events

We evaluated whether any events or transactions occurred after the balance sheet date that would require recognition or disclosure in our financial statements in accordance with GAAP, and determined that there were no events that occurred after July 31, 2011, but prior to October 31, 2011 that would affect the financial statements for the period ending July 31, 2011.