

ARI NETWORK SERVICES INC /WI

Form 10QSB

March 17, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB**

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 2008

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number 000-19608

ARI Network Services, Inc.

(Exact name of small business issuer as specified in its charter)

WISCONSIN

39-1388360

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

11425 W. Lake Park Drive, Milwaukee, Wisconsin 53224

(Address of principal executive offices)

Issuer's telephone number (414) 973-4300

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

As of March 7, 2008 there were 6,659,427 shares of the registrant's common stock outstanding.

Transitional Small Business Disclosure Format (check one).

YES NO

ARI Network Services, Inc.
FORM 10-QSB
FOR THE SIX MONTHS ENDED JANUARY 31, 2008
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ARI Network Services, Inc.
Consolidated Balance Sheets
(In thousands, except share and per share data)

	<i>(Unaudited)</i> January 31 2008	July 31 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 761	\$ 1,050
Trade receivables, less allowance for doubtful accounts of \$162 and \$148 at January 31, 2008 and July 31, 2007, respectively	989	1,302
Work in Process	238	223
Prepaid expenses and other	253	291
Current portion of deferred income taxes	555	555
Total Current Assets	2,796	3,421
Equipment and leasehold improvements:		
Computer equipment	5,356	5,324
Leasehold improvements	128	128
Furniture and equipment	2,790	2,749
	8,274	8,201
Less accumulated depreciation and amortization	7,267	6,991
Net equipment and leasehold improvements	1,007	1,210
Long term portion of deferred income taxes	1,539	1,539
Goodwill	1,079	1,079
Other assets	952	1,072
Capitalized software product costs	12,649	12,455
Less accumulated amortization	11,230	10,849
Net capitalized software product costs	1,419	1,606
Total Assets	\$ 8,792	\$ 9,927

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ARI Network Services, Inc.
Consolidated Balance Sheets
(In thousands, except share and per share data)

	<i>(Unaudited)</i> January 31 2008	July 31 2007
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of notes payable	\$ 483	\$ 1,023
Accounts payable	208	703
Deferred revenue	4,834	5,619
Accrued payroll and related liabilities	910	962
Accrued sales, use and income taxes	44	28
Accrued vendor specific liabilities	190	175
Other accrued liabilities	283	124
Current portion of capital lease obligations	8	8
 Total Current Liabilities	 6,960	 8,642
Long term liabilities:		
Notes payable (net of discount)	369	479
Long term payroll related	77	55
Other long term liabilities	17	28
Capital lease obligations	3	5
 Total Long Term Liabilities	 466	 567
Shareholders equity:		
Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at January 31, 2008 and July 31, 2007		
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 6,659,427 and 6,623,605 shares issued and outstanding at January 31, 2008 and July 31, 2007, respectively	7	7
Common stock warrants and options	241	195
Additional paid-in-capital	94,679	94,627
Accumulated deficit	(93,513)	(94,091)
Other accumulated comprehensive income	(48)	(20)
 Total Shareholders Equity	 1,366	 718
 Total Liabilities and Shareholders Equity	 \$ 8,792	 \$ 9,927

See notes to unaudited condensed consolidated financial statements.

Note: The balance sheet at July 31, 2007 has been derived from the audited balance sheet at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

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ARI Network Services, Inc.
Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

	Three months ended		Six months ended	
	January 31		January 31	
	2008	2007	2008	2007
Net revenues:				
Subscriptions, support and other services fees	\$ 2,977	\$ 2,754	\$ 5,957	\$ 5,417
Software licenses and renewals	508	575	1,049	1,118
Professional services	737	362	1,440	659
	4,222	3,691	8,446	7,194
Cost of products and services sold:				
Subscriptions, support and other services fees	310	334	594	606
Software licenses and renewals *	196	206	398	402
Professional services	274	44	535	122
	780	584	1,527	1,130
Gross Margin	3,442	3,107	6,919	6,064
Operating expenses:				
Depreciation and amortization (exclusive of amortization of software products included in cost of products and services sold)	186	110	381	216
Customer operations and support	256	276	536	544
Selling, general and administrative	2,304	2,101	4,684	4,086
Software development and technical support	339	359	688	728
Net operating expenses	3,085	2,846	6,289	5,574
Operating income	357	261	630	490
Other income (expense):				
Interest expense	(26)	(32)	(61)	(70)
Other, net	(1)	27	10	61
Total other expense	(27)	(5)	(51)	(9)
Income before provision for income taxes	330	256	579	481
Income tax benefit (provision)	5	(8)	(1)	(8)
Net income	\$ 335	\$ 248	\$ 578	\$ 473

Average common shares outstanding:

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Basic	6,656	6,304	6,645	6,257
Diluted	7,000	6,707	6,989	6,660
Basic and diluted net income per share:				
Basic	\$ 0.05	\$ 0.04	\$ 0.09	\$ 0.08
Diluted	\$ 0.05	\$ 0.04	\$ 0.08	\$ 0.07

See notes to unaudited condensed consolidated financial statements.

* Includes amortization of software products of \$187, \$198, \$381 and \$385 respectively and excludes other depreciation and amortization, which is shown separately

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ARI Network Services, Inc.
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six months ended	
	January 31	
	2008	2007
Operating activities		
Net income	\$ 578	\$ 473
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of software products	381	385
Amortization of deferred financing costs, debt discount and excess carrying value over face amount of notes payable	18	(33)
Depreciation and other amortization	402	216
Stock based compensation related to stock options	46	68
Deferred income taxes		
Stock issued as contribution to 401(k) plan	37	42
Net change in receivables, prepaid expenses and other current assets	293	(485)
Net change in accounts payable, deferred revenue, Accrued liabilities and long term liabilities	(1,141)	(388)
Net cash provided by operating activities	614	278
Investing activities		
Purchase of equipment and leasehold improvements	(61)	(292)
Purchase of assets related to acquisition		(1,081)
Software product costs capitalized	(194)	(181)
Net cash used in investing activities	(255)	(1,554)
Financing activities		
Payments under notes payable	(668)	(700)
Payments of capital lease obligations	(2)	
Proceeds from issuance of common stock	15	31
Net cash used in financing activities	(655)	(669)
Effect of foreign currency exchange rate changes	7	
Net decrease in cash and cash equivalents	(289)	(1,945)
Balance at beginning of period	1,050	3,584
Balance at end of period	\$ 761	\$ 1,639

Cash paid for interest	\$ 74	\$ 92
Cash paid for income taxes	\$ 10	\$ 14

Noncash investing and financing activities

Issuance of common stock in connection with acquisition	\$	\$ 707
Debt issued in connection with acquisitions		700
Debt assumed in connection with acquisition		37
Accrued liabilities related to acquisition		200
Stock based compensation related to stock options	46	68

See notes to unaudited condensed consolidated financial statements.

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**Notes to Condensed Consolidated Financial Statements
(Unaudited)
January 31, 2008**

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended January 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2008. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended July 31, 2007.

The financial statements include the accounts of ARI Network Services, Inc. and its wholly owned subsidiaries, ARI Europe B. V. and ARI Outsourced F&I Center, LLC. All inter-company transactions and balances have been eliminated.

The Company's outsourced F&I Center was suspended in December, 2007, although the LLC remains in place and the Company may re-initiate operations at a future date. The Company incurred no significant costs associated with the closing of this office, and expects to incur no additional costs related to this operation for the remainder of fiscal 2008.

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

2. BASIC AND DILUTED NET INCOME PER 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 the Company'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 the weighted average number of common shares and equivalents outstanding in the calculation of basic and diluted net income per common share (in thousands) for the periods indicated.

	Three months ended January 31		Six months ended January 31	
	2008	2007	2008	2007
Weighted average common shares outstanding	6,656	6,304	6,645	6,257
Dilutive effect of stock options and warrants	344	403	344	403
Diluted weighted average common shares outstanding	7,000	6,707	6,989	6,660

3. STOCK-BASED COMPENSATION

Effective August 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard No. 123R, Share-Based Payment (SFAS 123R), for its stock option and stock purchase plans. The Company previously accounted for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations and disclosure requirements established by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by Statement of Financial Accounting Standard No. 148, Accounting for Stock-Based Compensation—Transition and Disclosure.

The Company adopted SFAS 123R using the modified prospective method. Under this transition method, compensation cost recognized in fiscal 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of August 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and (b) compensation cost for all share-based payments granted subsequent to August 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Results for prior periods have not been restated. Compensation cost for options will be recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period. There were no capitalized stock-based compensation costs at January 31, 2008. Total stock compensation expense recognized by the Company during the three month periods ended January 31, 2008 and 2007 was

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approximately \$37,000 and \$42,000. For the six month periods ended January 31, 2008 and 2007 the expense was \$46,000 and \$68,000. As of January 31, 2008 and 2007 there was approximately \$137,000 and \$262,000 of total unrecognized compensation cost related to nonvested options granted under the plans.

The Company used the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant.

As stock-based compensation expense recognized in our results for the three and six months ended January 31, 2008 is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on our historical experience. Prior to fiscal year 2007, we accounted for forfeitures as they occurred for the purposes of our pro forma information under SFAS 123.

The fair value of each option grant is estimated using the assumptions in the following table:

	Three months ended		Six months ended	
	January 31,		January 31,	
	2008	2007	2008	2007
Expected life (years)	10 years	10 years	10 years	10 years
Risk-free interest rate	4.88%	4.88%	4.88%	4.88%
Expected volatility	120%	124%	120%	124%
Expected dividend yield	0%	0%	0%	0%

Employee Stock Purchase Plans

The Company's 1992 Employee Stock Purchase Plan had 62,500 shares of common stock reserved for issuance, and all 62,500 shares have been issued. The Company's 2000 Employee Stock Purchase Plan has 175,000 shares of common stock reserved for issuance, and 154,322 of the shares have been issued as of January 31, 2008. All employees of the Company, other than executive officers, with six months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.

1991 Stock Option Plan

The Company's 1991 Stock Option Plan was terminated August 14, 2001, except as to outstanding options. Options granted under the 1991 Plan may be either: (a) options intended to qualify as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended (the Code), or (b) nonqualified stock options.

Any incentive stock option that was granted under the 1991 Plan could not be granted at a price less than the fair market value of the stock on the date of grant (or less than 110% of the fair market value in the case of holders of 10% or more of the voting stock of the Company). Nonqualified stock options were allowed to be granted at the exercise price established by the Compensation Committee, which could be less than, equal to or greater than the fair market value of the stock on the date of grant.

Each option granted under the 1991 Plan is exercisable for a period of ten years from the date of grant (five years in the case of a holder of more than 10% of the voting stock of the Company) 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.

At its discretion, the Compensation Committee may require a participant to be employed by the Company for a designated number of years prior to exercising any options. The Committee may also require a participant to meet certain performance criteria, or that the Company meets certain targets or goals, prior to exercising any options.

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Changes in option shares under the 1991 Plan during the:

	Three months ended January 31, 2008				Three months ended January 31, 2007			
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	125,186	\$2.30	1.64		146,686	\$2.28	2.60	\$13,125
Granted								
Exercised								
Forfeited					(1,000)	\$3.25		
Outstanding at end of period	125,186	\$2.30	1.39		145,686	\$2.27	2.34	\$13,125
Exercisable at end of period	125,186	\$2.30	1.39		145,686	\$2.27	2.34	\$13,125
	Six months ended January 31, 2008				Six months ended January 31, 2007			
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	125,686	\$2.30	1.89		146,686	\$2.28	2.85	\$13,125
Granted								
Exercised								
Forfeited	(500)	\$4.06			(1,000)	\$3.25		
Outstanding at end of period	125,186	\$2.30	1.39		145,686	\$2.27	2.34	\$13,125
Exercisable at end of period	125,186	\$2.30	1.39		145,686	\$2.27	2.34	\$13,125

The range of exercise prices for options outstanding at January 31, 2008 and 2007 was \$2.06 to \$9.06 and \$2.00 to \$9.06, respectively.

1993 Director Stock Option Plan

The Company's 1993 Director Stock Option Plan (Director Plan) has expired and is terminated except for outstanding options. The Director Plan originally had 150,000 shares of common stock reserved for issuance to nonemployee directors. Options under the Director Plan were granted at the fair market value of the stock on the grant date. Each option granted under the Director Plan is exercisable one year after the date of grant and cannot be exercised later than ten years from the date of grant.

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Changes in option shares under the Director Plan during the:

	Three months ended January 31, 2008			Three months ended January 31, 2007				
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	1,313	\$2.65	2.72		1,313	\$2.65	3.72	\$152
Granted								
Exercised								
Forfeited								
Outstanding at end of period	1,313	\$2.65	2.47		1,313	\$2.65	3.72	
Exercisable at end of period	1,313	\$2.65	2.47		1,313	\$2.65	3.72	\$152

	Six months ended January 31, 2008			Six months ended January 31, 2007				
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	1,313	\$2.65	2.97		1,313	\$2.65	3.97	\$152
Granted								
Exercised								
Forfeited								
Outstanding at end of period	1,313	\$2.65	2.47		1,313	\$2.65	3.47	
Exercisable at end of period	1,313	\$2.65	2.47		1,313	\$2.65	3.47	\$152

The range of exercise prices for options outstanding at January 31, 2008 and 2007 was \$2.00 to \$3.56.

2000 Stock Option Plan

The Company's 2000 Stock Option Plan (2000 Plan) has 1,950,000 shares of common stock authorized for issuance. Options granted under the 2000 Plan may be either: (a) options intended to qualify as incentive stock options under Section 422 of the Code, or (b) nonqualified stock options.

Any incentive stock option that is granted under the 2000 Plan may not be granted at a price less than the fair market value of the stock on the date of the grant (or less than 110% of the fair market value in the case of a participant who is a 10% shareholder of the Company within the meaning of Section 422 of the Code). Nonqualified stock options may be granted at the exercise price established by the Compensation Committee.

Each incentive stock option 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 10% shareholder of the Company). Nonqualified stock options do not have this restriction.

Eligible participants include current and prospective employees, nonemployee directors, consultants or other persons who provide services to the Company and whose performance, in the judgment of the Compensation Committee or

management of the Company, can have a significant effect on the success of the Company.

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Changes in option shares under the 2000 Plan during the:

	Three months ended January 31, 2008				Three months ended January 31, 2007			
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	923,789	\$ 1.48	6.42	\$ 275,417	1,044,374	\$ 1.39	7.18	\$ 710,480
Granted	35,500	\$ 1.63			60,250	\$ 1.95		
Exercised					(14,500)	\$.31		
Forfeited	(68,314)	\$ 1.14			(7,500)	\$ 2.00		
Outstanding at end of period	890,975	\$ 1.52	6.43	\$ 289,823	1,082,850	\$ 1.43	7.10	\$ 688,028
Exercisable at end of period	732,611	\$ 1.46	5.96	\$ 276,774	817,612	\$ 1.33	6.57	\$ 605,278

	Six months ended January 31, 2008				Six months ended January 31, 2007			
	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value	Options	Wt-Avg Exercise Price	Wt-Avg Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at beginning of period	1,013,100	\$ 1.45	6.61	\$ 320,062	1,054,350	\$ 1.35	7.27	\$ 814,975
Granted	35,500	\$ 1.63			110,250	\$ 2.02		
Exercised					(20,376)	\$.30		
Forfeited	(157,625)	\$ 1.10			(61,374)	\$ 1.45		
Outstanding at end of period	890,975	\$ 1.52	6.43	\$ 289,823	1,082,850	\$ 1.43	7.10	\$ 688,028
Exercisable at end of period	732,611	\$ 1.46	5.96	\$ 276,774	817,612	\$ 1.33	6.57	\$ 605,278

Changes in non-vested option shares under the 2000 Plan during the:

	Three months ended January 31, 2008		Three months ended January 31, 2007	
	Options	Wt-Avg Grant Date Fair Value	Options	Wt-Avg Grant Date Fair Value
Non-vested at beginning of period	123,239	\$ 1.85	226,549	\$ 1.72
Granted	35,500	\$ 1.63	60,250	\$ 1.95
Vested				
Forfeited	(375)	\$ 1.80	(21,561)	\$ 2.12
Non-vested at end of period	158,364	\$ 1.80	265,238	\$ 1.74

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	Six months ended January 31, 2008		Six months ended January 31, 2007	
	Options	Wt-Avg Grant Date Fair Value	Options	Wt-Avg Grant Date Fair Value
Non-vested at beginning of period	137,675	\$ 1.79	188,799	\$ 1.59
Granted	35,500	\$ 1.63	110,250	\$ 2.02
Vested				
Forfeited	(14,811)	\$ 1.29	(33,811)	\$ 1.82
Non-vested at end of period	158,364	\$ 1.80	265,238	\$ 1.74

The range of exercise prices for options outstanding at January 31, 2008 and 2007 was \$0.15 to \$2.735.

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On January 26, 2007, the Company purchased all of the outstanding stock of OC-NET, Inc. (OC-NET). OC-NET, a privately held corporation in Cypress, CA, provided website development and hosting services to the Power Sports market (which includes motorcycles, All Terrain Vehicles, snowmobiles and personal watercraft), as well as certain customers outside the Power Sports market. Consideration for the acquisition included approximately \$1.1 million in cash, 350,000 shares of the Company's common stock, \$700,000 in debt to the sellers and future contingent payments totaling up to \$400,000.

The purchase price of this acquisition has been allocated to specific assets and liabilities acquired based on the fair value of those identified tangible and intangible assets and liabilities as determined by an independent valuation. These include capitalized software to be amortized over 4 years and intangibles related to customer relationships and assembled and trained workforce to be amortized over 5 years as well as goodwill. In addition, the final purchase price will be determined upon the settlement of the contingencies outlined in the Stock Purchase Agreement relating to the transaction. As noted above, a total of \$400,000 of the total purchase price is subject to contingencies. It was determined that it was more likely than not that the contingencies associated with this \$400,000 would be resolved such that the Company would owe those amounts. Accordingly, those amounts have been recorded as liabilities.

In connection with the acquisition of OC-Net, the Company entered into an employment agreement with Robert Hipp (the Employment Agreement) to serve as a Marketing/Business Development Manager for the Company. The term of the Employment Agreement is two years.

The foregoing description of the Stock Purchase Agreement and the transactions contemplated thereby is qualified in its entirety by reference to the Stock Purchase Agreement, attached as Exhibit 2.1 of Form 8-K, dated January 29, 2007 and Form 8-K/A dated April 13, 2007, and incorporated herein by reference. The acquisition was accounted for under the purchase method; accordingly, its results are included in the financial statements of the Company from the date of acquisition.

The following table shows actual results of operations for the three and six month periods ended January 31, 2008 and unaudited pro forma results of operations for the three and six months ended January 31, 2007, which assumes the acquisition of the OC-Net business occurred at the beginning of those periods:

Pro Forma Results
(in thousands, except per share data)

	Three months ended January 31		Six months ended January 31	
	2008 Actual	2007 Pro Forma	2008 Actual	2007 Pro Forma
Revenues	\$4,222	\$4,024	\$8,446	\$7,853
Net income	\$ 335	\$ 138	\$ 578	\$ 225
Earnings per share	\$ 0.05	\$ 0.02	\$ 0.09	\$ 0.03
Earnings per diluted share	\$ 0.05	\$ 0.02	\$ 0.08	\$ 0.03

The pro forma information for the three and six months ended January 31, 2007 does not purport to be indicative of the results that actually would have been obtained if the combined operations had been conducted during the periods presented and is not intended to be a projection of future results.

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The following table sets forth, for the periods indicated, certain information related to the Company's debt derived from the Company's unaudited financial statements.

Debt Schedule
(In thousands)

	January 31 2008 (Unaudited)	July 31 2007 (Audited)	Net Change
Note payable to WITECH:			
Current portion of note payable	\$	\$ 50	\$ (50)
Long term portion of note payable			
Total note payable to WITECH		50	(50)
Notes payable to New Holders:			
Current portion of notes payable		500	(500)
Long term portion of notes payable			
Total face value of notes payable to New Holders		500	(500)
Carrying value in excess of face value of notes payable		4	(4)
Debt discount (common stock warrants and options)		(3)	3
Total carrying value of notes payable to New Holders		501	(501)
Debt related to acquisition of OC-Net:			
Current portion of notes payable	233	233	
Long term portion of notes payable	232	350	(118)
Total notes payable	465	583	(118)
Current cash earn out	250	250	
Long term cash holdback	150	150	
Imputed interest on cash earn out/holdback	(13)	(32)	19
Total debt related to acquisition of OC-Net	852	951	(99)
Total debt	\$852	\$1,502	\$(650)

On April 24, 2003, the Company restructured its debt. In exchange for previously outstanding securities, the Company issued to a group of investors (collectively, the "New Holders"), in aggregate, \$500,000 in cash, new unsecured notes in the amount of \$3.9 million (the "New Notes") and new warrants for 250,000 common shares, exercisable at \$1.00 per share (the "New Warrants"). The interest rate on the New Notes is prime plus 2%, adjusted quarterly. The New Notes were payable in \$200,000 quarterly installments commencing March 31, 2004 through December 31, 2005 and \$300,000 quarterly installments commencing March 31, 2006 at the prime interest rate plus 2%. The New Notes were paid in full on December 31, 2007.

In accordance with SFAS No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, the exchange of the previously outstanding securities for \$500,000 in cash, the New Notes and the New Warrants was accounted for as a troubled debt restructuring and no gain was recorded. Instead the liability in excess of the future cash flows to the New Holders, which was approximately \$322,000, was amortized as a reduction of interest expense over the life of the New Notes.

On August 7, 2003, the Company purchased from WITECH Corporation 1,025,308 shares of the Company's common stock, 30,000 common stock warrants and 20,350 shares of Series A Preferred Stock for \$200,000 at closing and an \$800,000 promissory note which was payable in \$50,000 quarterly installments through September 30, 2007 at the prime interest rate plus 2%, adjusted quarterly. The note was paid in full on September 28, 2007.

The Company issued \$700,000 of notes in connection with the OC-Net acquisition. The interest rate on the notes is prime plus 2%, adjusted quarterly (effective rate of 8.00% as of January 31, 2008). The notes are payable in quarterly principal installments of \$58,333, commencing March 31, 2007 through April 30, 2010. The notes do not contain any financial covenants.

Table of Contents**6. SHAREHOLDER RIGHTS PLAN**

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

7. INCOME TAXES

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

	Three months ended January 31		Six months ended January 31	
	2008	2007	2008	2007
Current:				
Federal	\$ (113)	\$ 103	\$ 30	\$ 183
State	(20)	31	8	51
Deferred				
Generation / (utilization) of net operating loss carry-forwards, net of change in valuation allowance	128	(126)	(37)	(226)
Income tax (benefit) provision	\$ (5)	\$ 8	\$ 1	\$ 8

Provision for income taxes is an estimate based on taxes payable under currently enacted tax laws and an analysis of temporary differences between the book and tax bases of our assets and liabilities, including various accruals, allowances, depreciation and amortization and does not represent current taxes due. The tax effect of these temporary differences and the estimated tax benefit from tax net operating losses are reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed on a quarterly basis. To the extent that management believes it is more likely than not that some portion, or all, of the deferred tax asset will not be realized, a valuation allowance is established. 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 a significant estimate that is subject to change in the near future. The change in the valuation allowance during a period is reflected with a corresponding increase or decrease in the tax provision in the statement of operations. Because of the uncertainty of long-term future economic conditions, the estimated future utilization of deferred net tax assets is based on twelve quarters of projections. The Company made no change in its estimated valuation allowance this quarter.

The Company adopted the provisions of Financial Accounting Standards Board, or FASB, Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FIN 48), on August 1, 2007. The implementation of FIN 48 did not have a significant impact on our results of operations or financial position and therefore no amounts are reserved for uncertain tax positions as of January 31, 2008.

8. BUSINESS SEGMENTS

Our business segments are internally organized primarily by geographic location of the operating facilities. In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, we have segregated the Netherlands operation and the US operations into separate reportable segments. (Refer to Note 1,

Significant Accounting Policies , for a description of segment operations.) We evaluate the performance of and allocate resources to each of the segments based on their operating results excluding interest and taxes. The accounting policies for each of the segments are described in Note 1.

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Information concerning our operating business segments for fiscal 2008 and 2007 is as follows:

Business Segment Information
(In Thousands)

	Three months ended January 31		Percent Change	Six months ended January 31		Percent Change
	2008	2007		2008	2007	
Revenue						
Netherlands	\$ 177	\$ 160	11%	\$ 338	\$ 329	3%
United States	4,045	3,531	15%	8,108	6,865	18%
Consolidated	4,222	3,691	14%	8,446	7,194	17%
Earnings (loss)						
Netherlands	\$ (108)	\$ (155)	30%	\$ (177)	\$ (312)	43%
United States	443	403	10%	755	785	(4%)
Consolidated	335	248	35%	578	473	23%
				January 31 2008	July 31 2007	Percent Change
Total Assets						
Netherlands				\$ 239	\$ 309	(23%)
United States				8,553	9,618	(11%)
Consolidated				8,792	9,927	(11%)

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MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Results of Operations

Total revenue for the three and six month periods ended January 31, 2008 increased \$531,000 or 14% and \$1,252,000 or 17%, respectively, compared to the same periods last year, primarily due to an increase in revenues from the Company's marketing services. Approximately 47% of this six month growth was organic and 53% was from the OC-Net acquisition. Operating income increased \$96,000 or 37% for the three months ended January 31, 2008 and \$142,000 or 29% for the six months ended January 31, 2008, compared to the same periods last year, primarily due to the increase in revenue, offset in part by increased overhead. Net income increased \$87,000 or \$0.01 per basic share for the three months ended January 31, 2008 and \$107,000 or \$0.01 per basic share for the six months ended January 31, 2008, compared to the same periods last year. Essentially all of the growth in net income was organic, as pro forma net income, taking into account the OC-Net acquisition for the three and six month periods ended January 31, 2006, would have been less than reported net income for the period. Management expects earnings to continue to increase over the prior fiscal year for the remainder of fiscal 2008.

Critical Accounting Policies and Estimates

General

The Company's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to customer contracts, bad debts, capitalized software product costs, financing instruments, revenue recognition and other accrued expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its financial statements.

Revenue Recognition

Revenue for use of the network and for information services is recognized in the period such services are utilized. Revenue from annual or periodic maintenance fees, license and license renewal fees and catalog subscription fees is recognized ratably over the period the service is provided. Revenue under arrangements that include acceptance terms beyond the Company's standard terms is not recognized until acceptance has occurred. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When professional services are considered essential, revenue under the arrangement is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made. Revenue under arrangements with customers who are not the ultimate users (resellers) is deferred if there is any contingency on the ability and intent of the reseller to sell such software to a third party. Amounts invoiced to customers prior to recognition as revenue as discussed above are reflected in the accompanying balance sheets as deferred revenue.

Bad Debts

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

Use of Estimates

The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about accrued expenses that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Legal Provisions

The Company is periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. The Company reserves for any material estimated losses if the outcome is reasonably certain, in accordance with the provisions of SFAS No. 5 Accounting for Contingencies .

Table of Contents*Impairment of Long-Lived Assets*

Equipment and leasehold improvements and capitalized software product costs are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets.

Cash and Cash Equivalents

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

Debt Instruments

The Company valued debt discounts for warrants for shares of the Company's common stock granted in consideration for notes payable using the Black Scholes valuation method. Non-cash interest expense is recorded for the amortization of the debt discount over the term of the debt.

Deferred Tax Asset

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 are reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as valuation allowances is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the statement of operations.

Stock-Based Compensation

Effective August 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard No. 123R, Share-Based Payment – an Amendment of FASB Statement Nos. 123 and 95 (SFAS 123R), for its stock option and stock purchase plans. The Company previously accounted for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations and disclosure requirements established by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by Statement of Financial Accounting Standard No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure (SFAS 148).

Revenues

The Company is a leading provider of electronic parts catalogs and related technology and services to increase sales and profits for dealers, distributors and manufacturers in the manufactured equipment market. The Company currently provides 102 catalogs of manufactured equipment from 76 manufacturers via CD-Rom to approximately 22,000 dealers (and to others via the worldwide web) in approximately 89 countries in 12 segments of the worldwide manufactured equipment market including outdoor power, power sports, motorcycles, agricultural equipment, marine, recreation vehicles (RV), floor maintenance, auto and truck parts after-market, construction, and others primarily in the U.S., Canada, Europe and Australia. Collectively, dealers and distributors have approximately 70,000 CD catalog subscriptions and there are many others who use our web products to view their data. The Company supplies three types of software and services: (1) robust Web and CD-ROM interactive electronic parts catalogs, (2) marketing services including custom and template-based website services and technology-enabled direct mail services and e-mail marketing services and (3) communication or transaction services.

The following table shows the products and services that the Company offers, a brief description of them and the industries where they are currently in use.

Electronic Catalog Products And Services

Product or Service	Description	Primary Industry/Market
PartSmart® Classic	Electronic parts catalog for equipment dealers, formerly PartSmart Version 6	Equipment- all sub-markets except RV
PartSmart® 8	Electronic parts catalog for equipment dealers	Equipment- all sub-markets except RV
PartSmart® Web	Web based electronic parts catalog, formerly EMPARTweb	Equipment all sub-markets
Lookupparts.com	PartSmart Web-based lookup service offered to dealers on a subscription basis	Equipment all sub-markets except RV

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Product or Service	Description	Primary Industry/Market
PartSmart® WebÔ ASP	Electronic parts catalog viewing software offered as a hosted service for individual distributors and manufacturers, formerly EMPART _{web} ASP	Equipment all sub-markets
PartSmart® CartÔ	Add-on product to PartSmart Web that facilitates order taking from the catalog	Equipment all sub-markets
PartSmart® Data Manager	Electronic parts catalog creation software used to produce catalogs for viewing on PartSmart Classic, PartSmart 8, and PartSmart Web	Equipment all sub-markets
PartSmart® Data Publisher	Add-on product to PartSmart Data Manager that facilitates the creation of a file of parts and related information for use in PartSmart PDF Catalog Composer Module	Equipment all sub-markets
PartSmart® PDF Catalog Composer Module	Add-on product to PartSmart Data Manager that facilitates the creation of a parts manual, price sheet or other parts-related publications in the Adobe Acrobat format for printing, electronic distribution or online display	Equipment all sub-markets
Electronic publishing services	Project management, data conversion, editing, production, and distribution services for manufacturers who wish to outsource catalog production operations	Equipment all sub-markets
EMPART _{viewer}	Electronic parts catalog viewing software	Equipment RV
Professional services	Project management, software customization, data conversion, back-end system integration, roll-out management, and help desk support services	Equipment all sub-markets

MARKETING SERVICES

Product or Service	Description	Primary Industry/Market
WebsiteSmart Pro	Software to create customized websites and conduct business electronically, including optional shopping cart, superseding WebsiteSmart.	Equipment primarily outdoor power, power sports
WebsiteSmart	Software to create customized websites and conduct business electronically, including optional shopping cart	Equipment primarily outdoor power, power sports
Professional Services		Equipment all sub-markets

Large-scale website creation, hosting and maintenance services

ARI MailSmart

Direct mail solution that enables users to cost-effectively and efficiently reach customers and prospects with customized messages

Equipment all sub-markets