Net Element, Inc.
Form 10-Q
November 16, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from __________ to __________

Commission file number: **001-34887**

Net Element, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**90-1025599**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3363 NE 163rd Street, Suite 705	
North Miami Beach, Florida	**33160**
(Address of principal executive offices)	(Zip Code)

(305) 507-8808

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes ¨ No x

The number of outstanding shares of common stock, $.0001 par value, of the registrant as of November 5, 2015 was 80,001,143.

Defined Terms

Net Element, Inc. is a corporation organized under the laws of the State of Delaware. As used in this Quarterly Report on Form 10-Q (this "Report"), unless the context otherwise requires, the terms "Company," "we," "us" and "our" refer to Net Element, Inc. and, as applicable, its majority-owned and consolidated subsidiaries. References in this Report to "PayOnline" refer, collectively, to PayOnline System LLC, Innovative Payment Technologies LLC, Polimore Capital Limited and Brosword Holding.

Forward-Looking Statements

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements contained in this Report that are not statements of historical fact may be deemed forward-looking statements. Forward-looking statements generally are identified by the words "expects," "anticipates," "believes," "intends," "estimates," "aims," "plans," "
"will," "continue," "seeks," "should," "believe," "potential" or the negative of such terms and similar expressions. Forward-loo
statements are based on current plans, estimates and projections, and therefore you should not place too much reliance on them. Forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update any forward-looking statement in light of new information or future events, except as expressly required by law. Forward-looking statements involve inherent risks and uncertainties, most of which are difficult to predict and are generally beyond the Company's control. The Company cautions you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in, or implied by, the forward-looking statements. These factors include, among other factors:

- the impact of any new or changed laws, regulations, card network rules or other industry standards affecting our business including the U.S. government decision to impose sanctions or other legal restrictions that may restrict our ability to do business in Russia;
- the impact of any significant chargeback liability and liability for merchant or customer fraud, which we may not be able to accurately anticipate and/or collect;
- our ability to secure or successfully migrate merchant portfolios to new bank sponsors if current sponsorships are terminated;
- our and our bank sponsors' ability to adhere to the standards of the Visa® and MasterCard® payment card associations;
- our reliance on third-party processors and service providers;
- our dependence on independent sales groups ("ISGs") that do not serve us exclusively to introduce us to new merchant accounts;
- our ability to pass along increases in interchange costs and other costs to our merchants;
- our ability to protect against unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems or otherwise;
-

- the effect of the loss of key personnel on our relationships with ISGs, card associations, bank sponsors and our other service providers;
- the effects of increased competition, which could adversely impact our financial performance;
- the impact of any increase in attrition due to an increase in closed merchant accounts and/or a decrease in merchant charge volume that we cannot anticipate or offset with new accounts;
- the effect of adverse business conditions on our merchants;
- our ability to adopt technology to meet changing industry and customer needs or trends;
- the impact of any decline in the use of credit cards as a payment mechanism for consumers or adverse developments with respect to the credit card industry in general;
- the impact of any adverse conditions in industries in which we obtain a substantial amount of our bankcard processing volume;
- the impact of seasonality on our operating results;

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- the impact of any failure in our systems due to factors beyond our control;
- the impact of any material breaches in the security of third-party processing systems we use;
- the impact of any new and potential governmental regulations designed to protect or limit access to consumer information;
- the impact on our profitability if we are required to pay federal, state or local taxes on transaction processing;
- the impact on our growth and profitability if the markets for the services that we offer fail to expand or if such markets contract;
- our ability (or inability) to continue as a going concern;
- the willingness of the Company's majority stockholders, and/or other affiliates of the Company, to continue investing in the Company's business to fund working capital requirements;
- the Company's ability (or inability) to obtain additional financing in sufficient amounts or on acceptable terms when needed;
- the impact on our operating results as a result of impairment of our goodwill and intangible assets;
- our material weaknesses in internal control over financial reporting and our ability to maintain effective controls over financial reporting in the future; and
- the other factors those described in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and in Part II, Item 1A of this Report and our subsequent filings with the U.S. Securities and Exchange Commission (the "Commission").

If these or other risks and uncertainties (including those described in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and in Part II, Item 1A of this Report and the Company's subsequent filings with the Commission) materialize, or if the assumptions underlying any of these statements prove incorrect, the Company's actual results may be materially different from those expressed or implied by such statements. We undertake no obligation to publicly revise any forward-looking statement to reflect circumstances or events after the date of this Report to reflect the occurrence of unanticipated events. You should, however, review the factors and risks described in the reports we file from time-to-time with the Commission after the date of this Report.

World Wide Web addresses contained in this Report are for explanatory purposes only and they (and the content contained therein) do not form a part of and are not incorporated by reference into this Report.

Net Element, Inc.

Form 10-Q

For the Three and Nine Months Ended September 30, 2015

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PART I — FINANCIAL INFORMATION

NET ELEMENT, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash	$315,728	$503,343
Funds in Escrow	5,000,000	-
Accounts receivable, net	4,539,765	3,417,173
Advances to aggregators, net	45,114	18,455
Prepaid expenses and other assets	952,283	944,243
Total current assets, net	10,852,890	4,883,214
Fixed assets, net	200,932	70,918
Intangible assets, net	8,116,787	2,492,050
Goodwill	6,671,750	6,671,750
Other long term assets	335,268	204,737
Total assets	$26,177,627	$14,322,669
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,388,770	$2,698,257
Deferred revenue	530,013	472,482
Accrued expenses	2,580,818	2,351,885
Derivative liability conversion feature	428,884	-
Warrant derivative liability	3,978,495	-
Short term notes payable (net of discount)	694,445	-
Notes payable (current portion)	950,894	98,493
Due to related parties	467,806	-
Total current liabilities	14,020,125	5,621,117
Note payable (non-current portion)	3,014,106	3,216,507
Total liabilities	17,034,231	8,837,624
Series A Convertible Preferred stock ($1,000 stated value, 1,000,000 shares authorized, 972 shares issued and outstanding, at September 30, 2015, net of discount)	953,903	-
Commitments and contingencies		
STOCKHOLDERS' EQUITY		

Common stock ($.0001 par value, 300,000,000 shares authorized and 77,752,600 and 45,881,523 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively)	7,775	4,589
Paid in capital	149,507,581	136,689,629
Stock subscription receivable	(1,111,130)	(1,111,130)
Accumulated other comprehensive loss	(1,665,625)	(1,251,461)
Accumulated deficit	(138,779,508)	(129,116,344)
Noncontrolling interest	230,400	269,762
Total stockholders' equity	9,143,396	5,485,045
Total liabilities, mezzanine and stockholders' equity	$26,177,627	$14,322,669

See accompanying notes to unaudited condensed consolidated financial statements.

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NET ELEMENT, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net revenues	$ 12,675,123	$ 6,026,961	$ 25,122,250	$ 15,782,475
Costs and expenses:				
Cost of revenues	10,705,327	4,717,855	20,787,216	11,591,435
General and administrative (includes $601,371, $522,981, $1,804,113 and $1,275,498 of share based compensation for the three and nine months ended September 30, 2015 and 2014, respectively)	2,760,541	2,433,296	8,582,864	8,119,738
Provision for (recovery of) bad debt	284,384	136,150	425,225	(1,302,554)
Depreciation and amortization	851,636	684,503	1,916,901	1,900,995
Total costs and operating expenses	14,601,888	7,971,804	31,712,206	20,309,614
Loss from operations	(1,926,765)	(1,944,843)	(6,589,956)	(4,527,139)
Interest expense, net	(1,605,034)	(790,490)	(3,007,216)	(3,622,225)
(Loss) gain on change in fair value and settlement of beneficial conversion derivative	(1,083,028)	-	939,008	5,569,158
Gain (loss) on debt extinguishment	79,325	(2,221,813)	79,325	(6,184,219)
Gain on debt restructure	-	-	-	1,596,000
Gain from asset disposal	44,928	44,456	68,786	16,137
Other expense	(46,204)	(57,602)	(49,492)	(105,217)
Net loss before income taxes	(4,536,778)	(4,970,292)	(8,559,545)	(7,257,505)
Income taxes	-	-	-	-
Net loss	(4,536,778)	(4,970,292)	(8,559,545)	(7,257,505)
Net loss attributable to the noncontrolling interest	23,577	9,912	42,850	51,567
Net loss attributable to Net Element, Inc. shareholders	(4,513,201)	(4,960,380)	(8,516,695)	(7,205,938)
Dividends for the benefit of preferred stockholders	(621,273)	-	(1,146,470)	-
Net loss attributable to common stock	(5,134,474)	(4,960,380)	(9,663,165)	(7,205,938)
Foreign currency translation	(189,644)	(273,679)	(414,168)	887,400
Comprehensive loss attributable to common stock	$ (5,324,118)	$ (5,234,059)	$ (10,077,333)	$ (6,318,538)

Loss per share - basic and diluted	$ (0.07)	$ (0.13)	$ (0.18)	$ (0.21)
Weighted average number of common shares outstanding - basic and diluted	68,504,421	39,316,693	53,969,603	34,683,766

See accompanying notes to unaudited condensed consolidated financial statements.

NET ELEMENT, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities		
Net loss	$(8,516,695)	$(7,205,938)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities		
Non controlling interest	(42,850)	376,059
Share based compensation	1,202,742	1,275,498
Deferred revenue	(36,764)	26,310
Gain on change in fair value and settlement of beneficial conversion derivative	(939,008)	(5,569,158)
Depreciation and amortization	1,916,901	1,900,995
Amortization of debt discount	2,610,030	1,644,626
(Recovery of) provision for loan losses	-	(1,640,109)
(Gain) loss on disposal of fixed assets	(68,786)	16,137
(Gain) loss on debt extinguishment	(79,325)	6,184,219
Gain on MBF debt restructure	-	(1,596,000)
Changes in assets and liabilities, net of acquisitions and the effect of consolidation of equity affiliates		
Account receivable	(1,203,429)	8,274,683
Advances to aggregators	(32,890)	923,016
Prepaid expenses and other assets	(89,835)	(270,642)
Accounts payable	1,728,877	(310,965)
Accrued expenses	45,473	(1,069,530)
Net cash (used in) provided by operating activities	(3,505,559)	2,959,201
Cash flows from investing activities		
Purchase of portfolio and client acquisition costs	(423,250)	(1,339,096)
Sale of portfolio	300,000	-
Note receivable	(26,795)	-
Acquisition of PayOnline assets, net of cash received	(3,195,452)	-
Purchase of fixed and other assets	(484,137)	(5,019)
Net cash used in investing activities	(3,829,634)	(1,344,115)
Cash flows from financing activities		
Repayment to Financial Institutions	-	(8,454,027)
Proceeds from preferred stock	5,500,000	-
Proceeds from indebtedness	650,000	8,879,898
Repayment of indebtedness	-	(3,112,775)
Related party advances	650,000	-
Net cash provided by (used in) financing activities	6,800,000	(2,686,904)

Effect of exchange rate changes on cash	347,578	2,350,870
Net (decrease) increase in cash	(187,615)	1,279,052
Cash at beginning of period	503,343	126,319
Cash at end of period	$315,728	$1,405,371
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	$397,186	$1,338,402
Taxes	$74,417	$296,844
Non Cash activities:		
Notes payable (net of discount)	$694,445	$-
Funds in escrow from issuance of notes	$5,000,000	$-
Derivative Liability - warrants	$3,978,495	$-
Preferred dividends paid in common stock	$1,146,470	$-

See accompanying notes to unaudited condensed consolidated financial statements.

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NET ELEMENT, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Net Element, Inc. ("We", "us", "our" or the "Company") is a financial technology-driven group specializing in mobile payments and other transactional services in emerging countries and in the United States. We are differentiated by our proprietary technology which enables us to provide a broad suite of payment products, end-to-end transaction processing services and superior client support. We have three reportable segments: (i) U.S. payment processing, (ii) Emerging market online commerce and payment processing and (iii) Mobile commerce (primarily in Russian Federation and CIS). We are able to deliver these services across multiple points of access, or "multi-channel," including brick and mortar locations, software integration, e-commerce, mobile operator billing, mobile and tablet-based solutions. In the United States, via our U.S. based subsidiaries, we generate revenues from transactional services and other payment technologies for small and medium-sized businesses. Through TOT Group Russia and Net Element Russia, we provide transactional services, mobile payment transactions, online payment transactions and other payment technologies in emerging countries in the Russian Federation, Commonwealth of Independent States ("CIS"), Europe and Asia.

Business

Our transactional services business enables merchants to accept credit cards as well as other forms of payment, including debit cards, checks, gift cards, loyalty programs and alternative payment methods in traditional card-present or swipe transactions, as well as card-not-present transactions, such as those conducted over the phone or through the Internet or a mobile device. We market and sell our services through both independent sales groups ("ISGs"), which are non-employee, external sales organizations and other third party resellers of our products and services, and directly to merchants through electronic media, telemarketing and other programs, including utilizing partnerships with other companies that market products and services to local and international merchants. In addition, we partner with banks such as BMO Harris Bank, N.A. in the United States and VTB Bank, Bank of Moscow, Raiffeisen Bank, Kazkommertsbank, and Rietumu Bank in the Russian Federation, CIS, Europe and Asia to sponsor us for membership in Visa ® , MasterCard ® and/or other card associations and to settle transactions with merchants. We perform core functions for merchants such as application processing, underwriting, account set-up, risk management, fraud detection, merchant assistance and support, equipment deployment and chargeback services.

Our mobile payments business, Digital Provider, LLC (f/k/a Tot Money, LLC) ("Digital Provider") provides carrier-integrated mobile payments solutions. Our relationships with mobile operators give us substantial geographic coverage, a strong capacity for innovation in mobile payments and messaging, and the ability to offer our clients' in-app, premium SMS, online and carrier billing services. We also market our own branded content which is a new business line for our mobile payments business.

Aptito is a proprietary, next-generation, cloud-based payments platform for the hospitality industry, which creates an online consumer experience in offline commerce environments via tablet, mobile and all other cloud-connected devices. Aptito's easy to use point-of-sale ("POS") system makes things easier by providing comprehensive solution to the hospitality industry to help streamline management and operations. Orders placed tableside by customers directly speed up the ordering process and improve overall efficiency. Aptito's mobile POS system provides portability to the staff while performing all the same functions as a traditional POS system, and more.

PayOnline provides flexible high-tech payment solutions to companies doing business on the Internet or in the mobile environment. PayOnline specializes in integration and customization of payment solutions for websites and mobile apps. In particular, PayOnline arranges payment on the website of any commercial organization, which increases the convenience of using the website and helps maximize the number of successful transactions. In addition, PayOnline is focused on providing online and mobile payment acceptance services to the travel industry through direct integration with leading Global Distribution Systems, which includes Amadeus® and Sabre®. Key regions of the PayOnline company are: the CIS, Eastern Europe, Central Asia, Western Europe, North America and Asia major sub regions. PayOnline offices are located in Russia and in the Republic of Cyprus. We included the results of PayOnline starting May 20, 2015.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and reflect all adjustments, which are of a normal and recurring nature, that are, in the opinion of management, necessary for a fair presentation of our condensed consolidated financial position and results of operations for the related periods. All significant intercompany transactions and balances have been eliminated in consolidation. The consolidated results of operations for any interim periods are not necessarily indicative of results to be expected for the full year.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of expenses for the period presented. Actual results could differ from those estimates.

Significant estimates include (i) the valuation of acquired merchant portfolios (ii) the recoverability of indeterminate-lived assets, (iii) the remaining useful lives of long-lived assets, and (iv) the sufficiency of merchant, aggregator, legal, and other reserves. On an ongoing basis, we evaluate the sufficiency and accuracy of our estimates. Actual results could differ from those estimates.

Cash and Cash Equivalents

We maintain our U.S. dollar-denominated cash in several non-interest bearing bank deposit accounts and we have no cash equivalents. At September 30, 2015 and December 31, 2014, the U.S. based bank balances did not exceed Federal Deposit Insurance Corporation (FDIC) insured institution limits of $250,000.

We maintain approximately $200,799 and $318,416 in uninsured bank accounts in Russia, Ukraine, Cyprus and the Cayman Islands at September 30, 2015 and December 31, 2014, respectively.

In addition at September 30, 2015, we had $5,000,000 that the holders of the senior convertible notes and warrants had a contractual obligation to place in escrow for our offering of such notes and warrants. See "—Senior Convertible Notes and Warrants" in Note 8 and subsequent events in Note 18 for additional information.

Accounts Receivable

Receivables are stated net of allowance for doubtful accounts. We estimate an allowance based on experience with our service providers and judgment as to the likelihood of their ultimate payment. We also consider collection experience and make estimates regarding collectability based on trends in the customers aging. In Russia, the service providers are large telecommunication companies and we do not reserve for these receivables given their financial strengths and our experience with these service providers.

Other Current Assets

We maintain an inventory of point of sale terminals (including iPads® used for mobile point of sale), which we use to service both merchants and independent sales agents. If the terminals are sold for a fee, we expense the cost of these terminals, plus any set up fees at the time of the sale. Often, we will provide the terminals as an incentive to such merchants and independent sales agents to enter into a merchant contract with us, which have an average length of three years. In such case, the cost of the terminal plus any set up fees will be amortized over the three years. If the merchants early terminate their contract with us, they are obligated to either return the terminal or pay for the terminal. We had $414,297 in terminals and related equipment at September 30, 2015 and $532,315 at December 31, 2014, of which $210,998 has been placed with merchants at September 30, 2015 and $292,718 at December 31, 2014. Amortization of these terminals amounted to $33,353 and $95,764 for the three and nine months ended September 30, 2015, respectively, and $26,667 and $72,038 for the comparative 2014 periods.

Fixed Assets

We depreciate our furniture and equipment over a term of three to ten years. Computers and software are depreciated over terms between two and five years. Leasehold improvements are depreciated over the shorter of the economic life or term of each lease. All of our assets are depreciated on a straight-line basis for financial statement purposes.

Expenditures for repairs and maintenance are charged to operating expense as incurred. Expenditures that increase the value or productive capacity of assets are capitalized. At the time of retirements, sales, or other dispositions of property and equipment, the original cost and related accumulated depreciation are removed from the respective accounts, and the gains or losses are presented as other expenses.

Accrued Residual Commissions

We pay agent commissions to ISGs and independent sales agents based on the processing volume of the merchants enrolled. The commission payments are based on varying percentages of the volume processed by us on behalf of the merchants. Percentages vary based on the program type and transaction volume of each merchant. We report commission payments as a cost of revenues in the accompanying condensed consolidated statement of operations and comprehensive loss.

At September 30, 2015 and December 31, 2014 the residual commissions payable to ISGs and independent sales agents were $652,798 and $514,252 respectively.

We pay agent commission on annual fees between January and April of each year. We amortize the annual fees paid in equal monthly amounts from date of payment to end of year. We pay our agent commissions for annual fees in advance of recognizing the associated revenue. We deferred $306,449 and $175,800 of agent commissions paid for annual fees at September 30, 2015 and December 31, 2014, respectively. Prepaid agent commissions for annual fees are included in prepaid expenses, and commissions payable are included in accounts payable in the accompanying condensed consolidated balance sheets.

Intangible Assets

Included in our intangible assets are merchant portfolios which represent the net book value of an acquired merchant customer base. Merchant portfolios are amortized on a straight-line basis over their respective useful lives, generally three to five years. Merchant portfolios are assessed for impairment if events or circumstances indicate that their respective carrying values are not recoverable from the future anticipated undiscounted net cash flows attributable to such assets. In such cases, the amount of any potential impairment would be measured as the excess, if any, of carrying value over the fair value of such assets.

We also capitalize direct expenses associated with filing of patents and patent applications, and amortize the capitalized intellectual property costs over five years beginning when the patent is approved.

Additionally, we capitalize the fair value of intangible assets acquired in business combinations. We obtain third party valuations of net assets acquired, and allocate the purchase price of each acquired business to its respective net tangible and intangible assets. Acquired intangible assets include: merchant portfolios, trade and domain names, non-compete agreements, customer relationships, technology and certain contracts.

Capitalized Customer Acquisition Costs, Net

Included in intangible assets are capitalized customer acquisition costs, which consist of up-front cash payments made to certain ISGs for the establishment of new merchant relationships. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins (future net cash flows) associated with merchant contracts. The up-front payment to the ISG is based on the estimated gross margin for the first year of the merchant contract. The deferred customer acquisition cost asset is recorded at the time of payment and the capitalized acquisition costs are primarily amortized on a straight-line basis over a period of three years.

Management evaluates the capitalized customer acquisition cost for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net undiscounted cash flows from underlying merchant relationships to the carrying amount of capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the carrying value of the capitalized customer acquisition costs, the impairment loss is charged to operations.

Unamortized customer acquisition costs were $854,691 and $526,728 at September 30, 2015 and December 31, 2014, respectively, and are reflected as intangible assets in the accompanying unaudited condensed consolidated balance sheets. During the three and nine months ended September 30, 2015, we capitalized customer acquisition costs of $258,725 and $562,500, respectively, and amortized an additional $93,999 and $234,537 for the three and nine months ended September 30, 2015, respectively.

Financial Instruments

Convertible securities containing detachable warrants where the conversion price of the security and/or the exercise price of the warrants are affected by the current market price of our common stock are accounted for as derivative financial instruments when the exercise and conversion prices are not considered to be indexed to our stock. These derivatives are recorded as liabilities and presented in our condensed consolidated balance sheets under the captions "BCF derivative liabilities" and "Warrant derivative liabilities".

For such issuances of convertible securities with detachable warrants, we initially record both the warrant and the beneficial conversion feature ("BCF") at fair value, using option pricing models commonly used by the financial services industry (Black-Scholes-Merton options pricing model) using inputs generally observable in the financial services industry. These derivative financial instruments are marked-to-market each reporting period, with unrealized changes in value reflected in earnings under the caption "gain (loss) on change in fair value of derivative".

For discounts arising from issuances of instruments embedded in a debt security, the discount is presented on our condensed consolidated balance sheets as a discount to the principal amount of the related note payable. For discounts arising from issuances of instruments embedded in an equity security, the discount is presented as a reduction to additional paid-in-capital.

The resulting discounts arising from the initial recording of the warrants and BCF are amortized over the term of the host security. The classification of the amortization is based on the nature of the host instrument. In this respect, amortization of discounts associated with debt issuances are classified as interest expense, whereas amortization of discounts associated with preferred stock issuances are classified as preferred stock dividends.

At the time a warrant or BCF is exercised, the fair value of the derivative financial instrument at the time of exercise/conversion is calculated, and a realized gain or loss on conversion is determined and reported as “gain (loss) on settlement of derivative”.

Fair Value Measurements

Our financial instruments consist primarily of cash, accounts receivable, accounts payable and debt instruments. The carrying values of cash, accounts receivable and trade payables are considered to be representative of their respective fair values due to the short-term nature of these instruments. The carrying amount of the debt instruments of $4,659,445 at September 30, 2015 and $3,315,000 at December 31, 2014 approximates fair value because our current borrowing rate does not materially differ from market rates for similar bank borrowings. The September 30, 2015 debt balance is net of an unamortized discount of $4,305,555.

We measure certain non-financial assets and liabilities at fair value on a non-recurring basis. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. We use a three-level fair value hierarchy to prioritize the inputs used to measure fair value and maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 — Quoted market prices in active markets for identical assets or liabilities as of the reporting date

Level 2 — Observable market based inputs or unobservable inputs that are corroborated by market data

Level 3 — Unobservable inputs that are not corroborated by market data

These non-financial assets and liabilities include intangible assets and liabilities acquired in business combinations as well as impairment calculations, when necessary. The fair value of the assets acquired and liabilities assumed in connection with the PayOnline acquisition, as discussed in Note 4, were measured at fair value at the acquisition date. The fair values of our merchant portfolios are primarily based on Level 3 inputs and are generally estimated based upon independent appraisals that include discounted cash flow analyses based on our most recent cash flow projections, and, for years beyond the projection period, estimates based on assumed growth rates. Assumptions are also made regarding appropriate discount rates, perpetual growth rates, and capital expenditures, among others. In certain circumstances, the discounted cash flow analyses are corroborated by a market-based approach that utilizes comparable company public trading values, and, where available, values observed in private market transactions. The inputs used by management for the fair value measurements include significant unobservable inputs that are not corroborated by market data, and therefore, the fair value measurements employed are classified as Level 3. The goodwill impairment assessment is primarily based on observable inputs using company specific information and is classified as Level 3.

Foreign Currency Transactions

We are subject to exchange rate risk from our foreign operations in Russia, CIS and Europe, the functional currency of which is the Russian ruble, Kazakhstan tenge and euro. In Russia, we generate service fee revenues and incur product development, engineering, website development, interest expense, and general and administrative costs and expenses. The Russian operations receive income and pay a majority of their operating expenses in rubles, exposing us to exchange rate risk. PayOnline processing transactions in Kazakhstan and Europe and earns service fees in tenge and euro.

We do not engage in any currency hedging activities.

Revenue Recognition

We recognize revenue when the following four basic criteria have been met: (1) persuasive evidence of a sales arrangement exists, (2) performance of services or delivery of goods has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. We consider persuasive evidence of a sales arrangement to be the receipt of a billable transaction from aggregators, merchants or a signed contract. Collectability is assessed based on a number of factors, including transaction history with the customer and the credit worthiness of the customer. If it is determined that the collection is not reasonably assured, revenue is not recognized until collection becomes reasonably assured, which is generally upon receipt of cash. We record cash received in advance of revenue recognition as deferred revenue.

Our revenues for the three and nine months ended September 30, 2015 and 2014 are principally derived from the following sources:

Transactional Processing Fees: Transactional processing fees are generated primarily from TOT Payments doing business as Unified Payments, which is our US transaction processing company, PayOnline, which is our Russian online transaction processing company, consolidated effective May 20, 2015 when we obtained control of PayOnline. See "PayOnline" in Note 4 for additional more information and Aptito our point of sale solution for restaurants.

Our transactional processing companies derive revenues primarily from the electronic processing of services including: credit, debit, electronic benefits transfer and alternative payment methods card processing authorized and captured through proprietary and third party networks, electronic gift certificate processing, and equipment sales. These revenues are recorded as bankcard and other processing transactions when processed. In addition to generating service fees, Aptito earns monthly license fees for use of its platform.

Typically, fees charged to merchants for these processing services are based on a variable percentage of the dollar amount of each transaction and in some instances, additional fees are charged for each transaction. Merchant customers also may be charged miscellaneous fees, including statement fees, annual fees, monthly minimum fees, fees for handling chargebacks, gateway fees, and fees for other miscellaneous services.

Generally, we (i) are the primary obligor in our arrangements with our merchant customers, (ii) have latitude in establishing the price of our services, (iii) have the ability to change the product and perform parts of the services, (iv) have discretion in supplier selection, (v) have latitude in determining the product and service specifications to meet the needs of our merchant customers, and (vi) assume credit risk. In such cases, we report revenues as gross of fees deducted by our sponsoring member banks, as well as fees deducted from card-issuing member banks and card associations (Visa® and MasterCard®) on behalf of our sponsoring member banks for interchange and assessments. These fees charged by the card associations to process the credit card transactions are recorded separately as cost of revenue and interchange fees in the accompanying condensed consolidated statement of operations and comprehensive loss.

Service and Subscription Fees: Service fees are generated primarily from mobile payment processing services to third party content aggregators provided by Digital Provider. Service fees for services provided for content providers historically have been recorded net of mobile operator fees. During 2015, TOT Money began to offer branded content to customers and changed its name to "Digital Provider". Digital Provider's revenues for the access of branded content are recorded at the amounts charged to the mobile customer. A corresponding charge to cost of sales for mobile operator and content fees is recorded for branded content.

Mobile payment processing revenues for third party content providers are accounted for as service fees and presented net of aggregator and mobile operator payments on the condensed consolidated financial statements as these revenues are considered to be agency fees.

Cost of revenues for Digital Provider is comprised primarily of mobile operator fees, content provider fees and fees for short numbers paid to mobile operators. Additionally, penalties and penalty recoveries are recorded as cost of sales. Funds received from mobile operators, include amounts due to aggregators for supplying us with billable transactions from content providers. Service revenues are presented net of aggregator payments on the condensed consolidated financial statements as these revenues are considered to be agency fees.

Subscription revenues for our branded content are recognized when a content subscriber initiates the purchase of our content using WAP-click, Internet-click, or a SMS-to-short number registered to us.

Digital Provider's subscription revenues are recorded at the amounts charged to the third party customer.

Cost of revenues for Digital Provider branded content includes fees due to mobile operators and marketing partners, as well as short number fees.

Cost of revenues for TOT Payments, Aptito and PayOnline is comprised primarily of processing fees paid to third parties attributable to providing transaction processing and service fees for POS system usage by our merchant customers. Interchange fees and cost of services are recognized as incurred, which generally occurs in the same period in which the corresponding revenue is recognized. Interchange fees are set by the card networks, and are paid to the card-issuing bank. Interchange fees are calculated as a percentage of the dollar volume processed plus a per transaction fee. We also pay Visa® and MasterCard® network dues.

Net Loss per Share

Basic net loss per common share is computed by dividing net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares issuable upon exercise of common stock options or warrants. In periods when losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents because their inclusion would have an anti-dilutive effect. At September 30, 2015, we had 11,648,260 warrants and 119,194 stock options issued and outstanding that are anti-dilutive in effect. At December 31, 2014, we had 8,938,900 warrants and 119,194 incentive stock options issued and outstanding that are anti-dilutive in effect.

Impairment of Long-Lived Assets

We review our long-lived assets for impairment whenever events or changes indicate that the carrying amount of an asset or group of assets may not be recoverable. During the three and nine months ended September 30, 2015 and year ended December 31, 2014, we did not recognize any charges for impairment of goodwill and intangible assets.

Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the condensed consolidated financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We recognize net deferred tax assets to the extent that our management believes these assets are more likely than not to be realized. In making such a determination, management considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If management determines that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, an adjustment would be made to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

We account for uncertainty in income taxes using a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. We recognize a liability for unrecognized tax benefits as current to the extent that we anticipate payment (or receipt) of cash within one year. Interest and penalties related to uncertain tax positions are recognized and recorded as necessary in the provision for income taxes. Our evaluation of uncertain tax positions was performed for the tax years ended December 31, 2010 and forward, the tax years which remain subject to examination as of December 31, 2014. Please see Note 16 for discussion of our uncertain tax positions.

Recently Issued Accounting Guidance

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09 ("ASU 2014-09"), Revenue from Contracts with Customers (Topic 606). Under ASU 2014-09, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The original effective date for ASU 2014-09 would have required the Company to adopt the new standard beginning in its first quarter of 2017. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the mandatory effective date as well as providing the option to early adopt the standard on the original effective date. Accordingly, the Company may adopt the standard in either its first quarter of 2017 or 2018. We are evaluating ASU 2014-09 to determine if this guidance will have a material impact on our condensed consolidated financial statements.

In November 2014, the FASB issued Accounting Standards Update 2014-16 ("ASU 2014-16"), Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force). ASU 2014-16 does not change the current criteria in GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required, but clarifies how current GAAP should be interpreted in the evaluation of the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share, reducing existing diversity in practice. ASU 2014-16 is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. We are evaluating ASU 2014-16 to determine if this guidance will have a material impact on our condensed consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03 Interest-Imputation of Interest (Subtopic 835-30) ("ASU 2015-03") to modify the presentation of debt issuance costs. Prior to ASU 2015-03, issuance costs were presented as an asset on the statement of financial position, which the FASB concluded was inconsistent with both International Financial Reporting Standards (IFRS) as well as FASB Concept Statement No. 6. Under ASU 2015-03, debt issuance costs are required to be presented as a direct deduction of debt balances on the statement of financial position, similar to the presentation of debt discounts. ASU 2015-03 will be effective for public companies for years beginning after December 15, 2015, and interim periods within those fiscal periods. Additionally, the provisions should be applied on a retrospective basis as a change in accounting principle. The adoption of ASU 2015-03 will result in a reduction in total assets and total liabilities in the amount of the then unamortized debt issuance costs.

NOTE 2. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The following entities make up our continuing operations: (1) TOT Group, Inc., a 100% owned subsidiary formed in Delaware; (2) Netlab Systems, LLC, a wholly owned subsidiary formed in Florida; (3) NetLab Systems IP, LLC, a wholly owned subsidiary formed in Florida; (4) OOO Net Element Russia ("Net Element Russia"), a wholly owned subsidiary formed in Russia; and (5) Net Element Services, LLC, a wholly owned subsidiary formed in Florida.

The subsidiaries listed above are the parent companies of several other subsidiaries, which hold the Company's underlying investments or operating entities.

TOT Group is the parent company of TOT Payments, LLC ("TOT Payments") doing business as Unified Payments a wholly owned subsidiary formed in Florida, Aptito, LLC, a 80% owned subsidiary formed in Florida (acquired June 18, 2013), TOT Group Europe LTD, a wholly owned subsidiary formed in the United Kingdom, Unified Portfolios, LLC, a wholly owned subsidiary formed in Florida and OOO TOT Group Russia, a wholly owned subsidiary formed in Russia.

- TOT Payments, LLC is the parent company of:
  - Process Pink, LLC, a wholly owned subsidiary formed in Florida;
  - TOT HPS, LLC, a wholly owned subsidiary formed in Florida;
  - TOT FBS, LLC, a wholly owned subsidiary formed in Florida;
  - TOT New Edge, LLC, a wholly owned subsidiary formed in Florida;
  - TOT BPS, LLC, a wholly owned subsidiary formed in Florida

- OOO TOT Group Russia is the parent company of its wholly owned subsidiary OOO Digital Provider (f/k/a OOO TOT Money)(a company formed in Russia), Payonline Systems, LLC (a wholly-owned company formed in Russia), Innovative Payment Technologies, LLC (a wholly-owned company formed in Russia) and TOT Group Kazakhstan, a wholly owned subsidiary formed in Kazakhstan.

- Netlab Systems, LLC is the parent company of Tech Solutions LTD (Cayman Islands).
- Net Element Russia is the parent company of 99% owned OOO TOT Group.
- TOT Group Europe LTD is 100% owner of Polimore Capital Limited (Cyprus) and Brosword Holding Limited (Cyprus)

All material intercompany accounts and transactions have been eliminated in consolidation.

NOTE 3. LIQUIDITY AND GOING CONCERN CONSIDERATIONS

Our unaudited condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. We sustained a net loss of approximately $8.6 million and $7.2 million for the nine months ended September 30, 2015 and 2014 respectively. At September 30, 2015, we had a working capital deficit of approximately $3.0 million and an accumulated deficit of approximately $139 million. These conditions raise substantial doubt about our ability to continue as a going concern.

Failure to successfully continue developing our payment processing operations and maintain contracts with merchants, mobile phone carriers and content providers to use TOT Group’s services could harm our revenues and materially adversely affect our financial condition and results of operations. We face risks including the need for additional capital, our management’s potential underestimation of initial and ongoing costs, and potential delays and other problems in connection with developing our technologies and operations.

We are continuing with our plan to further grow and expand our payment processing operations in emerging markets, particularly in Russia and surrounding countries. Management believes that its current operating strategy will provide the opportunity for us to continue as a going concern so long as we are able to secure additional long-term financing; however, there is no assurance this will occur, or on terms favorable to us. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

On June 19, 2015, we received a deficiency letter from The NASDAQ Capital Market indicating that for 30 consecutive trading days our common stock had a closing bid price below the $1.00 per share minimum. In accordance with NASDAQ Listing Rules, we were provided a compliance period of 180 calendar days, or until December 16, 2015, to regain compliance with this requirement. We can regain compliance with the minimum closing bid price requirement if the bid price of our Common Stock closes at $1.00 per share or higher for a minimum of 10 consecutive business days. If we do not regain compliance with the minimum closing bid price requirement during the initial 180-day compliance period, we may be eligible for an additional 180-day compliance period, provided that we meet the continued listing requirement for market value of publicly held shares and all other initial listing standards, with the exception of the bid price requirement, and we notify The NASDAQ Capital Market staff of our intention to cure the deficiency during the additional compliance period. We have announced our intention to complete a reverse stock split in the conversion range of 1:20 to 1:30. We are currently seeking shareholder approval for the reverse stock split and there is no assurance the stock split will cure the compliance issue. For additional discussion, see “Our common stock may be delisted from The NASDAQ Capital Market, which could affect its market price and liquidity” in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2015.

NOTE 4. MERGER AND ACQUISITION TRANSACTIONS

PayOnline

On May 20, 2015, our subsidiaries TOT Group Europe, Ltd. and TOT Group Russia LLC, entered into an agreement to acquire all of the assets and liabilities that comprise PayOnline. PayOnline's business includes the operation of a protected payment processing system to accept bank card payments for goods and services.

Purchase consideration consists of a combination of $3.6 million in cash, and restricted common shares with a value of $3.6 million, payable in five quarterly installments, and, if applicable, additional earn-out payments in cash and restricted common shares based on a multiple of EBITDA. The acquisition agreement sets forth the determination of the value of such shares based on the closing stock price on the date before each applicable payment date. During the period ended September 30, 2015, we recorded a charge of $196,086 relating to the earn out provision, of which $80,173 remains payable at September 30, 2015.

The following table summarizes the fair value of consideration paid and the preliminary allocation of purchase price to the fair value of tangible and intangible assets and liabilities, including the estimated useful lives of acquired assets:

Purchase Consideration:	(in Millions)		
Cash	$	3.6	
Issuance of Net Element Stock		3.6	
Total Consideration Transferred	$	7.2	
Purchase Price Allocation to Identifiable assets acquired and liabilities assumed (Preliminary)			
Current Assets	$	0.8	
Merchant Portfolios and Client lists		1.9	
Other Intangible Assets		4.8	
Fixed Assets		0.1	
Current Liabilities		(0.4	)
Total Identifiable Net Assets		7.2	
Total Purchase Price Allocation	$	7.2	

Unaudited Pro Forma Information – PayOnline Acquisition

The following unaudited supplemental pro forma results of operations include the results of operations of PayOnline as if the acquisition of PayOnline occurred on January 1, 2014, and have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined companies for the periods presented or that may be achieved by the combined companies in the future. Future results may vary significantly from the results reflected in the following pro forma financial information because of future events and transactions, as well as other factors, many of which are beyond the Company's control.

The unaudited pro forma combined results of operations for the three and nine months ended September 30, 2015 and 2014 have been prepared by adjusting the historical results of the Company to include the historical results of PayOnline as if the acquisition of PayOnline occurred on January 1, 2014. The pro forma results of operations do not include any adjustments to eliminate the impact of acquisition related costs or any cost savings or other synergies that may result from these acquisitions. As noted above, the pro forma results of operations do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future.

	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Net Revenues	$ 12,675,123	$ 26,810,882	$ 8,062,221	$ 21,131,244
Net Loss from Operations	$ (1,926,765)	$ (6,556,032)	(2,282,692)	(6,085,294)

NOTE 5. ACCOUNTS RECEIVABLE AND ADVANCES TO AGGREGATORS

Accounts receivable consist of amounts due from processors and mobile operators. Total accounts receivable amounted to $4,539,765 and $3,417,173 at September 30, 2015 and December 31, 2014, respectively. Accounts receivable included $2,478,162 and $1,346,118 of amounts due from mobile operators and $2,061,660 and $2,071,053 of credit card processing receivables at September 30, 2015 and December 31, 2014, respectively. Credit card processing receivables are net of a $103,030 allowance for doubtful accounts at September 30, 2015 and December 31, 2014.

For the three months ended September 30, 2015 we recorded $307,154 for Automated Clearing House, (“ACH”) rejects in the normal course of operation, offset by loan recoveries of $22,769 from our Russian Operations. For the nine months ended September 30, 2015 we recorded $542,764 for ACH rejects in the normal course of operation, offset by loan recoveries of $117,539 from our Russian Operations.

The cycle of our TOT Payments processing business begins when TOT Payments charges merchants for processing services, based on a variable percentage of the dollar amount of each transaction and in some instances, additional fees are charged for each transaction. Merchant customers also may be charged miscellaneous fees, including statement fees, annual fees monthly minimum fees, fees for handling chargebacks, gateway fees, and fees for other miscellaneous service.

The cycle of our Digital Provider (f/k/a OOO TOT Money) mobile payment processing business begins with Digital Provider advancing funds to aggregators for data traffic to be provided to mobile operators. Aggregators provide transactions to Digital Provider for processing and billing via its agreements with mobile operators. We do not reserve for these accounts receivable given our payment history with the mobile operators. The collection cycle with mobile operators is approximately 45 days.

Occasionally, Digital Provider advances funds to aggregators for future processing volume. At September 30, 2015 Digital Provider had and advances to aggregators of $45,114 and an $850,286 obligation to aggregators for branded content and is included in the accounts payable balance. The balance of advances to aggregators was $18,455 at December 31, 2014.

We monitor all accounts receivable and transactions with mobile operators and aggregators on a monthly basis to ensure collectability and the adequacy of loss provisions. Considerations include payment history, business volume history, financial statements of borrower, projections of borrower and other standard credit review documentation. Management uses its best judgment to adequately reserve for future losses after all available information is reviewed.

NOTE 6. FIXED ASSETS

Fixed assets are stated at cost less accumulated depreciation and amortization as follows:

	Useful life (in years)	September 30, 2015	December 31, 2014
Furniture and equipment	3 - 10	$ 185,535	$ 132,228
Computers	2 - 5	170,106	61,369
Total		355,641	193,597
Less: Accumulated depreciation		(154,709)	(122,679)
Total fixed assets, net		$ 200,932	$ 70,918

Depreciation expense for the three months ended September 30, 2015 and 2014 was $57,860 and $29,135, respectively and $84,279 and $40,415 for the nine months ended September 30, 2015 and 2014, respectively.

NOTE 7. INTANGIBLE ASSETS

Shown below are the details of intangible assets at September 30, 2015 and December 31, 2014:

	IP Sofware	Portfolios and Client Lists	Client Acquisition Costs	Contracts	Trademarks	Domain Names	Covenant Not to Compete	Total
Balance at December 31, 2014	$520,924	$1,082,731	$526,728	$-	$-	$-	$361,667	$2,492,050
Additions	55,037	-	117,650	-	-	-	-	172,687
Amortization	(36,138)	(219,408)	(65,496)	-	-	-	(70,000)	(391,042)
Balance at March 31, 2015	$539,823	$863,323	$578,882	$-	$-	$-	$291,667	$2,273,695
Additions	3,092,470	1,866,258	186,125	1,000,000	512,200	306,350	-	6,963,403
Amortization	(162,855)	(202,675)	(75,042)	(41,667)	(20,833)	(12,500)	(70,000)	(585,572)
Balance at June 30, 2015	$3,469,438	$2,526,906	$689,965	$958,333	$491,367	$293,850	$221,667	$8,651,526
Additions	127,530	-	258,725	-	-	-	-	386,255

Amortization	(262,698)	(183,547)	(93,999)	(83,333)	(41,667)	(25,000)	(70,000)	(760,244)
Divested	-	(160,750)	-	-	-	-	-	(160,750)
Balance at September 30, 2015	$3,334,270	$2,182,609	$854,691	$875,000	$449,700	$268,850	$151,667	$8,116,787

Software Development Costs

We capitalize software development costs that add value to or extend the useful life of the related software we develop for internal use and licensing. Costs for routine software updates are expensed as incurred. Capitalized costs are amortized over 36 months on a straight-line basis. Impairment is reviewed quarterly to ensure only viable active costs are capitalized. During the nine months ended September 30, 2015 we capitalized approximately $3.3 million of development costs primarily consisting of the following.

- Point of sale software ($0.1 million)
- Mobile payments billing software and payment processing software ($0.1 million)
- PayOnline software and gateways ($3.1 million)

During the year ended December 31, 2014, we capitalized $371,992 of development costs as part of developing for point of sale software ($243,341), payment processing software ($100,782) and mobile payments billing software ($27,869).

Merchant Portfolios

Merchant Portfolios consist of portfolios owned by us that earn future streams of income. The useful lives of these portfolios range from 15 to 36 months at the time of acquisition. At September 30, 2015 and December 31, 2014 the net value of these portfolios was $2,182,610 and $1,082,731 respectively. The value of the portfolios increased primarily due to our acquisition of PayOnline, which included client lists with a fair market value of $1,866,258. The useful lives of merchant portfolios represent management’s best estimate over which we expect to recognize the economic benefits of these intangible assets.

Contracts, trademarks and domain names.

As part of the PayOnline acquisition we acquired a contract with SD Ventures to process transactions for premium dating networks such as: AnastasiaDate, AmoLatina and AsiaDate with a fair market value of $1,000,000 at the date of the acquisition. In addition, we acquired certain trademarks with a $312,220 fair market value and domain names with a $506,330 fair market value at the date of acquisition.

Non-Compete Agreements

In connection with the Company's acquisition of Unified Payments, LLC ("Unified Payments") in 2013, two key executives of Unified Payments signed covenants not to compete. These covenants have a three-year life and have a net book value $151,667 and $361,667 at September 30, 2015 and December 31, 2014, respectively.

Total amortization expense for the three and nine months ended September 30, 2015 was $793,774 and $1,832,619, respectively, of which $33,531 and $95,762 represented amortization of inventory placed with merchants for the three and nine months ended September 30, 2015, respectively. Total amortization expense was $595,655 and $1,158,633 for the three and nine months ended September 30, 2014, respectively.

The following table presents the estimated aggregate future amortization expense of other intangible assets:

Year	Amortization Expense
2015 (3 months)	$ 720,867
2016	2,685,134
2017	2,603,468
2018	2,067,094
2019	40,223
Total	$ 8,116,787

NOTE 8. SHORT TERM DEBT

Alfa-Bank Factoring Agreement

In September 2012, Digital Provider entered into a factoring agreement with Alfa-Bank. Pursuant to the agreement, as amended (as amended and supplemented prior to the date hereof by supplement agreements, the “Factoring Credit Facility”, or “FCF”), Digital Provider assigned to Alfa-Bank its accounts receivable as security for financing for up to 300 million Russian rubles (approximately $9.8 million in U.S. dollars at time of signing). The amount loaned by Alfa-Bank pursuant to the FCF with respect to any particular account receivable is limited to 80% of the amount of the account receivable assigned to Alfa-Bank. Pursuant to the FCF, Alfa-Bank is required to track the status of Digital Provider’s accounts receivable, monitor timeliness of payment of such accounts receivable and provide related services. Interest on the factoring arrangement ranged from 9.70% to 11.95% annually of the amounts borrowed, with servicing fees ranging from 10 Russian rubles (approximately $0.33 in U.S. dollars) to 100 Russian rubles (approximately $3.28 in U.S. dollars) per account receivable. Digital Provider’s obligations under the FCF also are secured by a guarantee given by AO SAT & Company. AO SAT & Company is an affiliate of Kenges Rakishev, who is the Chairman of our Board of Directors. This Factoring Credit Facility agreement expired on April 20, 2014.

In September 2014, Digital Provider entered into the Supplement Agreement No. 14 and the Supplement Agreement No. 15 with Alfa-Bank, which renewed and amended the Factoring Credit Facility. Pursuant to such amendments, the FCF was renewed and will expire on June 30, 2016, the maximum aggregate limit of financing (secured by Digital Provider's accounts receivable) to be provided by Alfa-Bank to Digital Provider under the FCF was increased to 415 million Russian rubles (approximately US$10.8 million based on the currency exchange rate on September 17, 2014), Alfa-Bank's fees (commissions) for providing financing to Digital Provider was amended to be computed as a financing rate that ranges from 13.22% to 14.50% of the amounts borrowed, depending upon the number of days in the period from the date financing is provided until the date the factored receivable is paid. The maximum financing amount was increased from 80% to 100% of the assigned accounts receivable. The agreement requires us to comply with covenants. Accordingly, the amounts of our draws will depend on amounts of accounts receivable suitable for assignment at the time we choose to draw under such facility. We have not drawn any funds under the Factoring Credit Facility. This facility is no longer secured by Kenges Rakishev (AO SAT & Company).

Bank Otkritie Credit Agreement

In November 2014, Digital Provider entered into a factoring services agreement (together with related and ancillary agreements, collectively, the "Bank Otkritie Agreement") with Bank Otkritie Financial Corporation ("Bank Otkritie").

We have not drawn any funds under the Bank Otkritie Agreement and this agreement was terminated on August 31, 2015.

Term Loan.

On April 14, 2015, Revere Wealth Management, LLC provided a $200,000 term loan for with an annual interest rate of 12% due May 31, 2015. Terms of the loan provided for fees of $2,500 and the first $65,000 of the loan proceeds should be used to fund legal expenses associated with the Company's convertible preferred stock transaction and convertible senior notes and warrants transaction. This loan was repaid in May 2015.

Senior Convertible Notes and Warrants.

On April 30, 2015, we entered into a $5,000,000 Securities Purchase Agreement (the "Debt SPA") for the issuance of (i) senior convertible notes in the aggregate principal amount of $5,000,000 (the "Notes"), convertible into shares of our common stock and (ii) 2,709,360 warrants (the "Warrants") to purchase shares of our common stock.

The investors have the right to purchase additional Notes and Warrants, up to $10,000,000.

The notes accrue interest at 7% (default rate 18%) per year on the full face amount of $5,000,000, with accelerated interest and principal payments, payable in five (5) monthly installments in cash and/or shares of our common stock, and mature on April 30, 2018. The Notes are convertible into shares of our common stock at an initial price of $1.624 per share, subject to market adjustments and “down round” reductions in the conversion price arising from future stock issuances at prices less than the conversion price.

The Warrants have a term of three years from issuance and are immediately exercisable to purchase shares of our common stock at an initial exercise price of $1.74 per share, subject to market adjustments and “down round” reductions in the conversion price arising from future stock issuances at prices less than the exercise price. Under certain circumstances, the holder of the Warrants may elect a cashless exercise.

Upon the occurrence of a change in control or an event of default, as defined, holders of our Notes may require us to redeem for cash all or a portion of its Notes at a premium amount equal to the sum of (x) the greater of (a) 125% of the amount being redeemed, and (b) the market value of the underlying shares and (y) the make-whole Interest amount through the maturity date of the Notes.

The exercise price of the Warrants are subject to market adjustments and “down round” reduction. Under certain circumstances, the holders of the Warrants may elect a cashless exercise. As a result, the Warrants are not considered to be indexed to our common stock and are accounted for as derivative financial instruments. The Warrants were valued at date of issuance using the Black-Scholes-Merton options pricing model with the following assumptions: risk-free interest rate of 0.54%, expected life of 3 years, expected volatility of 63% and dividend yield of zero, resulting in a fair value of $5,329,593 at the time of issuance and a value of $3,978,495 at September 30, 2015.

The conversion rights embedded in the Notes are at a conversion price below-market, and subject to further market price adjustments and “down round” provisions. As a result, the beneficial conversion feature (“BCF”) is accounted for as derivative financial instrument. The BCF was valued at date of issuance using the Black- Scholes-Merton options pricing model with the following assumptions: fair market value of our stock at $0.80, risk-free interest rate of 0.35%, expected life of 2 years, expected volatility of 63% and dividend yield of zero, resulting in a recorded value of $376,344 both at the time of issuance (April 30, 2015) and $428,884 at September 30, 2015.

The book value of the Notes at September 30, 2015 is $694,445 as calculated below:

Total face value of note	$5,000,000
Total discount resulting from warrants	$(5,329,593)
Total discount resulting from the benefical conversion feature	$(376,344)
Amortization of Discounts	$1,400,382
Net book value of note at September 30, 2015	$694,445

Pursuant to a letter agreement dated August 4, 2015, absent a written agreement otherwise, (i) all Notes became automatically (i.e., without any further action by Company or the investors) null and void as of October 11, 2015 (the “Moratorium Date”) with no obligations or liabilities whatsoever of the Company relating thereto; (ii) the investors' right to purchase, and the Company's obligation to issue, Additional Notes and Additional Warrants (each, as defined in the Debt SPA) became automatically (i.e., without any further action by the Company or the investors) null and void as of the Moratorium Date with no obligations or liabilities whatsoever of the Company relating thereto. In addition, due to the fact that the Warrants were issued in conjunction and together with the Notes, the Company and the investors are engaged in discussions to address disagreements relating to the Warrants (also see Note 18).

NOTE 9. ACCRUED EXPENSES

At September 30, 2015 and December 31, 2014, accrued expenses amounted to $2,580,818 and $2,351,885, respectively. Accrued expenses represent expenses that are owed at the end of the period and have not been billed by the provider or are estimates of services provided. The following table details the items comprising the balances outstanding at September 30, 2015 and December 31, 2014.

	September 30, 2015	December 31, 2014
Accrued professional fees	$322,807	$295,144
Short term loan advances	150,000	75,346
Accrued payroll	31,966	70,463
Accrued bonus	1,621,420	1,409,131
Accrued foreign taxes	120,757	189,690
Other accrued expenses	333,868	312,111
	$2,580,818	$2,351,885

Accrued bonuses are attributed to our TOT Group subsidiaries, consisting of bonuses that were owed at the date of the Unified Payments acquisition, plus a discretionary bonus accrual.

NOTE 10. LONG TERM DEBT

Long term debt consisted of the following:

	September 30, 2015		December 31, 2014	
RBL Capital Group LLC	$ 3,965,000		$ 3,315,000	
Convertible Notes Payable	694,445	*	-	
Total Debt	4,659,445		$ 3,315,000	
Less Current Portion	(1,645,339	)	(98,493	)
Long Term Debt	$ 3,014,106		$ 3,216,507	

* $5,000,000, net of unamortized discount of $4,305,555

See "—Senior Convertible Notes and Warrants" in Note 8 and subsequent events in Note 18 for additional information.

RBL Capital Group, LLC

Effective June 30, 2014, TOT Group, Inc. and its subsidiaries as co-borrowers, TOT Payments, LLC, TOT BPS, LLC, TOT FBS, LLC, Process Pink, LLC, TOT HPS, LLC and TOT New Edge, LLC, entered into a Loan and Security Agreement with RBL Capital Group, LLC ("RBL"), as lender (the "RBL Loan Agreement"). Pursuant to the RBL Loan Agreement, we may borrow up to $10,000,000 from RBL during the period of 18 months from the closing of this credit facility. Prior to maturity of the loan, the principal amount of the borrowings under the credit facility will carry a fixed interest rate of the higher of 13.90% per annum or the prime rate plus 10.65%. After maturity of the loan, until all borrowings are paid in full, with respect to the advances under the credit facility, an additional three percent per annum would be added to such interest rate, and for any other amounts, obligations or payments due to RBL, an annual default rate not to exceed the lesser of (i) the prime rate plus 13% per annum and (ii) 18.635% per annum. As further described below, borrowings from the line of credit in the amounts of $3,315,000, $400,000 and $250,000 were converted into term loans. At September 30, 2015 and December 31, 2014 we had $6,035,000 and $6,685,000 available on our RBL credit line.

The co-borrowers' obligations to RBL pursuant to the RBL Loan Agreement are secured by a first priority security interest in all of the co-borrowers' tangible and intangible assets, including but not limited to their merchants, merchant contracts and proceeds thereof, and all right title and interest in co-borrowers' processing contracts, contract rights, and portfolio cash flows with all processors of co-borrowers.

Effective July 17, 2014 we entered into a $3,315,000 term loan with RBL. Net proceeds from the loan were used to repay the $3.0 million MBF loan and related costs and interest, in addition to approximately $239 thousand for working capital. The loan requires interest only payments at 13.90% interest through January 2015, commencing on August 20, 2014 followed by monthly interest and principal payments of $90,421 through January 2019.

Effective February 10, 2015, we entered into a $400,000 term loan note with RBL. The loan provides for interest-only payments at 13.90% interest through July 20, 2015. From August 20, 2015 through July 20, 2019, the note maturity date, we are obligated to make interest and principal payments of $10,911 per month. We paid $8,000 in costs related to this loan, which is classified within other assets on the balance sheet.

Effective March 27, 2015, we entered into a $250,000 term loan note with RBL. The loan provides for interest-only payments at 13.90% interest through July 20, 2015. From August 20, 2015 through July 20, 2019, the note maturity date, we are obligated to make interest and principal payments of $6,819 per month. We paid $5,000 in costs related to this loan, which the amortized amount is classified within other assets on the condensed consolidated balance sheet.

Scheduled Debt Principal Repayment

Scheduled principal maturities on indebtedness at September 30, 2015 is as follows:

2015 (3 months)	$5,318,405
2016	843,318
2017	968,303
2018	1,111,812
2019	723,162
Total	8,965,000
Less unamortized portion	(4,305,555)
Balance at September 30, 2015	$4,659,445

NOTE 11. CONCENTRATIONS

Total revenue was $25,122,250 for the nine months ended September 30, 2015 of which $19,275,885 was derived from processing of Visa®, MasterCard®, Discover® and American Express® card transactions and $3,489,550 was derived from processing of mobile electronic payments and $2,356,815 was derived from our transactional gateway services from our PayOnline acquisition.

The credit card processing revenues were derived from merchant customer transactions, which are processed primarily by two third-party processors. For the nine months ended September 30, 2015 we processed 60% of our total revenue with Priority Payments, Inc. (f/k/a Cynergy Data, LLC) and 13% with Vantiv, Inc. (f/k/a National Processing Company (NPC).

The mobile electronic payment revenues were derived from merchant customer transactions, which are processed primarily by two mobile operators. For the three months ended September 30, 2015, we processed 5.4% of our total revenue with Megaphone and 5.1% with MTS (Mobile TeleSystems OJSC).

While PayOnline Services makes up 10% of our revenue no individual customer is significant.

Our total revenue was $15,782,475 for the nine months ended September 30, 2014. Of this amount, $14,234.441 was derived from processing of Visa®, MasterCard®, Discover® and American Express® card transactions and $1,548,033 was derived from processing of mobile electronic payments.

The transaction processing revenues were derived from processing merchant customer transactions, which are processed primarily by two "third-party" processing networks. For the nine months ended September 30, 2014, we processed 61% of total revenue with Priority Payments, Inc. and 25% with Vantiv, Inc.

Our mobile electronic payment revenues were derived from merchant customer transactions, which are processed primarily by two mobile operators. For the nine months ended September 30, 2014, we processed 4% of our total revenue with Megaphone, and 4% with MTS (Mobile TeleSystems OJSC).

NOTE 12. COMMITMENTS AND CONTINGENCIES

Leases

In May 2013, we entered into a lease agreement for approximately 5,200 square feet of office space in North Miami Beach, Florida. We moved our corporate headquarters and principal executive office to this location in June 2013. The term of the lease agreement is from May 1, 2013 through December 31, 2016, with monthly rent at the rates of $17,640 per month (or $211,680 per year) for 2014, $18,522 per month (or $222,264 per year) for 2015 and $19,448 per month (or $233,377 per year) for 2016.

Netlab Systems, LLC, through its Russian representative office, currently leases 940 square feet of office space in Yekaterinburg, Russia, where it conducts Aptito and Sales Central development activities, at annual rent of approximately $15,800. The current lease term expires January 2016.

Net Element Russia leases approximately 2,033 square feet of office space in Moscow, Russia at annual rent of $81,000, as well as one corporate apartment at annual rent of $22,500. The current lease term for the office space expires on July 30, 2016 and we expect to renew this lease at that time. The current lease term for corporate apartment expires on January 12, 2016. We believe that these facilities are adequate for our anticipated needs.

PayOnline System leases approximately 1,500 square feet of office space in Moscow, Russia at annual rent of $147,693. The current lease term for the office space expires on July 15, 2016, and we expect to renew this lease at that time. We believe that these facilities are adequate for our anticipated needs.

Litigation

First Data Corporation

On July 30, 2013, TOT Payments, LLC, brought an action against First Data Corporation in the State of New York Supreme Court (Index No. 652663-2013). The amount of damages being sought is $10,000,000 per cause. In its complaint, TOT Payments claims that the defendant breached its obligations pursuant to a 2006 Marketing Agreement entered into between Money Movers of America, Inc. (MMOA) and Paymentech, Inc. (the “MMOA Agreement”) to pay

MMOA monthly residual income on various merchant accounts boarded with Paymentech pursuant to the MMOA Agreement. TOT Payments, through a series of historic transactions, is the successor in interest to the rights and obligations of MMOA in the MMOA Agreement. The defendant is the successor in interest to Paymentech. On July 15, 2013, the defendant failed to pay to TOT Payments the monthly residuals otherwise due as the defendant alleges that the MMOA Agreement was lawfully terminated in April 2012 and that the defendant had 180 days after the termination notice to move the MMOA merchants to a new platform failing which the defendant could withhold residual payments and that the defendant would own all merchant accounts boarded under the MMOA Agreement. The amount of the unpaid residuals, are between \$150,000 and \$250,000 net of all interchange charges. TOT Payments disputes receiving proper notice and is disputing the rights of the defendant to withhold monthly residuals due. There was an adjournment because of the motions made in the appellate division. Plaintiffs' opposition to Defendant's motion to dismiss (for lack of standing) was filed on October 24, 2013. Defendant's Reply to Plaintiff's opposition was filed October 31, 2013. Defendants filed both a memorandum in support and an affirmation in support to dismiss and oral argument was heard November 1, 2013. The case was subsequently dismissed and an appeal was filed. On May 12, 2015 The Appellate Division of the Supreme Court overturned the dismissal ruling of the lower Court and reinstated the Plaintiffs case. The Parties are in the process of Discovery and TOT payments will continue pursuit of its claims against First Data through the litigation process.

OOO-RM Invest

On March 17, 2014, we were served with a lawsuit brought by OOO-RM Invest in the US District Court, Southern District of Florida. In its complaint, OOO-RM Invest claims that on or about July 11, 2012 it entered into an "oral agreement" with us allegedly agreeing: (a) to form a new entity, TOT Money International, LTD that would continue the operations of Plaintiff; (b) that we would provide TOT Money International, LTD financing in the amount of 600,000,000 Russian rubles; (c) that we would assume certain liabilities of Plaintiff; (d) that we would be responsible for all business operations of Plaintiff and TOT Money International, LTD; (e) that we would deliver DST account and stated key DST structures to TOT Money International, LTD; (f) that Plaintiff would receive a 30% ownership stake in TOT Money International, LTD and/or receive shares of stock in the Company; (g) that Tcahai Hairullaevich Katcaev would hold the position of General Director of TOT Money; (h) Plaintiff would provide TOT Money International, LTD with access to Plaintiff's operating accounts; and (i) Plaintiff would transfer client accounts and contracts to TOT Money. Plaintiff claims that we breached our obligations pursuant to that alleged oral agreement, and is seeking, among other things, compensatory damages in excess of $50 million. We strongly deny the allegations referenced in the complaint and engaged legal counsel to defend its interests. A Motion to Dismiss on jurisdictional as well as substantive grounds was filed but denied by the court. We filed multiple counterclaims against the Plaintiff.

On August 12, 2014, legal counsel representing Net Element, Inc. received a Notice from the American Arbitration Association advising that the same Plaintiffs in the RMV Invest case above have instituted a parallel Arbitration claim dealing with substantially the same issues as addressed in the lawsuit. As with the referenced lawsuit, we strongly deny the allegations referenced in the arbitration proceedings. Legal counsel representing us filed a Motion to Dismiss, or in the Alternative, Stay Arbitration in the federal court case. That Motion was denied on the basis that there is a pending Motion to Dismiss on jurisdictional Grounds. In October 2014, legal counsel filed a Motion to Dismiss with the Arbitrator on several grounds: (1) by filing the federal court action RM Invest waived its right to arbitrate and (2) RM Invest should not be permitted to pursue the same relief in two actions. The Arbitration case was dismissed in view of the pending Federal Court action.

On October 1, 2015 the parties to the lawsuit entered into a confidential settlement agreement fully and finally resolving and settling any and all claims against one another arising from the matters referenced in this lawsuit. As part of the settlement agreement, the parties also agreed to broad releases precluding legal action for any claims against one another, howsoever arising and whether referenced in the lawsuit or not. On October 2, 2015, the parties to the lawsuit filed a Joint Stipulation of Settlement and the court entered an order administratively closing the case.

Wayne Orkin

On June 27, 2014, we were served with a lawsuit filed in the Los Angeles County of the Superior Court of California by Wayne Orkin ("Orkin"). Orkin was a former employee of an entity First Business Solutions, LLC ("FBS") that was a subsidiary of Unified Payments, LLC. The assets of Unified Payments, LLC were acquired by us in April 2013. Unified Payments, LLC is also a named defendant in this lawsuit. In his complaint, Orkin is claiming a "unity of interest in ownership" between the Defendants and that each of the named defendants were agents, alter egos and authorized representatives of one another. Orkin claims that the defendants breached its obligations pursuant to a verbal agreement allegedly into entered into in 2010 whereby he would allegedly be entitled to certain royalties resulting from the sales of a payment browser technology purchased by FBS from Orkin's entity. The Plaintiff is claiming unspecified damages for alleged breach of contract, breach of covenant of good faith and fair dealing, misappropriation of technology, fraud and conversion. The Company asserts that we never had any dealings with Orkin and strongly deny all allegations contained in the Complaint. We have engaged California counsel to represent our interests.

On September 23, 2014, The Court upheld the Motion to set aside a default judgment previously entered against Unified Payments. On the Motion to Dismiss ("demurrer"), Plaintiffs attorney filed an amended complaint to address certain deficiencies raised by our counsel. Requests for Discovery were served on Plaintiff's counsel who recently requested an extension for filing responses thereto. At the court hearing on our demurrer to the Plaintiffs First Amended Complaint, the court gave the Plaintiff another opportunity to clarify its Complaint and Orkin filed a Second Amended Complaint in the California litigation on June 8, 2015. The Defendants filed a Demurrer in response. At a hearing on the matter, the judge sustained the Defendants demurrer to the breach of fiduciary duty claim against Unified Payments and Net Element –essentially dismissing these claims. However, the judge allowed the contract and fraud claims to proceed against all defendants.

We intend to depose Orkin and then bringing a summary judgment motion. The trial is currently scheduled for June 27, 2016.

As the employment agreement between Orkin and FBS has an arbitration clause that is binding on Orkin in his lawsuit against Unified Payments for alleged breach of the employment agreement, the parties agreed in early November 2014 to stipulate to arbitration in Florida and to stay the California proceedings pending the outcome of the arbitration. A Demand for Arbitration was served on the company on May 5th. The Company will be defending the claims set out in the Arbitration Complaint. Unified Payments has formally filed counterclaims against Orkin in the arbitration matter. The Arbitration process is proceeding and this matter will be scheduled for hearing in the coming weeks.

Aptito.com, Inc.

Our subsidiary (Aptito, LLC) filed a lawsuit against Aptito.com, Inc. and the shareholders of Aptito.com, Inc., in state court in the 11th Judicial Circuit in and for Miami-Dade County. This is an interpleader action in regards to 125,000 shares of stock. Aptito, LLC acquired Aptito.com, Inc. in exchange for, among other things, 125,000 shares of Net Element, Inc. stock. There has been disagreement among the Aptito.com, Inc. shareholders as to proper distribution of the 125,000 shares. To avoid any liability in regards to improper distribution, Aptito, LLC filed the interpleader action so as to allow the Defendants to litigate amongst themselves as to how the shares should be distributed. We continue to attempt service of process on all defendants.

Gene Zell

In June 2014, we, as plaintiff, commenced an action in the Miami-Dade Circuit Court, Florida against Gene Zell for defamation of our Company and CEO and tortious interference with our business relationships. In October 2014, the court granted a temporary injunction against Zell enjoining him from posting any information about our Company and CEO on any website and enjoining him from contacting our business partners or investors. Zell violated the Court Order and the Court granted a Motion imposing sanctions against Zell. We continue to seek enforcement of the Court Order.

Zell recently filed a Motion to set aside the Court Order alleging he was unaware of the Court Proceedings. We are opposing the Motion. There is a hearing scheduled on August 26, 2015 on Zell’s motion to dissolve the injunction in place against him.

The Court dismissed Zell’s Motion to dissolve the injunction and the case is moving forward. On October 5, Zell served Discovery demands on the Company that will be addressed in a timely manner.

Dan Hudson

In August 2015, we, as plaintiff, commenced an action in the Miami-Dade Circuit Court, Florida against Dan Hudson for defamation of our Company and CEO and tortious interference with our business relationships. The Motion is for an injunction against Hudson enjoining him from posting any information about our Company and CEO on any website and enjoining him from contacting our business partners or investors. This matter is still proceeding.

Other Legal Proceedings

We also are involved in certain legal proceedings and claims which arise in the ordinary course of business. In our opinion, based on consultations with outside counsel, the results of any of these ordinary course matters, individually and in the aggregate, are not expected to have a material effect on our results of operations, financial condition, or cash flows. As more information becomes available, if management should determine that an unfavorable outcome is probable on such a claim and that the amount of such probable loss that it will incur on that claim is reasonably estimable, we will record a reserve for the claim in question. If and when we record such a reserve is recorded, it could be material and could adversely impact our results of operations, financial condition, and cash flows.

NOTE 13. RELATED PARTY TRANSACTIONS

On each of July 16, 2015 and July 29, 2015, we received advances of $150,000 and an advance on August 25, 2015 for $200,000 (for a total of $500,000) from an entity related to our CEO. These advances are non-interest bearing, and were used to fund current operating expenses.

On September 11, 2015, we entered into a letter agreement (as subsequently amended) by and among our company and certain accredited investors, including certain of our directors and officers, providing for the issuance of 11,357,143 restricted shares of our common stock in the aggregate and options to purchase 11,357,143 restricted shares of common stock for cash (the "Equity Funding"). The per share purchase price of each restricted share was $0.14.

The restricted options will expire on the fifth (5th) annual anniversary of the date of the letter agreement. Prior to expiration, each restricted options is exercisable into one restricted share at the exercise price equal 110% of the closing trading price per one share of Common Stock reported on The NASDAQ Capital Market on the date of the letter agreement. Each investor may elect to exercise it or his amended restricted option through a cashless exercise.

On September 18, 2015 we received $50,000 and $100,000 from an officer of the Company and a member of the board of directors, respectively, in connection with the Equity Funding. See subsequent events in Note 18 for additional information about the Equity Funding.

NOTE 14. STOCKHOLDERS' EQUITY

Equity Incentive Plan

On December 5, 2013, our Board submitted and the shareholders approved the Net Element International, Inc. 2013 Equity Incentive Plan (the "2013 Plan"). Awards under the 2013 Plan may be granted in any one or all of the following forms: (i) incentive stock options ("Incentive Stock Options") meeting the requirements of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"); (ii) non-qualified stock options ("Non-Qualified Stock Options") (unless otherwise indicated, references to "Options" include both Incentive Stock Options and Non-Qualified Stock Options); (iii) stock appreciation rights ("Stock Appreciation Rights"), which may be awarded either in tandem with Options ("Tandem Stock Appreciation Rights") or on a stand-alone basis ("Nontandem Stock Appreciation Rights"); (iv) shares of common stock that are restricted ("Restricted Shares"); (v) units representing shares of common stock ("Performance Shares"); (vi) units that do not represent shares of common stock but which may be paid in the form of common stock ("Performance Units"); and (vii) shares of common stock that are not subject to any conditions to vesting ("Unrestricted Shares"). The maximum aggregate number of shares of common stock available for award under the 2013 Plan at September 30, 2015 is 9,121,422, subject to adjustment as provided for in the 2013 Plan. The 2013 Plan is administered by the compensation committee.

For the quarter ended September 30, 2015, 18,750 shares of our common stock previously granted to the members of our Board of Directors became vested, and we recorded a compensation charge of $21,750. Additionally, 279,189 shares of our common stock previously granted to employees became vested and we recorded a compensation charge of $579,621.

At September 30, 2015, we had 119,194 incentive stock options outstanding with a weighted average exercise price of $1.34 and a weighted average contract term of 9.19 years. These options were out-of-the-money, and had no value at September 30, 2015 and December 31, 2014.

Sale of Series A Preferred Stock

On April 30, 2015, we entered into a $5,500,000 Securities Purchase Agreement for the issuance of 5,500 shares of newly-issued Series A Convertible Preferred Stock. The Series A Convertible Preferred Stock pays dividends at 9% (default rate 18%) per year on the full face amount of $5,500,000, requiring accelerated principal redemption and dividends payments to be made monthly in cash and/or shares of our common stock through October, 2015, and matures on April 20, 2017. The Series A convertible Preferred Stock initially is convertible into shares of our common stock at $1.74 per share, subject to market adjustments and “down round” reductions in the conversion price arising from future stock issuances at prices less than the conversion price.

The conversion rights embedded in the Series A Convertible Preferred Stock are at a conversion price below-market, and subject to further market price adjustments and "down round" provisions. As a result, the beneficial conversion feature ("BCF") is accounted for as derivative financial instrument. The BCF was valued at date of issuance using the Black- Scholes-Merton options pricing model, resulting in a recorded value of $212,918 at the time of issuance, and revalued to $52,540 at September 30, 2015.

During the quarter ended September 30, 2015, holders of Series A Convertible Preferred Stock converted 2,073 shares of such preferred stock in exchange for 15,645,728 shares of our common stock. We issued an additional 4,208,049 shares of our common stock resulting in a $1,346,648 charge to interest expense for the full value of the shares provided. In addition, due to the fact that these shares were issued as a pre-installment payment for preferred stock, the Company and the investors are engaged in discussions to address disagreements relating to the preferred stock conversion amount for the shares provided. See subsequent events in Note 18 for additional information.

NOTE 15. WARRANTS AND OPTIONS

At September 30, 2015, we had outstanding warrants to purchase 11,648,260 shares of common stock with a weighted average exercise price of $6.16 and a weighted average contract term of 2.14 years.

Of the 11,648,260 warrants, 8,938,900 warrants entitle the registered holder thereof to purchase one share of our common stock at a price of $7.50 per share. These warrants have been registered with the U.S. Securities and Exchange Commission and are currently exercisable. The Warrants expire on October 1, 2017 or earlier upon exercise or redemption. Francesco Piovanetti (the former Chief Executive Officer and a former director) and David P. Kelley II (a current director) own 3,609,631 and 14,000, respectively, of such warrants, to purchase an aggregate of 3,623,631 shares of our common stock.

In addition, we issued 2,709,360 warrants on April 30, 2015. These warrants have a term of three years from issuance and are immediately exercisable to purchase shares of our common stock at an initial exercise price of $1.74 per share, subject to market adjustments and "down round" reductions in the conversion price arising from future stock issuances at prices less than the exercise price. For additional information, see "—Senior Convertible Notes and Warrants" in Note 8 above.

At September 30, 2015, we had 119,194 incentive stock options outstanding with a weighted average exercise price of $1.34 and a weighted average contract term of 9.19 years. These options were out-of-the-money, and had no value at September 30, 2015 and December 31, 2014.

NOTE 16. INCOME TAXES

Our net deferred tax assets primarily are comprised of net operating loss carryforwards (“NOLs”), and basis difference in goodwill and intangibles. These NOLs total approximately $44.6 million and $43.4 million for federal and state, and approximately $9.7 million and $9.2 million for foreign NOLs as of September 30, 2015 and December 31, 2014, respectively.

The timing and manner in which we will be able to utilize our NOLs is limited by Section 382 of the Internal Revenue Code of 1986, as amended (IRC). IRC Section 382 imposes limitations on a corporation’s ability to use its NOLs when it undergoes an “ownership change.” Generally, an ownership change occurs if one or more shareholders, each of whom owns 5% or more in value of a corporation’s stock, increase their percentage ownership, in the aggregate, by more than 50% over the lowest percentage of stock owned by such shareholders at any time during the preceding three-year period. Because on June 10, 2014, we underwent an ownership change as defined by IRC Section 382, the limitation applies to us. The losses generated prior to the ownership change date (pre-change losses) are subject to the Section 382 limitation. The pre-change losses may only become available to be utilized by us at the rate of $2.4 million per year. Any unused losses can be carried forward, subject to their original carry forward limitation periods. In the year 2014, approximately $1.3 million in the pre-change losses was released from the Section 382 loss limitation. We can still fully utilize the NOLs generated after the change of the ownership, which was approximately $4.3 million. In 2015, $2.3 million of the pre-change losses will be released. Thus, we expect the total of approximately $8.9 million as of September 30, 2015 is available to offset future taxable income.

In order to fully utilize the net deferred tax assets, we will need to generate sufficient taxable income in future years to utilize its NOLs prior to their expiration. ASC Topic 740, “Income Taxes”, requires us to analyze all positive and negative evidence to determine if, based on the weight of available evidence, we are more likely than not to realize the benefit of the net deferred tax assets. The recognition of the net deferred tax assets and related tax benefits is based upon our conclusions regarding, among other considerations, estimates of future earnings based on information currently available, current and anticipated customers, contracts and product introductions, as well as historical operating results and certain tax planning strategies.

We have evaluated the available evidence and the likelihood of realizing the benefit of our net deferred tax assets. From our evaluation, we have concluded that based on the weight of available evidence, it is more likely than not that we will not realize any of the benefit of its net deferred tax assets. Accordingly, at September 30, 2015, we maintain a full valuation allowance totaling approximately $21.2 million.

NOTE 17. SEGMENT INFORMATION

Prior to May 20, 2015, we had a single reportable business segment: payment processing for electronic commerce. On May 20, 2015, we obtained financial and operational control of PayOnline, a provider of online payment processing of online transactions in emerging markets for services fees. Additionally, we rebranded our mobile payments business to Digital Provider and began reporting gross revenues for mobile payments where we provide access to branded content. Given the size of assets and revenues from PayOnline and Digital Provider, we began reporting segment information for three segments.

We have three reportable segments: (i) U.S. payment processing for electronic commerce, (ii) Emerging markets online commerce and payment processing and (iii) mobile commerce (primary Russian Federation and CIS). Management determines the reportable segments based on the internal reporting used by our Chief Operating Decision Maker to evaluate performance and to assess where to allocate resources. During the nine months ending September 30, 2015, the principal revenue stream for all segments came from services fees.

US Paymen