NETSOL TECHNOLOGIES INC
Form 10QSB
May 14, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

(Mark One)

(X) Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2008

( ) For the transition period from __________ to __________

Commission file number: 0-22773

NETSOL TECHNOLOGIES, INC.
(Exact name of small business issuer as specified in its charter)

NEVADA	95-4627685
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer NO.)

23901 Calabasas Road, Suite 2072, Calabasas, CA 91302
(Address of principal executive offices) (Zip Code)

(818) 222-9195 / (818) 222-9197
(Issuer's telephone/facsimile numbers, including area code)

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

Yes X No___

The issuer had 25,502,332 shares of its $.001 par value Common Stock and 1,920 shares of Series A 7% Cumulative Convertible Preferred Stock issued and outstanding as of May 12, 2008.

Transitional Small Business Disclosure Format (check one)

Yes ___ No X___

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NETSOL TECHNOLOGIES, INC.

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NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET — MARCH 31, 2008
(UNAUDITED)

ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,848,513	
Accounts receivable, net of allowance for doubtful accounts of $168,443	10,227,903	
Revenues in excess of billings	12,006,231	
Other current assets	2,933,047	
Total current assets		30,015,694
Property and equipment, net of accumulated depreciation		8,153,405
Other assets, long-term		800,435
Intangibles:		
Product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, net	9,137,381	
Customer lists, net	1,906,422	
Goodwill	7,786,032	
Total intangibles		18,829,835
Total assets		$ 57,799,369
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 3,323,046	
Current portion of loans and obligations under capitalized leases	605,551	
Other payables - acquisitions	83,399	
Unearned revenues	3,616,555	
Due to officers	184,173	
Dividend to preferred stockholders payable	33,508	
Loans payable, bank	1,977,689	
Total current liabilities		9,823,921
Obligations under capitalized leases, less current maturities		270,927
Long term loans; less current maturities		552,166
Total liabilities		10,647,014
Minority interest		5,834,732
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized; 1,920 issued and outstanding	1,920,000	
Common stock, $.001 par value; 45,000,000 shares authorized; 25,247,568 issued and outstanding	25,248	
Additional paid-in-capital	75,299,379	
Treasury stock	(35,681)	
Accumulated deficit	(33,477,767)	
Stock subscription receivable	(600,907)	
Common stock to be issued	64,612	
Other comprehensive loss	(1,877,261)	
Total stockholders' equity		41,317,623
Total liabilities and stockholders' equity		$ 57,799,369

See accompanying notes to these unaudited consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2008	2007	2008	2007
Net Revenues:				
Licence fees	$ 2,998,867	$ 2,554,289	$ 7,769,226	$ 6,851,496
Maintenance fees	1,482,654	1,335,893	4,556,450	3,990,096
Services	4,585,292	3,725,784	13,800,844	9,864,055
Total revenues	9,066,813	7,615,966	26,126,520	20,705,647
Cost of revenues				
Salaries and consultants	2,620,722	2,234,809	7,342,743	6,608,606
Travel	394,841	447,288	972,998	1,195,315
Repairs and maintenance	99,262	133,961	332,448	313,514
Insurance	30,005	51,294	153,760	153,595
Depreciation and amortization	316,652	279,405	847,288	693,703
Other	522,013	790,927	1,341,513	1,479,478
Total cost of sales	3,983,495	3,937,684	10,990,750	10,444,211
Gross profit	5,083,318	3,678,282	15,135,770	10,261,436
Operating expenses:				
Selling and marketing	898,686	825,586	2,817,908	2,105,920
Depreciation and amortization	477,630	483,801	1,422,181	1,389,704
Bad debt expense	-	(231)	3,277	117,267
Salaries and wages	1,034,784	915,481	2,758,434	2,914,707
Professional services, including non-cash compensation	114,436	254,359	413,437	774,203
General and adminstrative	792,499	687,881	2,287,693	2,202,182
Total operating expenses	3,318,035	3,166,877	9,702,930	9,503,983
Income from operations	1,765,283	511,405	5,432,840	757,453
Other income and (expenses):				
Gain (loss) on sale of assets	(891)	(6,729)	(33,044)	(19,067)
Beneficial conversion feature	-	-	-	(2,208,334)
Amortization of debt discount and capitalized cost of debt	-	-	-	(2,803,691)
Liquidation damages	-	(47,057)	-	(180,890)
Fair market value of warrants issued	-	(33,987)	-	(33,987)
Interest expense	(121,651)	(83,819)	(544,597)	(543,342)
Interest income	84,363	46,867	159,801	265,916
Gain on sale of subsidiary shares	1,240,808	-	1,240,808	-
Other income and (expenses)	447,889	10,081	709,113	88,935
Total other income (expenses)	1,650,518	(114,644)	1,532,081	(5,434,460)
Net income (loss) before minority interest in subsidiary	3,415,801	396,761	6,964,921	(4,677,007)
Minority interest in subsidiary	(1,098,703)	(568,237)	(1,756,509)	(1,374,081)
Income taxes	(15,314)	(57,655)	(46,272)	(126,620)
Net income (loss)	2,301,784	(229,131)	5,162,140	(6,177,708)
	(33,508)	(94,088)	(145,033)	(159,686)

Dividend required for preferred stockholders								
Subsidiary dividend (minority holders portion)		-		-		(817,173)		-
Bonus stock distribution (minority holders portion)		-		-		(545,359)		-
Net income (loss) applicable to common shareholders		2,268,276		(323,219)		3,654,575		(6,337,394)
Other comprehensive gain:								
Translation adjustment		(910,838)		81,564		(1,401,831)		203,343
Comprehensive income (loss)	$	1,357,438	$	(241,655)	$	2,252,744	$	(6,134,051)
Net income (loss) per share:								
Basic	$	0.09	$	(0.02)	$	0.21	$	(0.36)
Diluted	$	0.09	$	(0.01)	$	0.21	$	(0.35)
Weighted average number of shares outstanding								
Basic		25,205,995		18,311,290		23,686,204		17,680,115
Diluted		25,665,924		18,311,290		24,146,133		17,680,115

See accompanying notes to these unaudited consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended March 31, 2008	2007
Cash flows from operating activities:		
Net income (loss) applicable to common shareholders	$ 5,162,140	$ (6,177,708)
Adjustments to reconcile net income (loss) applicable to common shareholders to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,269,469	2,083,407
Bad debt expense	3,277	117,267
Loss on sale of assets	33,044	19,067
Gain on sale of subsidiary shares in Pakistan	(1,240,808)	-
Minority interest in subsidiary	1,756,509	1,374,081
Stock issued for services	48,163	88,099
Stock issued for convertible note payable interest	-	311,868
Fair market value of warrants and stock options granted	24,320	33,987
Beneficial conversion feature	-	2,208,334
Amortization of debt discount and capitalized cost of debt	-	2,803,691
Changes in operating assets and liabilities:		
Decrease/(increase) in accounts receivable	(2,087,736)	(1,913,135)
Increase in other current assets	(4,885,181)	(2,793,410)
(Decrease)/increase in accounts payable and accrued expenses	(510,968)	1,716,251
Net cash provided by (used in) operating activities	572,229	(128,201)
Cash flows from investing activities:		
Purchases of property and equipment	(1,985,651)	(1,282,427)
Sales of property and equipment	120,436	208,419
Net proceeds of certificates of deposit	-	1,737,481
Payment for acquisition	(879,007)	(4,027,753)
Increase in intangible assets	(2,219,673)	(2,001,502)
Net cash used in investing activities	(4,963,895)	(5,365,782)
Cash flows from financing activities:		
Proceeds from sale of common stock	1,500,000	30,093
Proceeds from the exercise of stock options	2,800,917	704,250
Proceeds from sale of subsidiary stock	1,765,615	-
Finance costs incurred for sale of common stock	(10,000)	-
Purchase of treasury stock	(25,486)	-
Reduction in restricted cash	-	4,533,555
Proceeds from loans from officers	-	165,000
Proceeds from bank loans	3,862,759	-
Payments on bank loans	(1,245,846)	-
Capital lease obligations & loans (net)	(3,462,334)	874,128
Net cash provided by financing activities	5,185,625	6,307,026
Effect of exchange rate changes in cash	44,390	76,159
Net increase in cash and cash equivalents	838,349	889,202
Cash and cash equivalents, beginning of period	4,010,164	2,493,768
Cash and cash equivalents, end of period	$ 4,848,513	$ 3,382,970

See accompanying notes to these unaudited consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

	For the Nine Months Ended March 31,			
	2008		2007	
SUPPLEMENTAL DISCLOSURES:				
Cash paid during the period for:				
Interest	$	378,802	$	154,478
Taxes	$	79,070	$	20,148
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Common stock issued for intangible assets	$	-	$	269,128
Common stock issued for acquisition of 100% of subsidiary	$	76,750	$	1,584,009
Common stock issued for payment of note payable and related interest	$	-	$	339,368
Common stock issued for dividend payable	$	189,165	$	-
Bonus stock distribution issued by subsidiary to minority holders	$	545,359	$	-
Stock issued for the conversion of Preferred Stock	$	2,210,000	$	475,000
Preferred stock issued for conversion of convertible note payable	$	-	$	5,500,000

See accompanying notes to these unaudited consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The Company designs, develops, markets, and exports proprietary software products to customers in the automobile finance and leasing, banking, healthcare, and financial services industries worldwide. The Company also provides system integration, consulting, IT products and services in exchange for fees from customers.

The consolidated condensed interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these consolidated condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-KSB for the year ended June 30, 2007. The Company follows the same accounting policies in preparation of interim reports. Results of operations for the interim periods are not indicative of annual results.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, NetSol Technologies North America, Inc. ("NTNA"), NetSol Technologies Limited ("NetSol UK"), NetSol-Abraxas Australia Pty Ltd. ("Abraxas"), NetSol Technologies Europe Limited ("NTE"), and its majority-owned subsidiaries, NetSol Technologies, Ltd.("NetSol PK"), NetSol Connect (Pvt), Ltd. ("Connect"), TIG-NetSol (Pvt) Limited ("NetSol-TIG"), and NetSol Omni (Private) Limited ("Omni"). All material inter-company accounts have been eliminated in the consolidation.

For comparative purposes, prior year's consolidated financial statements have been reclassified to conform to report classifications of the current year.

NOTE 2 - USE OF ESTIMATES:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS:

In September 2006, FASB issued SFAS 157 "Fair Value Measurements". This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on the consolidated financial

statements.

In September 2006, FASB issued SFAS 158 “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R).” This Statement improves financial reporting by requiring an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements:

1. A brief description of the provisions of this Statement
2. The date that adoption is required
3. The date the employer plans to adopt the recognition provisions of this Statement, if earlier.

The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The adoption of this statement will not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115." The statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Management is currently evaluating the effect of this pronouncement on the consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements". This Statement amends ARB 51 to establish accounting and reporting standards for the non-controlling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 is effective for the Company's fiscal year beginning October 1, 2009. Management is currently evaluating the effect of this pronouncement on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". This Statement replaces SFAS No. 141, Business Combinations. This Statement retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement also establishes principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and, c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) will apply prospectively to business combinations for which the acquisition date is on or after Company's fiscal year beginning October 1, 2009. While the Company has not yet evaluated this statement for the impact, if any, that SFAS No. 141(R) will have on its consolidated financial statements, the Company will be required to expense costs related to any acquisitions after September 30, 2009.

In March, 2008, the FASB issued FASB Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities". The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The new standard also improves transparency about the location and amounts of derivative instruments in an entity's financial statements; how derivative instruments and related hedged items are accounted for under Statement 133; and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. FASB Statement No. 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity's liquidity by requiring disclosure of derivative features that are credit risk-related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important. Based on current conditions, the Company does not expect the adoption of SFAS 161 to have a significant impact on its results of operations or financial position.

NOTE 4 - EARNINGS/(LOSS) PER SHARE:

"Earnings per share" is calculated in accordance with the Statement of financial accounting standards No. 128 (SFAS No. 128), "Earnings per share". Basic net income per share is based upon the weighted average number of common

shares outstanding. Diluted net income per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

For the nine months ended March 31, 2008		**Net Income**	**Shares**		**Per Share**
Basic earnings per share:	$	5,017,107	23,686,204	$	0.21
Dividend to preferred shareholders		145,033			
Net income available to common shareholders					
Effect of dilutive securities					
Stock options			221,129		
Warrants			180,920		
Convertible Preferred Shares			57,880		
Diluted earnings per share	$	5,162,140	24,146,133	$	0.21

For the nine months ended March 31, 2007		**Net Income**	**Shares**		**Per Share**
Basic earnings per share:					
Net loss	$	(6,177,708)	17,680,115	$	(0.35)
Effect of dilutive securities *					
Stock options			-		
Warrants			-		
Diluted earnings per share	$	(6,177,708)	17,680,115	$	(0.35)

* As there is a loss, these securities are anti-dilutive. The basic and diluted earnings per share is the same for the nine months ended March 31, 2007

NOTE 5 - FOREIGN CURRENCY:

The accounts of NetSol UK and NTE use the British Pound; NetSol PK, Connect, Omni, and NetSol-TiG use Pakistan Rupees; and Abraxas uses the Australian dollar as the functional currencies. NetSol Technologies, Inc., and subsidiary, NTNA, use the U.S. dollar as the functional currency. Assets and liabilities are translated at the exchange rate on the balance sheet date, and operating results are translated at the average exchange rate throughout the period. Accumulated translation losses of $1,877,261 at March 31, 2008 are classified as an item of accumulated other comprehensive loss in the stockholders' equity section of the consolidated balance sheet. During the nine months ended March 31, 2008 and 2007, comprehensive gain (loss) in the consolidated statements of operations included translation loss of $1,401,831 and gain of $203,343, respectively.

NOTE 6 - OTHER CURRENT ASSETS

Other current assets consist of the following at March 31, 2008:

Prepaid Expenses	$ 1,146,229
Advance Income Tax	331,509
Employee Advances	198,025
	243,952

Security Deposits	
Advance Rent	223,219
Tender Money Receivable	336,605
Other Receivables	433,443
Other Assets	20,065
Total	$ 2,933,047

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NOTE 7 - PROPERTY AND EQUIPMENT

Property and equipment, net, consist of the following at March 31, 2008:

Office furniture and equipment	$ 1,226,920
Computer equipment	7,567,156
Assets under capital leases	1,342,001
Building	3,154,201
Construction in process	423,201
Land	1,005,567
Autos	251,656
Improvements	458,805
Subtotal	15,429,507
Accumulated depreciation	(7,276,102)
	$ 8,153,405

For the nine months ended March 31, 2008 and 2007, fixed asset depreciation expense totaled $1,034,720 and $869,240, respectively. Of these amounts, $661,114 and $528,111, respectively, are reflected as part of cost of goods sold.

NOTE 8 - INTANGIBLE ASSETS:

Intangible assets consist of product licenses, renewals, enhancements, copyrights, trademarks, trade names, customer lists and goodwill. The Company evaluates intangible assets, goodwill and other long-lived assets for impairment, at least on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows. Recoverability of intangible assets, other long-lived assets and, goodwill is measured by comparing their net book value to the related projected undiscounted cash flows from these assets, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. If the net book value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss. Potential impairment of goodwill has been evaluated in accordance with SFAS No. 142.

As part of intangible assets, the Company capitalizes certain computer software development costs in accordance with SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” Costs incurred internally to create a computer software product or to develop an enhancement to an existing product are charged to expense when incurred as research and development expense until technological feasibility for the respective product is established. Thereafter, all software development costs are capitalized and reported at the lower of unamortized cost or net realizable value. Capitalization ceases when the product or enhancement is available for general release to customers.

The Company makes on-going evaluations of the recoverability of its capitalized software projects by comparing the amount capitalized for each product to the estimated net realizable value of the product. If such evaluations indicate that the unamortized software development costs exceed the net realizable value, the Company writes off the amount by which the unamortized software development costs exceed net realizable value. Capitalized and purchased computer software development costs are being amortized ratably based on the projected revenue associated with the related software or on a straight-line basis over three years, whichever method results in a higher level of amortization.

Product licenses and customer lists were comprised of the following as of March 31, 2008:

	Product Licenses	Customer Lists	Total
Intangible assets - June 30, 2007	$ 14,511,208	$ 5,451,094	$ 19,962,302
Additions	2,176,751	-	2,176,751
Effect of translation adjustment	(110,168)	-	(110,168)
Accumulated amortization	(7,440,410)	(3,544,672)	(10,985,082)
Net balance - March 31, 2008	$ 9,137,381	$ 1,906,422	$ 11,043,803
Amortization expense:			
Nine months ended March 31, 2008	$ 713,766	$ 520,983	$ 1,234,749
Nine months ended March 31, 2007	$ 693,184	$ 520,983	$ 1,214,167

At March 31, 2008 and 2007, product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, included unamortized software development and enhancement costs of $7,674,491 and $4,525,955, respectively, as the development and enhancement is yet to be completed. Software development amortization expense was $186,174 and $165,592 for the nine months ended March 31, 2008 and 2007, respectively and is shown in “Cost of Goods Sold” in these consolidated financial statements.

Amortization expense of intangible assets over the next five years is as follows:

	FISCAL YEAR ENDING					
Asset	3/31/09	3/31/10	3/31/11	3/31/12	3/31/13	TOTAL
Product Licences	$ 1,236,736	$ 1,070,405	$ 501,325	$ 27,893	$ -	$ 2,836,359
Customer Lists	694,644	672,696	431,268	107,815	-	1,906,423
	$ 1,931,380	$ 1,743,101	$ 932,593	$ 135,708	$ -	$ 4,742,782

There were no impairments of the goodwill asset during the nine months ended March 31, 2008 and 2007.

NOTE 9 - OTHER ASSETS - LONG TERM

NetSol PK has outgrown its current facility and has looked to other sources to house its growing numbers of employees. During the year ended June 30, 2007, the owner of the adjacent land agreed to build an office to the Company’s specifications and the Company agreed to help pay for the development of the land in exchange for discounted rent for the next three years. As of March 31, 2008, the Company has paid a total of $493,095 in connection with this agreement. Of this amount, $223,219 has been classified as current, representing one-year of rental payments, and $128,760 shown as long-term assets. During the nine months ended March 31, 2008, $133,257 was expensed.

In addition, NetSol PK has begun work on building a new building behind the current one. The enhancement of infra-structure is necessary to meet the company’s growth in local and international business. The balance for advance for Capital-Work-In-Progress was $671,675.

NOTE 10 - ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following at March 31, 2008:

Accounts Payable	$ 966,986
Accrued Liabilities	2,014,565
Accrued Payroll	2,102
Accrued Payroll Taxes	51,143
Interest Payable	156,257
Deferred Revenues	29,962
Taxes Payable	102,031
Total	$ 3,323,046

NOTE 11 - DEBTS

A) LOANS AND LEASES PAYABLE

Notes payable as of March 31, 2008 consist of the following:

Name	Balance at 3/31/08	Current Maturities	Long-Term Maturities
D&O Insurance	$ 72,031	$ 72,031	$ -
Professional Liability Insurance	2,310	2,310	-
HSBC Loan	820,746	268,580	552,166
Subsidiary Capital Leases	533,557	262,630	270,927
	$ 1,428,644	$ 605,551	$ 823,093

In February 2005, the Company received a loan from Noon Group in the amount of $500,000. The note carried an interest rate of 9.75% per annum and was due in one year. The maturity date of the loan may be extended at the option of the holder for an additional year. In March, 2006, the note was extended for another year. During the fiscal year ended June 30, 2007, $48,750 of accrued interest was recorded for this loan. In April 2006, $51,250 of accrued interest was paid. Total unpaid accrued interest at June 30, 2006 was $65,044. In July 2007, the full principal and interest were paid.

On July 4, 2007, the Company entered into a debt agreement with AMZ, a brokerage firm, in Lahore, Pakistan for a total of $2,457,642. AMZ brokered the loan with 2 banks in Pakistan, Bank Islami Pakistan Ltd, and Security Leasing Corporation Ltd. The loan called for 30% of the value of the loan to be collateralized by shares the Company owns in its Pakistan subsidiary, NetSol PK, plus an additional 10% of the total share pledged to cover any extra margin due to the change in value of the pledged shares. Finance costs associated with this debt totaled $39,445 and the Company received a net balance of $2,418,197. The loan had a maturity of three months and an interest rate 18.35%, consisting of the Karachi Interbank Offer Rate (“KIBOR” of 9.09%, a base rate of 4.26%, and a mark-up rate of 5%. On October 4, 2007, the loan matured and was rolled over for an additional three months. The new interest rate was 14.75%. Upon maturity on January 4, 2008, payment of the note and accrued interest was extended for six weeks. On February 16, 2008, the full balance of the loan and accrued interest of $256,608 was paid. All pledged shares were returned to the Company.

In August 2007, the Company’s subsidiary, NetSol UK, entered into an agreement with HSBC Bank whereby the line of credit outstanding of £500,000 or approximately $1,023,850 was converted into a loan payable with a maturity of three years. The interest rate is 7.5% with monthly payments of £15,558 or approximately $31,858. The Parent has

guaranteed payment of the loan in the event the subsidiary should default on it. During the nine months ended March 31, 2008, £88,619 or approximately $176,803 was paid on the principal of this note and £20,291 or approximately $40,886 was paid in interest. The loan outstanding as of March 31, 2008 was £411,381 or $820,746; of this amount $268,580 is classified as current maturities and $552,166 as long-term debt.

In January 2008, the Company renewed its directors' and officers' liability insurance for which the annual premium is $102,585. This is a reduction from $163,620 in the prior year. In January 2008, the Company arranged financing with AFCO Credit Corporation with a down payment of $10,584 with the balance to be paid in nine monthly installments of $10,584 each. The balance owing as of March 31, 2008 was $72,031.

CAPITAL LEASE OBLIGATIONS

The Company leases various fixed assets under capital lease arrangements expiring in various years through 2013. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are depreciated over the lesser of their related lease terms or their estimated useful lives and are secured by the assets themselves. Depreciation of assets under capital leases is included in depreciation expense for the nine months ended March 31, 2008 and 2007.

Following is the aggregate minimum future lease payments under capital leases as of March 31, 2008:

Minimum Lease Payments		
Due FYE 3/31/09	$	242,496
Due FYE 3/31/10		243,499
Due FYE 3/31/11		119,081
Due FYE 3/31/12		10,229
Due FYE 3/31/13		10,315
Total Minimum Lease Payments		625,620
Interest Expense relating to future periods		(92,063)
Present Value of minimum lease payments		533,557
Less: Current portion		(262,630)
Non-Current portion	$	270,927

Following is a summary of fixed assets held under capital leases as of March 31, 2008:

Computer Equipment and Software	$	760,419
Furniture and Fixtures		49,788
Vehicles		429,036
Building Equipment		102,758
Total		1,342,001
Less: Accumulated Depreciation		(632,919)
Net	$	709,082

B) BANK LOAN

The Company's Pakistan subsidiary, NetSol PK, has one loan with a bank, secured by the Company's assets. The note consists of the following as of March 31, 2008:

TYPE OF LOAN	MATURITY DATE	INTEREST RATE		BALANCE USD
Export Refinance	Every 6 months	7.50%	$	1,977,689
Total			$	1,977,689

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C) OTHER PAYABLE - ACQUISITION

McCue Systems (now NetSol Technologies North America, Inc.)

As of March 31, 2008, Other Payable - Acquisition consists of total payments of $83,399 due to the former shareholders of McCue Systems, Inc.

On June 30, 2006, the acquisition with McCue Systems, Inc. (“McCue”) closed (see Note 17). As a result, the first installment consisting of $2,117,864 cash and 958,213 shares of the Company’s restricted common stock was recorded. The cash portion was shown as “Other Payable - Acquisition” and the stock was shown as “Shares to Be Issued” as of June 30, 2006. During the fiscal year ended June 30, 2007, $2,059,413 of the cash portion was paid to the former McCue shareholders and in July 2006 the stock was issued. In June 2007, the second installment on the acquisition consisting of $903,955 in cash and 408,988 shares of the Company’s restricted common stock became due and was recorded. The cash portion was shown as “Other Payable - Acquisition” and the stock portion was issued on June 27, 2007. The balance at June 30, 2007 was $962,406. During the three months ended September 30, 2007, $879,007 of the cash was paid, leaving a balance of $83,399 to be paid which represents the few remaining McCue shareholders that have not been located as of the date of this report.

DUE TO OFFICERS

The officers of the Company, from time to time, loan funds to the Company.

On September 1, 2006, an officer of the Company loaned $165,000 to the Company for its immediate short-term cash needs in the corporate office. The loan had a maturity date of three months and is interest free and had been automatically extended. The terms of the loan were approved by the Company’s board of directors. The balance of this loan was repaid in July 2007.

In 2006, an officer of the Company loaned $150,000 to the Company for its immediate short-term cash needs in the corporate office.

In addition, the officers of the Company have advanced $34,173 as working capital. The balance due to officers as of March 31, 2008 was $184,173.

NOTE 12 - DIVIDEND PAYABLE

PREFERRED SHAREHOLDERS

The Company has issued Series A 7% Cumulative Convertible Preferred Stock under which dividends are payable (see Note 13). The dividend is to be paid quarterly, either in cash or stock at the Company’s election. The dividend for the three months ended March 31, 2008 totaled $33,508 and is reflected as a payable in these consolidated financial statements. This amount was paid with the issuance of 18,764 shares of the Company’s common stock in April 2008.

SUBSIDIARY DIVIDEND

On September 26, 2007, the Company’s joint-venture subsidiary, NetSol-TiG declared a cash dividend of 100,000,000 Pakistan Rupees (“pkr”) or approximately $1,651,522. Of this amount, the Company was due 50,520,000 pkr or approximately $834,349. This amount was paid during the quarter ended December 31, 2007. The amount attributable to the minority holders is approximately $817,173 and is reflected on these unaudited consolidated financial statements. As of December 31, 2007, the dividend had been paid to the Company and to the minority holders.

NOTE 13 - STOCKHOLDERS' EQUITY:

EQUITY TRANSACTIONS

PREFERRED STOCK

On October 30, 2006, the convertible notes payable (see note 16) were converted into 5,500 shares of Series A 7% Cumulative Convertible Preferred Stock. The preferred shares are valued at $1,000 per share or $5,500,000. The preferred shares are convertible into common stock at a rate of $1.65 per common share. The total shares of common stock that can be issued under these Series A Preferred Stock is 3,333,333. On January 19, 2007, the Form S-3 statement to register the underlying common stock and related dividends became effective. As of June 30, 2007, the balance of the preferred shares was 4,130 shares. During the nine months ended March 31, 2008, 2,210 shares of preferred stock were converted into 1,339,392 shares of common stock valued at $2,210,000.

During the nine months ended March 31, 2008, the Company issued 95,824 shares of the Company's common stock valued at $189,165 as payment of the dividends due.

The Series A Convertible Preferred Stock carries certain liquidation and preferential rights. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, before any distribution of assets of the Corporation can be made to or set apart for the holders of Common Stock, the holders of Convertible Preferred Stock shall be entitled to receive payment out of such assets of the Corporation in an amount equal to $1,000 per share of Convertible Preferred Stock then outstanding, plus any accumulated and unpaid dividends thereon (whether or not earned or declared) on the Convertible Preferred Stock. In addition, the Convertible Preferred Stock ranks senior to all classes and series of Common Stock and existing preferred stock and to each other class or series of preferred stock established hereafter by the Board of Directors of the Corporation, with respect to dividend rights, redemption rights, rights on liquidation, winding-up and dissolution and all other rights in any manner, whether voluntary or involuntary.

Business Combinations

McCue Systems, Inc. (now NetSol Technologies North America, Inc.)

In June 2006, the Company completed the acquisition of McCue Systems, Inc. A total of 37,731 shares valued at $64,612 are shown in "Shares to Be Issued" in these consolidated financial statements representing McCue Systems shareholders that have not been located as of this date.

NetSol Omni ("Omni")

In December 2007, the Company entered into an agreement with the minority shareholders of Omni, whereby the Company purchased the remaining 49.9% of Omni for 25,000 shares of the Company's common stock valued at $76,750.

Private Placements

In June 2007, the Company sold 757,576 shares of the Company's common stock to two institutional investors for $1,250,000. The Company received $1,000,000 of this by June 30, 2007 and the remaining $250,000 cash due was received on July 2, 2007. The shares were issued in July 2007. This purchase agreement contained a "green shoe" clause whereby the investors had the option to purchase within six months the same number of shares at the same price and receive the same number of warrants. In October 2007, the investors exercised the "green shoe" clause and the Company sold them 757,576 shares of the Company's common stock valued at $1,250,000. In addition, as part of the agreement, the investors were granted 378,788 warrants with an exercise price of $1.65 and expires in five years.

Services

In October 2006, the Company entered into an agreement with a consultant whereby the Company agreed to issue a total of 40,000 of the Company's restricted stock, to be paid at the end of each quarter of service. As of June 30, 2007, the Company had recorded as "Stock to Be Issued" 10,000 shares valued at $15,000 or $1.50 per share under this agreement. In October 2007, these shares were issued. As the consultant hasn't provided the service contracted on a timely basis, the shares are only due to the consultant upon performance of the service, therefore, during the quarter ended December 31, 2007, an additional 10,000 shares valued at $15,000 or $1.50 per share have been recorded as "Stock to be Issued". These shares were issued in March 2008.

In October 2006, the Company entered into an agreement with an employee whereby the Company agreed to issue a total of 35,000 shares of the Company's restricted common stock valued at $132,650; vesting over one year on a quarterly basis. In January 2008, the first quarter of shares were vested and 8,750 shares valued at $33,162 were

issued to the employee.

Options and Warrants Exercised

During the nine months ended March 31, 2008, the Company issued 599,538 shares of its common stock for the exercise of options valued at $1,023,099.

During the nine months ended March 31, 2008, the Company issued 1,087,359 shares of its common stock for the exercise of warrants valued at $1,754,547.

STOCK SUBSCRIPTION RECEIVABLE

Stock subscription receivable represents stock options exercised and issued that the Company has not yet received the payment from the purchaser as they were in processing when the quarter ended.

During the nine months ended March 31, 2008, $542,000 was collected and new receivables of $211,500 were issued. In addition, the Company wrote-off $70,000 of receivables as uncollectible from employees who have since left the Company. The balance at March 31, 2008 was $600,907.

COMMON STOCK PURCHASE WARRANTS AND OPTIONS

From time to time, the Company issues options and warrants as incentives to employees, officers and directors, as well as to non-employees.

Common stock purchase options and warrants consisted of the following as of March 31, 2008:

	# shares	Exercise Price	Aggregated Intrinsic Value
Options:			
Outstanding and exercisable, June 30, 2007	7,102,363	$0.75 to $5.00	$ 129,521
Granted	20,000	$1.60	
Exercised	(599,538)	$0.75 to $2.55	
Expired	(10,000)	$0.75	
Outstanding and exercisable, March 31, 2008	6,512,825	$0.75 to $5.00	$ 345,413
Warrants:			
Outstanding and exercisable, June 30, 2007	3,002,725	$1.75 to $5.00	$ 58,091
Granted	378,788	$1.65	
Exercised	(1,269,199)	$1.65 to $3.30	
Expired	(120,000)	$2.50 to $5.00	
Outstanding and exercisable, March 31, 2008	1,992,314	$1.65 to $5.00	$ 304,780

Following is a summary of the status of options and warrants outstanding at March 31, 2008:

Exercise Price	Number Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Ave Exericse Price
OPTIONS:			
$0.01 - $0.99	14,000	3.82	0.75
$1.00 - $1.99	2,513,825	7.27	1.86
$2.00 - $2.99	3,155,000	6.98	2.68
$3.00 - $5.00	830,000	6.03	4.27
Totals	6,512,825	6.96	2.56
WARRANTS:			
$1.00 - $1.99	1,527,652	3.68	1.79
$2.00 - $2.99	-	-	0
$3.00 - $5.00	464,662	1.39	3.31
Totals	1,992,314	3.14	2.15

Options:

During the quarter ended September 30, 2007, 20,000 options were granted to two officers with an exercise price of $1.60 per share and an expiration date of ten years, vesting immediately. Using the Black-Scholes method to value the options, the Company recorded $24,320 in compensation expense for these options in the accompanying consolidated financial statements.

The Black-Scholes option pricing model used the following assumptions:

Risk-free interest rate	4.5%
Expected life	10 years
Expected volatility	65%

Warrants:

On October 11, 2006, the Company entered into an agreement with a consultant whereby the Company agreed to grant the consultant a total of 100,000 warrants with an exercise price of $1.85 and 100,000 warrants with an exercise price of $3.70. The warrants vest equally over the term of the agreement on a quarterly basis commencing on January 11, 2007 and vest only upon completion of the quarter's service as earned. The agreement was terminated on March 31, 2007. The 25,000 warrants vested are exercisable until October 10, 2011 and all non-vested warrants were cancelled at the time of the agreement termination. During the quarter ended March 31, 2007, a total of 25,000 of the warrants had vested. The warrants were valued using the fair value method at $33,987 or $1.44 and $1.28 per share and recorded the expense in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

Risk-free interest rate	7.0%
Expected life	5 years
Expected volatility	100%
Dividend yield	0%

In October 2007, the investors exercised the “green shoe” clause and the Company sold them 757,576 shares of the Company’s common stock valued at $1,250,000. In addition as part of the agreement, the investors were granted 378,788 warrants with an exercise price of $1.65 and expire in five years.

NOTE 14 - SEGMENT INFORMATION

The Company has identified three global regions or segments for its products and services; North America, Europe, and Asia-Pacific. Our reportable segments are business units located in different global regions. Each business unit provides similar products and services; license fees for leasing and asset-based software, related maintenance fees, and implementation and IT consulting services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies due to their particular regional location. We account for intercompany sales and expenses as if the sales or expenses were to third parties and eliminate them in the consolidation. The following table presents a summary of operating information and certain balance sheet information for the nine months ended March 31:

	2008	2007
Revenues from unaffiliated customers:		
North America	$ 3,153,066	$ 3,259,700
Europe	5,272,598	4,097,758
Asia - Pacific	17,700,856	13,348,189
Consolidated	$ 26,126,520	$ 20,705,647
Operating income (loss):		
Corporate headquarters	$ (2,617,524)	$ (2,529,923)
North America	(252,458)	(426,832)
Europe	925,421	(698,115)
Asia - Pacific	7,377,401	4,412,323
Consolidated	$ 5,432,840	$ 757,453
Net income (loss):		
Corporate headquarters	$ (1,557,051)	$ (8,115,730)
North America	(253,215)	(417,691)
Europe	867,620	(789,235)
Asia - Pacific	6,104,786	3,144,948
Consolidated	$ 5,162,140	$ (6,177,708)
Identifiable assets:		
Corporate headquarters	$ 14,204,166	$ 11,089,939
North America	2,250,831	2,002,815
Europe	5,278,163	5,582,204
Asia - Pacific	36,066,209	24,918,496
Consolidated	$ 57,799,369	$ 43,593,454
Depreciation and amortization:		
Corporate headquarters	$ 1,051,595	$ 1,056,482
North America	121,525	97,432
Europe	211,523	187,114
Asia - Pacific	884,826	742,379
Consolidated	$ 2,269,469	$ 2,083,407
Capital expenditures:		
Corporate headquarters	$ 4,189	$ 3,103
North America	51,882	20,820
Europe	52,570	200,847
Asia - Pacific	1,877,010	1,057,657
Consolidated	$ 1,985,651	$ 1,282,427

Net revenues by our various products and services provided are as follows:

	For the Nine Months Ended March 31,	
	2008	2007
Licensing Fees	$ 7,769,226	$ 6,851,496
Maintenance Fees	4,556,450	3,990,096
Services	13,800,844	9,864,055
Total	26,126,520	20,705,647

NOTE 15 - MINORITY INTEREST IN SUBSIDIARY

The Company had minority interests in several of its subsidiaries. The balance of the minority interest as of March 31, 2008, was as follows:

SUBSIDIARY	MIN INT%	MIN INT BALANCE AT 3/31/08
PK Tech	39.11%	$ 4,283,250
NetSol-TiG	49.90%	1,282,724
Connect	49.90%	268,758
Total		$ 5,834,732

<u>NetSol PK</u>

In August 2005, the Company's wholly-owned subsidiary, NetSol PK became listed on the Karachi Stock Exchange in Pakistan. The Initial Public Offering ("IPO") sold 9,982,000 shares of the subsidiary to the public thus reducing the Company's ownership by 28.13%. During the three months ended September 30, 2007, the Company was notified by an affiliate party that they had sold their shares; therefore, the adjusted minority ownership was increased to 37.21%. Net proceeds of the IPO were $4,890,224. As a result of the IPO, the Company is required to show the minority interest of the subsidiary on the accompanying consolidated financial statements.

For the nine months ended March 31, 2008 and 2007, the subsidiary had net income of $6,257,479 and $3,845,363, of which $1,882,231 and $1,375,247, respectively, was recorded against the minority interest. The balance of the minority interest at March 31, 2008 was $4,283,250

On May 18 2007, the subsidiary's board of directors authorized a 15% stock bonus dividend to all its stockholders as of that date. The net value of shares issued to minority holders was $345,415.

On October 19, 2007, the subsidiary's board of directors authorized a 22% stock bonus dividend to all its stockholders as of that date. The net value of shares issued to minority holders was $545,359.

In February 2008, the Parent sold 948,100 shares of its ownership in NetSol PK on the open market with a value of $1,765,615. A net gain of $1,240,808 was recorded as "Other Income" on these consolidated financial statements. As a result of the sale, the minority interest percentage increased 1.9% to 39.11%.

<u>NetSol-TiG:</u>

In December 2004, NetSol forged a new and a strategic relationship with a UK based public company TiG Plc. A Joint Venture was established by the two companies to create a new company, TiG NetSol Pvt Ltd. ("NetSol-TiG"), with 50.1% ownership by NetSol Technologies, Inc. and 49.9% ownership by TiG. The agreement anticipates TiG's technology business to be outsourced to NetSol's offshore development facility.

During year ended June 30, 2005, the Company invested $253,635 and TiG invested $251,626 and the new subsidiary began operations during the quarter ended March 31, 2005.

For the nine months ended March 31, 2008 and 2007, the subsidiary had net income of $1,609,396 and $777,794, of which $(131,124), after considering cash dividends of $1,651,522, and $333,036 was recorded against the minority interest, respectively. The balance of the minority interest at March 31, 2008 was $1,282,724.

On September 26, 2007, the subsidiary's board of directors authorized a cash dividend of 100,000,000 Pakistan Rupees ("pkr") or approximately $1,651,522. Of this amount, the Company is due 50,520,000 pkr or approximately $834,349. The net value to the minority holders is approximately $817,173 and is reflected on these unaudited consolidated financial statements.

Connect:

In August 2003, the Company entered into an agreement with United Kingdom based Akhter Group PLC ("Akhter"). Under the terms of the agreement, Akhter Group acquired 49.9 percent of the Company's subsidiary; Pakistan based NetSol Connect PVT Ltd. ("Connect"), an Internet service provider ("ISP"), in Pakistan through the issuance of additional Connect shares. The partnership with Akhter Computers is designed to rollout connectivity and wireless services to the Pakistani national market.

As of June 30, 2005, a total of $751,356 had been transferred to Connect, of which $410,781 was from Akhter. In June 2006, a total of $40,000 cash was distributed to each partner as a return of capital.

For the nine months ended March 31, 2008 and 2006, the subsidiary had net income of $12,391 and net loss of $63,165, respectively, of which $6,183 and ($31,519) respectively, was recorded against the minority interest. The balance of the minority interest at March 31, 2008 was $268,758.

Omni

In February 2006, the Company purchased for $60,012 50.1% of the outstanding shares in Talk Trainers (Private) Limited, ("Talk Trainers"), a Pakistan corporation for $60,012. Talk Trainers provides educational services, professional courses, training and human resource services to the corporate sector. During the quarter ended June 30, 2006, Talk Trainers changed their name to NetSol Omni. The major stockholder of Talk Trainers was Mr. Ayub Ghauri, brother to the executive officers of the Company, and therefore the acquisition was recorded at historical cost as the entities are under common control. As the effects of this transaction are immaterial to the Company overall, no pro forma information is provided.

In December 2007, the Company purchased the remaining 49.9% of the outstanding shares from the minority shareholders with a historical value of $12,399 for 25,000 shares of the Company's common stock valued at $76,750 (see note 13). Also in December, the operations of the subsidiary were merged into the operations of NetSol PK and will be reported under that subsidiary in the future.

For the nine months ended March 31, 2008 and 2007, the subsidiary had a net loss of $10,224 and $39,157, of which $0 and ($7,959) was recorded against the minority interest. The balance of the minority interest at March 31, 2008 was $0.

NOTE 16 - CONVERTIBLE NOTE PAYABLE

On June 15, 2006, the Company entered into an agreement with five accredited investors whereby the Company issued five convertible notes payable for an aggregate principal value of $5,500,000. These notes bore interest at the

rate of 12% per annum and were due in full one year from the issuance date or on June 15, 2007 (the "Financing"). The Convertible Notes could have immediately converted into shares of common stock of the Company at the conversion value (initially set at one share per $1.65 of principal dollar) to the extent that such conversion did not violate Nasdaq Market Place rules. Due to the limitation rule, none of the note was convertible as of September 30, 2006. Upon the approval of the stockholders, to the extent not already converted into common shares, the Convertible Notes Payable would be immediately converted into shares of Preferred Stock. On October 18, 2006, the shareholders approved the issuance of the shares and on October 30, 2006 the notes were converted into 5,500 shares of Preferred Stock. During the quarter ended September 30, 2006, $167,489 of interest was accrued. As of September 30, 2006, a total of $194,989 in accrued interest had been recorded on the notes and was added to the principal of the notes. During the fiscal year ended June 30, 2007, $251,167 of interest was accrued. On December 13, 2006, the note holders agreed to accept shares of the Company's common stock in payment of the interest owed to them. In addition, the note holders required the Company to issue a total of 60,000 shares of the Company's common stock valued at $88,201 as a premium to receive payment in shares rather than cash. This amount is included in "interest expense" in the accompanying consolidated financial statements.

The beneficial conversion feature expense based on the net value of the loan after reducing the proceeds by the value of the warrants issued was $2,208,334.

The common stock shares issued under this financing agreement, including warrants, were to be registered within 120 days after closing (or October 19, 2006). If the Company did not meet the registration requirement, the Company was to pay in cash as liquidated damages for such failure and not as a penalty to each Holder an amount equal to one percent (1%) of such Holder's Purchase Price paid by such Holder pursuant to the Purchase Agreement for each thirty (30) day period until the applicable Event has been cured. The registration statement became effective on January 19, 2007. During the fiscal year ended June 30, 2007, the Company accrued $168,667 as liquidation damages due and has paid the full amount. As a result, the Company recorded an additional $12,223 in liquidation damages during the fiscal year ended June 30, 2007. This amount is included in “Accrued Liabilities” in the accompanying consolidated financial statements.

As part of the agreement, the investors received warrants to purchase 1,666,668 shares of the Company’s common stock. The warrants have an exercise price of $2.00 and expire in five years. These warrants were valued using the Black-Scholes model at $2,108,335 and have been capitalized as a contra-account against the note balance in these consolidated financial statements. These costs are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. As the loans were converted on October 30, 2006, the balance of $2,022,363 was amortized and recorded as “amortization of debt discount” in the accompanying consolidated financial statements.