ARI NETWORK SERVICES INC /WI
Form 10-Q
March 16, 2016

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 January 31, 2016

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

For the transition period from to

Commission file number 000-19608

ARI Network Services, Inc.

(Exact name of registrant as specified in its charter)

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

10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224

(Address of principal executive offices)

(414) 973-4300

(Registrant's telephone number, including area code)

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

YES NO

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

YES NO

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

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

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

YES NO

As of March 10, 2016, there were 17,260,228 shares of the registrant’s common stock outstanding.

ARI Network Services, Inc.

FORM 10-Q

FOR THE THREE AND SIX MONTHS ENDED JANUARY 31, 2016

INDEX

		Page
PART I FINANCIAL INFORMATION		
Item 1	Consolidated Financial Statements	3
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3	Quantitative and Qualitative Disclosures about Market Risk	32
Item 4	Controls and Procedures	32
PART II OTHER INFORMATION		
Item 1	Legal Proceedings	33
Item 1A	Risk Factors	33
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 3	Defaults upon Senior Securities	33
Item 4		33

	Mine Safety Disclosures	
Item 5	Other Information	33
Item 6	Exhibits	33
Signatures		34

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	(Unaudited) January 31 2016	(Audited) July 31 2015
ASSETS		
Cash and cash equivalents	$ 3,166	$ 2,284
Trade receivables, less allowance for doubtful accounts of $372 at January 31, 2016 and July 31, 2015	2,152	2,046
Work in process	184	165
Prepaid expenses and other	704	820
Deferred income taxes	3,145	3,092
Total current assets	9,351	8,407
Equipment and leasehold improvements:		
Computer equipment and software for internal use	3,356	2,800
Leasehold improvements	629	629
Furniture and equipment	2,624	2,981
Total equipment and leasehold improvements	6,609	6,410
Less accumulated depreciation and amortization	(4,413)	(3,989)
Net equipment and leasehold improvements	2,196	2,421
Capitalized software product costs:		
Amounts capitalized for software product costs	26,523	25,463
Less accumulated amortization	(21,377)	(20,337)
Net capitalized software product costs	5,146	5,126
Deferred income taxes	1,753	2,398
Other intangible assets	8,660	10,116
Goodwill	21,639	21,168
Total non-current assets	39,394	41,229
Total assets	$ 48,745	$ 49,636

See accompanying notes

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

	(Unaudited) January 31 2016	(Audited) July 31 2015
LIABILITIES		
Current portion of long-term debt	$ 1,929	$ 1,338
Current portion of contingent liabilities	470	754
Accounts payable	723	708
Deferred revenue	6,165	7,327
Accrued payroll and related liabilities	1,772	1,752
Accrued sales, use and income taxes	208	140
Other accrued liabilities	787	748
Current portion of capital lease obligations	78	174
Total current liabilities	12,132	12,941
Long-term debt	7,899	9,079
Long-term portion of contingent liabilities	224	362
Capital lease obligations	81	106
Other long-term liabilities	185	199
Total non-current liabilities	8,389	9,746
Total liabilities	20,521	22,687
SHAREHOLDERS' EQUITY		
Cumulative preferred stock, par value $.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at January 31, 2016 and July 31, 2015, respectively	—	—
Junior preferred stock, par value $.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at January 31, 2016 and July 31, 2015, respectively	—	—
Common stock, par value $.001 per share, 25,000,000 shares authorized; 17,257,728 and 17,097,426 shares issued and outstanding at January 31, 2016 and July 31, 2015, respectively	17	17
Additional paid-in capital	115,139	114,700
Accumulated deficit	(86,956)	(87,793)
Other accumulated comprehensive income	24	25
Total shareholders' equity	28,224	26,949
Total liabilities and shareholders' equity	$ 48,745	$ 49,636

See accompanying notes

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

	Three months ended January 31		Six months ended January 31	
	2016	2015	2016	2015
Net revenue	$ 11,752	$ 10,139	$ 23,489	$ 19,251
Cost of revenue	2,064	1,862	4,133	3,611
Gross profit	9,688	8,277	19,356	15,640
Operating expenses:				
Sales and marketing	2,748	2,668	5,513	5,210
Customer operations and support	2,428	1,871	4,874	3,561
Software development and technical support (net of capitalized software product costs)	1,319	1,072	2,574	1,944
General and administrative	1,730	1,588	3,515	3,192
Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue)	590	408	1,199	780
Net operating expenses	8,815	7,607	17,675	14,687
Operating income	873	670	1,681	953
Other income (expense):				
Interest expense	(120)	(140)	(232)	(229)
Loss on change in fair value of contingent liabilities	—	—	(8)	—
Other, net	—	4	—	3
Total other income (expense)	(120)	(136)	(240)	(226)
Income before provision for income tax	753	534	1,441	727
Income tax expense	(305)	(274)	(604)	(363)
Net income	$ 448	$ 260	$ 837	$ 364
Weighted average common shares outstanding:				
Basic	17,188	14,393	17,170	14,043
Diluted	17,695	14,861	17,655	14,475
Net income per common share:				
Basic	$ 0.03	$ 0.02	$ 0.05	$ 0.03
Diluted	$ 0.03	$ 0.02	$ 0.05	$ 0.03

See accompanying notes

Consolidated Statements of Comprehensive Income (Loss)
(Dollars in Thousands)

(Unaudited)

	Three months ended January 31		Six months ended January 31	
	2016	2015	2016	2015
Net income	$ 448	$ 260	$ 837	$ 364
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	1	28	(1)	37
Total other comprehensive income (loss)	1	28	(1)	37
Comprehensive income	$ 449	$ 288	$ 836	$ 401

See accompanying notes

ARI Network Services, Inc.

Consolidated Statements of Cash Flows

(Dollars in Thousands)

(Unaudited)

	Six months ended January 31	
	2016	2015
Operating activities:		
Net income	$ 837	$ 364
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of software products	1,040	1,102
Non-cash interest expense	19	39
Depreciation and other amortization	1,199	778
Loss on change in fair value of earn-out payable	8	-
Provision for bad debt allowance	78	79
Deferred income taxes	592	314
Stock based compensation	147	141
Stock based director fees	56	69
Net change in assets and liabilities:		
Trade receivables	(166)	(842)
Work in process	(19)	145
Prepaid expenses and other	126	162
Other long-term assets	-	(112)
Accounts payable	4	303
Deferred revenue	(1,207)	(144)
Accrued payroll and related liabilities	144	283
Accrued sales, use and income taxes	68	(2)
Other accrued liabilities	25	55
Net cash provided by operating activities	$ 2,951	$ 2,734
Investing activities:		
Purchase of equipment, software and leasehold improvements	(324)	(279)
Cash received on earn-out from disposition of a component of the business	-	58
Cash paid for contingent liabilities related to acquisitions	(322)	(250)
Cash paid for net assets related to acquisitions	-	(4,200)
Software development costs capitalized	(827)	(718)
Net cash used in investing activities	$ (1,473)	$ (5,389)
Financing activities:		
Borrowings under line of credit, net	$ -	$ 750
Payments on long-term debt	(530)	(319)
Borrowings under long-term debt	-	2,168
Payments of capital lease obligations	(121)	(115)
Proceeds from exercise of common stock options	56	72

Net cash provided by (used in) financing activities	$ (595)	$ 2,556
Effect of foreign currency exchange rate changes on cash	(1)	(21)
Net change in cash and cash equivalents	882	(120)
Cash and cash equivalents at beginning of period	2,284	1,808
Cash and cash equivalents at end of period	$ 3,166	$ 1,688
Cash paid for interest	$ 227	$ 176
Cash paid for income taxes	$ 43	$ 55
Non-cash investing and financing activities		
Issuance of common stock in connection with acquisitions	$ -	$ 1,980
Debt issued in connection with acquisition	-	2,933
Capital leases acquired in connection with acquisitions	-	109
Current assets acquired in connection with acquisitions	36	626
Accrued liabilities assumed in connection with acquisitions	58	517
Issuance of common stock related to payment of contingent liabilities	60	42
Tax benefit of stock options exercised	-	55
Cashless exercise of common stock warrants	46	-
Issuance of common stock related to payment of director compensation	-	69
Issuance of common stock related to payment of employee compensation	-	38
Contingent liabilities incurred in connection with acquisition	(62)	711

See accompanying notes

ARI Network Services, Inc.

Notes to Consolidated Financial Statements

1. Description of the Business and Significant Accounting Policies

Description of the Business

ARI Network Services, Inc. (“ARI” or “the Company”) creates software-as-a-service (“SaaS”), data-as-a-service (“DaaS”) and other solutions that help equipment manufacturers, distributors and dealers in selected vertical markets to Sell More Stuff!™ – online and in-store. We remove the complexity of selling and servicing new and used whole goods inventory and PG&A for customers in the automotive tire and wheel aftermarket (“ATW”), automotive aftermarket parts and service (“AAPS”), powersports, outdoor power equipment (“OPE”), marine, home medical equipment (“HME”), recreational vehicles (“RV”) and appliance industries. Our innovative products are powered by a proprietary library of enriched original equipment and aftermarket content from over 1,800 manufacturers. More than 23,500 equipment dealers, distributors and manufacturers worldwide leverage our web and eCatalog platforms to Sell More Stuff!™

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

Basis of Presentation

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

Fiscal Year

Our fiscal year ends on July 31. References to fiscal 2016, for example, refer to the fiscal year ending July 31, 2016, and references to fiscal 2015 refer to the fiscal year ended July 31, 2015.

Revenue Recognition

Revenues from subscription fees for use of our software, access to our catalog content, and software maintenance and support fees are all recognized ratably over the contractual term of the arrangement. The Company has customer contracts with multiple services or elements, which may be delivered at different times. The Company accounts for delivered elements in accordance with the selling price when arrangements include multiple product components or other elements and vendor-specific objective evidence exists for the value of all undelivered elements. Revenue on

undelivered elements is recognized when the elements are delivered. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

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

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

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

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

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

No single customer accounted for 10% or more of ARI's revenue during the six months ended January 31, 2016 or 2015.

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

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

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

Capitalized and Purchased Software Product Costs

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

The annual amortization of software products is computed using the straight-line method over the estimated economic life of the product, which currently ranges from 2 to 14 years. Amortization starts when the product is available for general release to customers. The Company capitalizes software enhancements on an on-going basis and all other software development and support expenditures are charged to expense in the period incurred.

Deferred Loan Fees and Debt Discounts

Fees associated with securing debt are capitalized and shown as contra-debt, reducing the carrying amount of long-term debt on the consolidated balance sheet. Deferred loan fees and debt discounts are amortized to interest expense over the life of the debt using the effective interest method.

Deferred Income Taxes

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

Legal Provisions

ARI is periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable and reasonably estimable, in accordance with GAAP. We had no provisions for legal proceedings during the six months ended January 31, 2016 or 2015.

Recently Adopted Accounting Standards

On August 1, 2015, the Company retrospectively adopted Accounting Standards Update (“ASU”) 2015-03 related to the presentation of debt issuance costs. Debt issuance costs of $29,000, previously recorded to prepaid expenses and other, and $84,000, previously recorded to other long-term assets as of July 31, 2015, are now presented as a direct deduction from the carrying amount of long-term debt on the balance sheet.

2. Basic and Diluted Net Income per Common Share

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

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

	Three months ended January 31		Six months ended January 31	
	2016	2015	2016	2015
Net income	$ 448	$ 260	$ 837	$364

Weighted-average common shares outstanding	17,188	14,393	17,170	14,043
Effect of dilutive stock options and warrants	507	468	485	432
Diluted weighted-average common shares outstanding	17,695	14,861	17,655	14,475
Net income per share				
Basic	$ 0.03	$ 0.02	$ 0.05	$0.03
Diluted	$ 0.03	$ 0.02	$ 0.05	$0.03
Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive	-	-	-	5

9

3. Debt

Silicon Valley Bank

On April 26, 2013, the Company entered into a Loan and Security Agreement (the “Agreement”) with Silicon Valley Bank (“SVB”), pursuant to which SVB extended to the Company credit facilities consisting of a $3,000,000 revolving credit facility with a maturity date of April 26, 2015 and a $4,500,000 term loan with a maturity date of April 26, 2018.

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

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

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to the Prime Rate plus the Applicable Margin for Prime Rate Loans set forth in the chart below based on the Total Leverage Ratio, as defined in the Modification Agreement. The Company had $0 outstanding on the revolving credit facility and the effective interest rate was 4.00% at January 31, 2016, based upon a prime rate of 3.50%.

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

Principal in respect of any loans made under the revolving facility is required to be paid in its entirety on or before September 30, 2016. Principal in respect of the term loan is required to be paid in quarterly installments on the first day of each fiscal quarter of the Company as follows: $151,250 commenced on November 1, 2014 through August 1, 2016; $226,875 commencing on November 1, 2016 through August 1, 2017; and $302,500 commencing on November 1, 2017 through August 1, 2019. All remaining principal in respect of the term loan is due and payable on September 30, 2019. The Company is permitted to prepay all of, but not less than all of, the outstanding principal amount of the term loan upon notice to SVB and, in certain circumstances, the payment of a prepayment penalty of up to $61,000. Following July 31, 2015, the Modification Agreement requires the Company to make additional payments in the amount of 25% of excess cash flow, as defined in the agreement, until the Company’s Total Leverage Ratio is less than

2.00 to 1.00.

The Modification Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to permit a change of control, incur debt, create liens on its assets, make certain investments, enter into merger or acquisition transactions and make distributions to its shareholders. Financial covenants include the maintenance of a minimum Total Leverage Ratio equal to or less than 3.00 to 1.00 and the maintenance of a Fixed Charge Coverage Ratio (as defined in the Modification Agreement) equal to or greater than 1.25 to 1.00. The Total Leverage Ratio was 1.26 and the Fixed Charge Ratio was 3.60 for the twelve months ended January 31, 2016. The Modification Agreement also contains customary events of default that, if triggered, could result in an acceleration of the Company's obligations under the Modification Agreement. The loans are secured by a first priority security interest in substantially all assets of the Company.

TCS Promissory Notes

In connection with the acquisition of TCS, on September 30, 2014, the Company issued two promissory notes (the "TCS Notes") in the aggregate principal amount of $3,000,000 to the former owners of TCS. In February 2015, the principal amount of the TCS Notes was reduced by approximately $67,000 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The TCS Notes initially accrue interest on the outstanding unpaid principal balance at a rate per annum equal to 5.0%; however, if any amount payable under a TCS Note is not paid when due, such overdue amount will bear interest at the default rate of 7.5% from the date of such non-payment until such amount is paid in full. Accrued interest on the TCS Notes is due and payable quarterly commencing on December 29, 2014 and continuing on each 90th calendar day thereafter, until September 30, 2018, at which time all accrued interest and outstanding principal balance will be due and payable in full. The first four payments due and payable under the TCS Notes were interest-only payments, and payments of principal and interest commenced on December 29, 2015. The payments are subject to acceleration upon certain Events of Default, as defined in the TCS Notes.

DCi Promissory Note

In connection with the acquisition of Direct Communications Inc. (“DCi”), on July 13, 2015, the Company issued a promissory note (the “DCi Note”) in the aggregate principal amount of $2,000,000 to the former owners of DCi. The principal amount of the DCi Note was reduced by approximately $64,000 as a result of post-closing adjustments to the estimated valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The DCi Note initially accrues interest on the outstanding unpaid principal balance at a rate per annum equal to 4.0%. Accrued interest on the DCi Note is due and payable quarterly commencing on October 13, 2015 and continuing on each 90th calendar day thereafter, until July 13, 2019, at which time all accrued interest and outstanding principal balance will be due and payable in full. The first four payments due and payable under the DCi Note are interest only payments, and payments of principal and interest shall not commence until the payment due on October 13, 2016. The payments are subject to acceleration upon certain Events of Default, as defined in the DCi Note.

The following table sets forth certain information related to the Company’s long-term debt as of January 31, 2016 and July 31, 2015 (in thousands):

	January 31 2016	July 31 2015
Notes payable principal	$ 9,935	$ 10,529
Less debt issuance costs	(107)	(112)
Less current maturities	(1,929)	(1,338)
Notes payable - non-current	$ 7,899	$ 9,079

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

	SVB Term Note	TCS Notes	DCi Notes	Total Notes Payable
2016	$ 303	$ 465	$ —	$ 768
2017	832	965	620	2,417
2018	1,134	1,014	645	2,792
2019	1,210	261	671	2,143
2020	1,815	—	—	1,815
	$ 5,294	$ 2,705	$ 1,936	$ 9,935

4. Business Combinations

DCi Acquisition

On July 13, 2015, the Company acquired substantially all of the assets of DCi, a leading provider of differentiated product content and electronic catalog software serving manufacturers, distributors, jobbers and independent retailers in the AAPS. Consideration for the acquisition included: (1) a cash payment equal to $3,750,000; (2) 159,795 shares of the Company's common stock; and (3) the issuance of a promissory note in principal amount of $2,000,000 to DCi. The principal amount of the DCi Note was reduced by approximately $64,000 as a result of post-closing adjustments to the estimated valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement.

The Company expects the DCi acquisition to accelerate its growth in the AAPS and provide a platform to further expand the reach of ARI's data-driven eCommerce websites and automotive point-of-sale software. The combined customer benefits and operational efficiencies are expected to result in a stronger organization that can create more value for our customers, shareholders and employees.

The DCi acquisition was funded from cash on hand, seller financing and the Company's common stock. The following tables show the preliminary allocation of the preliminary DCi purchase price (in thousands):

	Preliminary Purchase Price
Cash	$ 3,750
Financed by note payable	1,936
Issuance of common stock	500
Purchase price	$ 6,186

	Preliminary Purchase Allocation
Trade receivables	$ 422
Prepaid expense and other	38
Assumed liabilities	(260)
Furniture and equipment	387
Software product costs	698
Intangible assets	1,830
Goodwill	3,071
Purchase price allocation	$ 6,186

Intangible assets include the fair value of tradenames, customer relationships, and non-competition agreements. Estimated goodwill represents the additional benefits provided to the Company by the acquisition of DCi operational synergies. The Company acquired approximately $3,300,000 of tax deductible goodwill related to the DCi acquisition. The final purchase price, as well as the purchase price allocation, is subject to the completion of the final valuation of the acquired net assets. The final valuation is expected to be completed as soon as is practicable but no later than July 13, 2016 and could have a material impact on the preliminary purchase price allocation disclosed above.

TASCO Acquisition

On April 27, 2015, the Company acquired substantially all of the assets of TASCO Corporation and its affiliated company Signal Extraprise Corporation (collectively "TASCO"), a leading provider of business management software designed exclusively for the automotive tire and wheel aftermarket industry. Consideration for the acquisition included: (1) a cash payment at the closing of the transaction equal to $1,750,000, which was funded through a borrowing on the Company's revolving credit facility; (2) 242,424 shares of the Company's common stock; and (3) a $200,000 holdback payable on April 27, 2016. In October 2015, the holdback amount was reduced by approximately $62,000 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The Company acquired approximately $1,500,000 of tax deductible goodwill related to the TASCO acquisition. The Company determined that the TASCO assets acquired did not constitute a business that is "significant" as defined in the applicable SEC regulations.

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

	Preliminary Purchase Price
Cash	$ 1,750
Issuance of common stock	800
Contingent holdback	138
Purchase price	$ 2,688

	Preliminary Purchase Allocation
Trade receivables	$ 120
Assumed liabilities	(227)
Software product costs	434
Intangible assets	1,000
Goodwill	1,361
Purchase price allocation	$ 2,688

The final purchase price, as well as the purchase price allocation, is subject to the completion of the final valuation of the net assets acquired. The final valuation is expected to be completed as soon as is practicable but no later than April 27, 2016 and could have a material impact on the preliminary purchase price allocation disclosed above.

TCS Acquisition

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

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

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

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

	Purchase Allocation	
Trade receivables	$ 606	
Prepaid expense and other	33	
Assumed liabilities	(668)	
Furniture and equipment	117	
Software product costs	820	
Intangible assets	4,080	
Goodwill		4,836

Purchase price allocation	$ 9,824

Intangible assets include the fair value of tradenames, customer relationships, and non-competition agreements. Goodwill represents the additional benefits provided to the Company by the acquisition of TCS operational synergies. The Company acquired approximately $5,200,000 of tax deductible goodwill related to the TCS acquisition.

Pro Forma Information

The following unaudited pro forma combined financial information presents the Company's results as if the Company had acquired TCS and DCi on August 1, 2014. The unaudited pro forma information has been prepared with the following considerations:

i. The unaudited pro forma condensed consolidated financial information has been prepared using the acquisition method of accounting under existing GAAP. The Company is the acquirer for accounting purposes.
ii. The pro forma combined financial information does not reflect any operating cost synergy savings that the combined company may achieve as a result of the acquisition, the costs necessary to achieve these operating synergy savings or additional charges necessary as a result of the acquisition.

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

	Three months ended January 31		Six months ended January 31	
	2016	2015	2016	2015
Revenue	$ 11,752	$ 11,158	$ 23,489	$ 22,131
Net income	$ 448	$ 260	$ 837	$ 463
Net income per common share:				
Basic	$ 0.03	$ 0.02	$ 0.05	$ 0.03
Diluted	$ 0.03	$ 0.02	$ 0.05	$ 0.03

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

	Three months ended January 31		Six months ended January 31	
	2016	2015	2016	2015
Amortization of intangible assets	-	72	-	199
Acquisition-related professional fees	-	(7)	-	(218)
Interest expense	-	20	-	85
Income tax benefit (expense)	-	0	-	66
Total adjustments	-	85	-	132

The Company increased goodwill by approximately $471,000 during the six months ended January 31, 2016, as a result of adjustments to the preliminary purchase price allocation of the TCS, TASCO and DCi acquisitions. The

Company cannot determine revenue and expenses specifically related to its acquisitions since the date of acquisition, as we begin integrating these operations into our business upon closing of the acquisitions.

5. Contingent Liabilities

Consideration for the April 2015 TASCO acquisition includes a $138,000 (as adjusted) holdback payable $10,000 on November 27, 2015 and $64,000 payable each on January 27, 2016 and April 27, 2016.

Consideration for the September 2014 TCS acquisition includes a contingent earn-out purchase price payable in three potential payments and contingent upon the attainment of specific revenue goals. The earn-out does not have an upper range, however, the payout at 100% per the asset purchase agreement is $933,000 and the fair value was estimated at $711,000.

Consideration for the 2012 Ready2Ride acquisition included a contingent hold-back purchase price of up to $250,000 and contingent earn-out payments as follows: (i) the first earn-out payment, composed of $125,000 was paid in October 2013 and 10,000 shares of common stock issued in November 2013; (ii) the second earn-out payment, composed of $125,000 and 15,000 shares of common stock, was paid in September 2014; and (iii) the third earn-out payment, composed of $125,000 and 15,000 shares of common stock, was paid in August 2015.

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

	Six months ended January 31	
	2016	2015
Beginning balance	$ 1,116	$ 448
Additions	—	711
Adjustments	(62)	—
Payments	(382)	(292)
Imputed interest recognized	14	28
Loss on change in fair value of earn-out	8	-
Ending balance	$ 694	$ 895
Less current portion	$ (470)	$ (668)
Ending balance, long-term	$ 224	$ 227

The following table shows the remaining estimated payments of contingent liabilities related to the TCS and TASCO acquisitions at January 31, 2016, (in thousands):

2016	$ 306
2017	254
2018	133
2019	30
Total estimated payments	723
Less imputed interest	(29)
Present value of contingent liabilities	$ 694

6. Other Intangible Assets

Amortizable intangible assets include customer relationships and other intangibles including trade names and non-compete agreements. Amortizable intangible assets are composed of the following at January 31, 2016 and 2015 (in thousands):

	Six months ended January 31, 2015			Wtd. avg.
	Cost	Accumulated	Net	remaining
Customer relationships	Basis	Amortization	Value	life
Beginning balance	$ 7,174	$ (3,584)	$ 3,590	

Activity	2,680	(360)	2,320	
Ending balance	$ 9,854	$ (3,944)	$ 5,910	12.49
Other intangibles				
Beginning balance	$ 383	$ (361)	$ 22	
Activity	1,400	(99)	1,301	
Ending balance	$ 1,783	$ (460)	$ 1,323	2.05
Total intangibles				
Beginning balance	$ 7,557	$ (3,945)	$ 3,612	
Activity	4,080	(459)	3,621	
Ending balance	$ 11,637	$ (4,404)	$ 7,233	11.88

	Six months ended January 31, 2016			Wtd. avg.
	Cost	Accumulated	Net	remaining
Customer relationships	Basis	Amortization	Value	life
Beginning balance	$ 11,947	$ (4,418)	$ 7,529	
Activity	(220)	(565)	(785)	
Ending balance	$ 11,727	$ (4,983)	$ 6,744	12.13
Other intangibles				
Beginning balance	$ 3,203	$ (616)	$ 2,587	
Activity	(467)	(204)	(671)	
Ending balance	$ 2,736	$ (820)	$ 1,916	8.92
Total intangibles				
Beginning balance	$ 15,150	$ (5,034)	$ 10,116	
Activity	(687)	(769)	(1,456)	
Ending balance	$ 14,463	$ (5,803)	$ 8,660	11.42

7. Stock-based Compensation Plans

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

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

As recognizing stock-based compensation expense is based on awards ultimately expected to vest, the amount of recognized expense has been reduced for estimated forfeitures based on the Company's historical experience. Total stock option compensation expense recognized by the Company was approximately $16,000 and $40,000 during the three month periods ended January 31, 2016 and 2015, respectively, and approximately $40,000 and $69,000 for the six month periods ended January 31, 2016 and 2015, respectively. There was approximately $82,000 and $234,000 of total unrecognized compensation costs related to non-vested options granted under the Company's stock option plans as of January 31, 2016 and 2015, respectively. Total unrecognized compensation cost will be adjusted for any future changes in estimated and actual forfeitures. There were no capitalized stock-based compensation costs during the periods presented.

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

	Six months ended January 31			
	2016		2015	
Expected life (years)	n/a		5.0	
Risk-free interest rate	n/a		1.7	%
Expected volatility	n/a		65.3	%
Expected forfeiture rate	10.0	%	7.0	%
Expected dividend yield	n/a		-	
Weighted-average estimated fair value of options granted during the year	n/a		$ 1.80	
Cash received from the exercise				

of stock options	$ 56,000	$ 80,000

2000 Stock Option Plan

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

Changes in option shares under the 2000 Plan during the six months ended January 31, 2016 were as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/15	472,250	$ 1.52	2.52	$ 783,174
Granted	-	n/a	n/a	n/a
Exercised	(36,000)	1.35	n/a	n/a
Forfeited	(1,000)	2.15	n/a	n/a
Outstanding at 1/31/2016	435,250	$ 1.53	2.19	$ 968,722
Exercisable at 1/31/2016	435,250	$ 1.53	2.19	$ 968,722

The range of exercise prices for options outstanding under the 2000 Plan was $0.49 to $2.10 at January 31, 2016.

2010 Equity Incentive Plan

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

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

Changes in option shares under the 2010 Plan during the six months ended January 31, 2016 were as follows:

	Number of Options	Wtd. Avg.	Wtd. Avg. Remaining	Aggregate Intrinsic

		Exercise Price	Contractual Period (Years)	Value
Outstanding at 7/31/15	434,751	$ 2.34	7.47	$ 387,964
Granted	-	n/a	n/a	n/a
Exercised	(31,250)	1.38	n/a	n/a
Forfeited	(18,250)	1.91	n/a	n/a
Outstanding at 1/31/2016	385,251	$ 2.44	7.40	$ 509,148
Exercisable at 1/31/2016	244,003	$ 2.12	7.04	$ 400,743

The range of exercise prices for options outstanding under the 2010 Plan was $0.59 to $3.61 at January 31, 2016.

Changes in the 2010 Plan's non-vested option shares included in the outstanding shares above during the six months ended January 31, 2016 were as follows:

	Number of Options	Wtd. Avg. Exercise Price
Non-vested at 7/31/15	161,498	$ 2.99