

ARI NETWORK SERVICES INC /WI
Form 10-Q
June 16, 2008

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

(Mark One)

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

For the quarterly period ended April 30, 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
(State or other jurisdiction of incorporation or
organization)

39-1388360
(IRS Employer Identification No.)

11425 W. Lake Park Drive, Milwaukee, Wisconsin 53224
(Address of principal executive offices)

Issuer's telephone number (414) 973-4300

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

YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

ARI Network Services, Inc.

FORM 10-Q

FOR THE NINE MONTHS ENDED APRIL 30, 2008

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ITEM 1. FINANCIAL STATEMENTS

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

| ASSETS | (Unaudited) | July 31 |
|--|-------------|----------|
| | April 30 | 2007 |
| | 2008 | 2007 |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,244 | \$ 1,050 |
| Trade receivables, less allowance for doubtful accounts of \$154 and \$148 at April 30, 2008 and July 31, 2007, respectively | 1,258 | 1,302 |
| Work in Process | 236 | 223 |
| Prepaid expenses and other | 334 | 291 |
| Current portion of deferred income taxes | 555 | 555 |
| Total Current Assets | 3,627 | 3,421 |
| Equipment and leasehold improvements: | | |
| Computer equipment | 5,370 | 5,324 |
| Leasehold improvements | 128 | 128 |
| Furniture and equipment | 2,810 | 2,749 |
| | 8,308 | 8,201 |
| Less accumulated depreciation and amortization | 7,394 | 6,991 |
| Net equipment and leasehold improvements | 914 | 1,210 |
| Long term portion of deferred income taxes | 1,539 | 1,539 |
| Goodwill | 1,079 | 1,079 |
| Other assets | 893 | 1,072 |
| Capitalized software product costs | 12,820 | 12,455 |
| Less accumulated amortization | 11,417 | 10,849 |
| Net capitalized software product costs | 1,403 | 1,606 |
| Total Assets | \$ 9,455 | \$ 9,927 |

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

| LIABILITIES AND SHAREHOLDERS' EQUITY | (Unaudited) April 30 2008 | July 31 2007 |
|---|---------------------------------|-----------------|
| Current liabilities: | | |
| Current portion of notes payable | \$ 233 | \$ 1,023 |
| Accounts payable | 393 | 703 |
| Deferred revenue | 4,967 | 5,619 |
| Accrued payroll and related liabilities | 1,087 | 962 |
| Accrued sales, use and income taxes | 66 | 28 |
| Accrued vendor specific liabilities | 219 | 175 |
| Other accrued liabilities | 262 | 124 |
| Current portion of capital lease obligations | 11 | 8 |
| Total Current Liabilities | 7,238 | 8,642 |
| Long term liabilities: | | |
| Notes payable (net of discount) | 314 | 479 |
| Long term payroll related | 77 | 55 |
| Other long term liabilities | 10 | 28 |
| Capital lease obligations | 8 | 5 |
| Total Long Term Liabilities | 409 | 567 |
| Shareholders' equity: | | |
| Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at April 30, 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 April 30, 2008 and July 31, 2007, respectively | 7 | 7 |
| Common stock warrants and options | 260 | 195 |
| Additional paid-in-capital | 94,679 | 94,627 |
| Accumulated deficit | (93,086) | (94,091) |
| Other accumulated comprehensive income (loss) | (52) | (20) |
| Total Shareholders' Equity | 1,808 | 718 |
| Total Liabilities and Shareholders' Equity | \$ 9,455 | \$ 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 | | Nine months ended | |
|---|--------------------|-----------|-------------------|----------|
| | April 30 | | April 30 | |
| | 2008 | 2007 | 2008 | 2007 |
| Net revenues: | | | | |
| Subscriptions, support and other services fees | \$ 2,906 | \$ 2,916 | \$ 8,863 | \$ 8,333 |
| Software licenses and renewals | 549 | 547 | 1,598 | 1,665 |
| Professional services | 703 | 638 | 2,143 | 1,297 |
| | 4,158 | 4,101 | 12,604 | 11,295 |
| Cost of products and services sold: | | | | |
| Subscriptions, support and other services fees | 222 | 282 | 816 | 888 |
| Software licenses and renewals * | 197 | 253 | 595 | 655 |
| Professional services | 255 | 296 | 790 | 418 |
| | 674 | 831 | 2,201 | 1,961 |
| Gross Margin | 3,484 | 3,270 | 10,403 | 9,334 |
| Operating expenses: | | | | |
| Depreciation and amortization (exclusive of amortization of software products included in cost of products and services sold) | 180 | 203 | 561 | 419 |
| Customer operations and support | 252 | 298 | 788 | 842 |
| Selling, general and administrative | 2,292 | 2,491 | 6,976 | 6,577 |
| Software development and technical support | 333 | 450 | 1,021 | 1,178 |
| Net operating expenses | 3,057 | 3,442 | 9,346 | 9,016 |
| Operating income | 427 | (172) | 1,057 | 318 |
| Other income (expense): | | | | |
| Interest expense | (14) | (40) | (75) | (110) |
| Other, net | 5 | 16 | 15 | 77 |
| Total other expense | (9) | (24) | (60) | (33) |
| Income before provision for income taxes | 418 | (196) | 997 | 285 |
| Income tax benefit (provision) | 9 | (9) | 8 | (17) |
| Net income | \$ 427 | \$ (205) | \$ 1,005 | \$ 268 |
| Average common shares outstanding: | | | | |
| Basic | 6,659 | 6,444 | 6,650 | 6,320 |
| Diluted | 7,069 | 6,844 | 7,060 | 6,720 |
| Basic and diluted net income per share: | | | | |
| Basic | \$ 0.06 | \$ (0.03) | \$ 0.15 | \$ 0.04 |
| Diluted | \$ 0.06 | \$ (0.03) | \$ 0.14 | \$ 0.04 |

See notes to unaudited condensed consolidated financial statements.

* Includes amortization of software products of \$187, \$213, \$568 and \$598, 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)

| | Nine months ended April 30 | |
|---|-------------------------------|----------|
| | 2008 | 2007 |
| Operating activities | | |
| Net income | \$ 1,005 | \$ 268 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of software products | 568 | 598 |
| Amortization of deferred financing costs, debt discount and excess carrying value over face amount of notes payable | 22 | (22) |
| Depreciation and other amortization | 561 | 419 |
| Stock based compensation related to stock options | 65 | 109 |
| Stock issued as contribution to 401(k) plan | 37 | 42 |
| Net change in receivables, prepaid expenses and other current assets | - | (428) |
| Net change in accounts payable, deferred revenue, Accrued liabilities and long term liabilities | (683) | 61 |
| Net cash provided by operating activities | 1,575 | 1,047 |
| Investing activities | | |
| Purchase of equipment and leasehold improvements | (63) | (629) |
| Purchase of assets related to acquisition | - | (1,179) |
| Software product costs capitalized | (365) | (247) |
| Net cash used in investing activities | (428) | (2,055) |
| Financing activities | | |
| Payments under notes payable | (977) | (1,145) |
| Payments of capital lease obligations | (4) | - |
| Proceeds from issuance of common stock | 15 | 37 |
| Net cash used in financing activities | (966) | (1,108) |
| Effect of foreign currency exchange rate changes | 13 | - |
| Net increase (decrease) in cash and cash equivalents | 194 | (2,116) |
| Balance at beginning of period | 1,050 | 3,584 |
| Balance at end of period | \$ 1,244 | \$ 1,468 |
| Cash paid for interest | \$ 88 | \$ 137 |
| Cash paid for income taxes | \$ 3 | \$ 20 |
| Noncash investing and financing activities | | |
| Issuance of common stock in connection with acquisition | \$ - | \$ 707 |
| Capital lease obligations incurred for computer equipment | 10 | - |
| Debt issued in connection with acquisitions | - | 700 |
| Debt assumed in connection with acquisition | - | 37 |
| Accrued liabilities related to acquisition | - | 175 |

| | | |
|---|----|-----|
| Stock based compensation related to stock options | 65 | 109 |
|---|----|-----|

See notes to unaudited condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements
(Unaudited)
April 30, 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 nine months ended April 30, 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 fiscal year ended July 31, 2007.

The financial statements include the accounts of ARI Network Services, Inc. (the "Company") 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 basic and diluted net income per common share for the periods indicated (in thousands, except per share data):

| | Three months ended | | Nine months ended | |
|---|--------------------|----------|-------------------|--------|
| | April 30 | | April 30 | |
| | 2008 | 2007 | 2008 | 2007 |
| Net income (loss) | \$ 427 | \$ (205) | \$ 1,005 | \$ 268 |
| Weighted average common shares outstanding | 6,659 | 6,444 | 6,650 | 6,320 |
| Dilutive effect of stock options and warrants | 410 | 400 | 410 | 400 |

| | | | | |
|--|---------|-----------|---------|---------|
| Diluted weighted average common shares outstanding | 7,069 | 6,844 | 7,060 | 6,720 |
| Net income (loss) per share: | | | | |
| Basic | \$ 0.06 | \$ (0.03) | \$ 0.15 | \$ 0.04 |
| Diluted | \$ 0.06 | \$ (0.03) | \$ 0.14 | \$ 0.04 |

Shares attributable to outstanding stock options that were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive were 677,753 and 319,437 for the three and nine month periods ended April 30, 2008 and 2007, respectively.

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, 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 April 30, 2008. Total stock compensation expense recognized by the Company during the three month periods ended April 30, 2008 and 2007 was approximately \$19,000 and \$41,000. For the nine month periods ended April 30, 2008 and 2007 the expense was \$65,000 and \$109,000. As of April 30, 2008 and 2007 there was approximately \$96,000 and \$196,000 of total unrecognized compensation cost related to nonvested options granted under the plans.

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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 nine months ended April 30, 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 April 30, 2008 | | Nine months ended April 30, 2007 | |
|-------------------------|--|-------|---|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Expected life (years) | 10 | 10 | 10 | 10 |
| | years | years | years | years |
| Risk-free interest rate | 4.88% | 4.88% | 4.88% | 4.88% |
| Expected volatility | 102% | 124% | 102% | 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 April 30, 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 April 30, 2008 | | | | Three months ended April 30, 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 | 1.39 | - | 145,686 | \$ 2.27 | 2.34 | \$ 13,125 |
| Granted | - | - | - | - | - | - | - | - |
| Exercised | - | - | - | - | - | - | - | - |
| Forfeited | - | - | - | - | - | - | - | - |
| Outstanding at end of period | 125,186 | \$ 2.30 | 1.14 | - | 145,686 | \$ 2.27 | 2.09 | \$ 13,125 |
| Exercisable at end of period | 125,186 | \$ 2.30 | 1.14 | - | 145,686 | \$ 2.27 | 2.09 | \$ 13,125 |

| | Nine months ended April 30, 2008 | | | | Nine months ended April 30, 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 | 1.14 | - | 145,686 | \$ 2.27 | 2.09 | \$ 13,125 |
| Exercisable at end of period | 125,186 | \$ 2.30 | 1.14 | - | 145,686 | \$ 2.27 | 2.09 | \$ 13,125 |

The range of exercise prices for options outstanding at April 30, 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 April 30, 2008 | | | | Three months ended April 30, 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 | 2.47 | - | 1,313 | \$ 2.65 | 3.72 | \$ 152 |
| Granted | - | - | - | - | - | - | - | - |
| Exercised | - | - | - | - | - | - | - | - |
| Forfeited | - | - | - | - | - | - | - | - |
| Outstanding at end of period | 1,313 | \$ 2.65 | 2.22 | - | 1,313 | \$ 2.65 | 3.22 | - |
| Exercisable at end of period | 1,313 | \$ 2.65 | 2.22 | - | 1,313 | \$ 2.65 | 3.22 | \$ 152 |

| | Nine months ended April 30, 2008 | | | | Nine months ended April 30, 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 | 2.22 | - | 1,313 | \$ 2.65 | 3.22 | - |
| Exercisable at end of period | 1,313 | \$ 2.65 | 2.22 | - | 1,313 | \$ 2.65 | 3.22 | \$ 152 |

The range of exercise prices for options outstanding at April 30, 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 April 30, 2008 | | | | Three months ended April 30, 2007 | | | |
|------------------------------------|--------------------------------------|-----------------------------|------------------------------------|---------------------------------|--------------------------------------|-----------------------------|------------------------------------|---------------------------------|
| | Options | Wt-Avg Exercise Price | Remaining Contractual Period | Aggregate Intrinsic Value | Options | Wt-Avg Exercise Price | Remaining Contractual Period | Aggregate Intrinsic Value |
| Outstanding at beginning of period | 890,975 | \$ 1.52 | 6.43 | \$ 289,823 | 1,082,850 | \$ 1.43 | 7.10 | \$ 688,028 |
| Granted | - | - | - | - | 750 | \$ 1.53 | - | - |
| Exercised | - | - | - | - | (13,750) | \$.75 | - | - |
| Forfeited | (8,500) | \$ 2.00 | - | - | (25,374) | \$ 1.38 | - | - |
| Outstanding at end of period | 882,475 | \$ 1.51 | 6.16 | \$ 167,802 | 1,044,476 | \$ 1.44 | 6.85 | \$ 654,011 |
| Exercisable at end of period | 730,329 | \$ 1.45 | 5.71 | \$ 166,124 | 802,080 | \$ 1.34 | 6.32 | \$ 588,159 |

| | Nine months ended April 30, 2008 | | | | Nine months ended April 30, 2007 | | | |
|------------------------------------|-------------------------------------|-----------------------------|------------------------------------|---------------------------------|-------------------------------------|-----------------------------|------------------------------------|---------------------------------|
| | Options | Wt-Avg Exercise Price | Remaining Contractual Period | Aggregate Intrinsic Value | Options | Wt-Avg Exercise Price | 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 | - | - | 111,000 | \$ 2.02 | - | - |
| Exercised | - | - | - | - | (34,126) | \$.48 | - | - |
| Forfeited | (166,125) | \$ 1.15 | - | - | (86,748) | \$ 1.43 | - | - |
| Outstanding at end of period | 882,475 | \$ 1.51 | 6.16 | \$ 167,802 | 1,044,476 | \$ 1.44 | 6.85 | \$ 654,011 |
| Exercisable at end of period | 730,329 | \$ 1.45 | 5.71 | \$ 166,124 | 802,080 | \$ 1.34 | 6.32 | \$ 588,159 |

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

| | Three months ended April 30, 2008 | | Three months ended April 30, 2007 | |
|-----------------------------------|--------------------------------------|------------------------------------|--------------------------------------|------------------------------------|
| | Options | Wt-Avg Grant Date Fair Value | Options | Wt-Avg Grant Date Fair Value |
| Non-vested at beginning of period | 158,364 | \$ 1.80 | 265,238 | \$ 1.74 |
| Granted | - | - | 750 | \$ 1.96 |
| Vested | - | - | - | - |
| Forfeited | (6,218) | \$ 2.00 | (23,592) | \$ 1.27 |
| Non-vested at end of period | 152,146 | \$ 1.79 | 242,396 | \$ 1.79 |

| | Nine months ended April 30, 2008 | Nine months ended April 30, 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 | 111,000 | \$ 2.02 |
| Vested | - | - | - | - |
| Forfeited | (21,029) | \$ 1.50 | (57,403) | \$ 1.60 |
| Non-vested at end of period | 152,146 | \$ 1.79 | 242,396 | \$ 1.79 |

The range of exercise prices for options outstanding at April 30, 2008 and 2007 was \$0.15 to \$2.735.

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4. ACQUISITIONS

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 was subject to contingencies, of which \$250,000 was paid in February 2008. It was determined that it was more likely than not that the contingencies associated with the remaining \$150,000 would be resolved such that the Company would owe this amount. Accordingly, this amount has been recorded as a liability.

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 nine month periods ended April 30, 2008 and unaudited pro forma results of operations for the three and nine months ended April 30, 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 April 30 | | Nine months ended April 30 | |
|----------------------------|--------------------------------|-------------------|-------------------------------|-------------------|
| | 2008 Actual | 2007 Pro Forma | 2008 Actual | 2007 Pro Forma |
| Revenues | \$ 4,158 | \$ 4,101 | \$ 12,604 | \$ 11,954 |
| Net income | \$ 428 | \$ (205) | \$ 1,005 | \$ 20 |
| Earnings per share | \$ 0.06 | \$ (0.03) | \$ 0.15 | \$ 0.00 |
| Earnings per diluted share | \$ 0.06 | \$ (0.03) | \$ 0.14 | \$ 0.00 |

The actual and pro forma information are the same for the three months ended April 30, 2007, as the acquisition of the OC-Net business occurred prior to this period. The pro forma information for the nine months ended April 30, 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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5. NOTES PAYABLE

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)

| | April 30 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 | 173 | 350 | (177) |
| Total notes payable | 406 | 583 | (177) |
| Current cash earn out | - | 250 | (250) |
| Long term cash holdback | 150 | 150 | - |
| Imputed interest on cash earn out/holdback | (9) | (32) | 23 |
| Total debt related to acquisition of OC-Net | 547 | 951 | (404) |
| Total debt | \$ 547 | \$ 1,502 | \$ (955) |

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 was 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 and \$400,000 of future contingent payments 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 April 30, 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. The Company paid \$250,000 of the future contingent payments in February, 2008, and the remaining \$150,000 is due in January, 2009.

6. LINE OF CREDIT

On July 9, 2004, the Company entered into a line of credit with JPMorgan Chase, N.A. which, as since amended, permits the Company to borrow an amount equal to 80% of the book value of all eligible accounts receivable plus 45% of the value of all eligible open renewal orders (provided the renewal rate is at least 85%) minus \$75,000, up to \$1,000,000, and bears interest at prime rate. Eligible accounts include certain non-foreign accounts receivable which are less than 90 days from the invoice date. The line of credit terminates July 9, 2008, and is secured by substantially all of the Company's assets. The line of credit limits repurchases of common stock, the payment of dividends, liens on assets and new indebtedness. As of April 30, 2008, there were no borrowings on the line of credit.

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7. 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.

8. INCOME TAXES

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

| | Three months ended April 30 | | Nine months ended April 30 | |
|--|--------------------------------|--------|-------------------------------|--------|
| | 2008 | 2007 | 2008 | 2007 |
| Current: | | | | |
| Federal | \$ 164 | \$ 140 | \$ 193 | \$ 323 |
| State | 45 | 32 | 53 | 83 |
| Deferred | - | - | - | - |
| Generation / (utilization) of net operating loss carry-forwards, net of change in valuation allowance | (200) | (163) | (238) | (389) |
| Income tax provision | \$ 9 | \$ 9 | \$ 8 | \$ 17 |

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 were reserved for uncertain tax positions as of April 30, 2008.

9.

BUSINESS SEGMENTS

The Company's 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", the Company has segregated the Netherlands operation and the US operations into separate reportable segments. (Refer to Note 1, "Description of Business and Significant Accounting Policies" to the financial statements included in the Company's annual report on Form 10-KSB for the fiscal year ended July 31, 2007, for a description of segment operations and the accounting policies for each of the segments.) We evaluate the performance of and allocate resources to each of the segments based on their operating results excluding interest and taxes.

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Information concerning the Company's operating business segments for fiscal 2008 and 2007 is as follows:

Business Segment Information
(In Thousands)

| | Three months ended | | | Nine months ended | | |
|------------------------|--------------------|----------|-------------------|-------------------|----------|-------------------|
| | April 30 | | Percent Change | April 30 | | Percent Change |
| | 2008 | 2007 | | 2008 | 2007 | |
| Revenue | | | | | | |
| Netherlands | \$ 189 | \$ 181 | 4% | \$ 527 | \$ 510 | 3% |
| United States | 3,969 | 3,920 | 1% | 12,077 | 10,785 | 12% |
| Consolidated | 4,158 | 4,101 | 1% | 12,604 | 11,295 | 12% |
| Earnings (loss) | | | | | | |
| Netherlands | \$ (107) | \$ (206) | (48%) | \$ (283) | \$ (518) | (45%) |
| United States | 534 | 1 | 51,463% | 1,288 | 786 | 64% |
| Consolidated | 427 | (205) | (308%) | 1,005 | 268 | 275% |

| | April 30 2008 | July 31 2007 | Percent Change |
|---------------------|------------------|-----------------|-------------------|
| Total Assets | | | |
| Netherlands | \$ 224 | \$ 309 | (28%) |
| United States | 9,231 | 9,618 | (4%) |
| Consolidated | 9,455 | 9,927 | (5%) |

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Total revenue for the three and nine month periods ended April 30, 2008 increased \$57,000 or 1% and \$1,309,000 or 12%, respectively, compared to the same periods last year, primarily due to an increase in revenues from the Company's marketing services. All of the three month growth and approximately 50% of the nine month growth was organic. Approximately half of the nine month growth was from the OC-Net acquisition. Operating income increased \$599,000 or 348% for the three months ended April 30, 2008, primarily due to an overall decrease in spending and \$739,000 or 232% for the nine months ended April 30, 2008, compared to the same periods last year, primarily due to an increase in revenue. Over \$300,000 of the reduced spending was due to non-recurring expenses incurred in fiscal 2007 for distribution, development and support costs associated with fixing a major new release of the Company's catalog product, non-capitalized merger and acquisition costs and severance for management that was not replaced. Net income increased \$632,000 or \$0.10 per basic share for the three months ended April 30, 2008 and \$737,000 or \$0.11 per basic share for the nine months ended April 30, 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 nine month periods ended April 30, 2007, 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.

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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".

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, 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, and related interpretations and disclosure requirements established by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation, as amended by Statement of Financial Accounting Standard No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure.

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 97 catalogs of manufactured equipment from 76 manufacturers via CD-Rom to approximately 20,000 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.

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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 Related 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 [®] | 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 |
| PartSmart Web [®] ASP | Electronic parts catalog viewing software offered as a hosted service for individual distributors and manufacturers, formerly EMPARTweb ASP | Equipment - all sub-markets |
| PartSmart Cart [®] | 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 |
| EMPARTviewer [™] | | Equipment - RV |

| | | |
|-----------------------|---|-----------------------------|
| | Electronic parts catalog viewing software | |
| WarrantySmart™ | Web-based end-to-end warranty claims processing system that enables dealers, distributors and manufacturers to streamline product registration and warranty claim submission and processing, as well as check claim status online | Equipment – all sub-markets |
| 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 | Large-scale website creation, hosting and maintenance services | Equipment – all sub-markets |
| ARI MailSmart™ | Direct mail solution that enables users to cost-effectively and efficiently reach customers and prospects with customized messages | Equipment – all sub-markets |
| eMailSmart™ | Email solution that enables users to stay in touch with customers through special offers and a quarterly newsletter | Equipment – all sub-markets |
| Content Management Services | Add-on solution to WebsiteSmart and Website Smart Pro that automatically updates a website with Weather Alerts, promotions based on customer seasonality and supplier promotions | Equipment – all sub-markets |

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eComMERCE Products and Services

| Product or Service | Description | Primary Industry/Market |
|--------------------|---|----------------------------------|
| TradeRoute® | Document handling and communications for product ordering, warranty claims and other business documents | Equipment - Outdoor power and RV |

As part of its historical business practice, the Company continues to provide electronic transaction services to the North American agribusiness industry, representing approximately 4% of total revenue for the nine months ended April 30, 2008.

The following table sets forth, for the periods indicated, certain revenue information derived from the Company's unaudited financial statements. In the table below, revenue is categorized by customer location, rather than by ARI subsidiary. Since some non-North American customers are billed from the US subsidiary, the presentation is different from the segment reporting in Note 9 above.

Revenue by Location and Service
(In Thousands)

| | Three months ended | | | Nine months ended | | |
|-------------------------------------|--------------------|------------------|-------------------|-------------------|------------------|-------------------|
| | April 30 2008 | April 30 2007 | Percent Change | April 30 2008 | April 30 2007 | Percent Change |
| North American | | | | | | |
| Catalog subscriptions | \$ 2,435 | \$ 2,503 | (3%) | \$ 7,464 | \$ 7,711 | (3%) |
| Catalog professional services | 311 | 329 | (5%) | 920 | 923 | 0% |
| Marketing services | 588 | 536 | 10% | 1,705 | 1,047 | 63% |
| Marketing professional services | 373 | 230 | 62% | 1,201 | 230 | 422% |
| Dealer & distributor communications | 181 | 165 | 10% | 496 | 512 | (3%) |
| Subtotal | 3,888 | 3,763 | 3% | 11,786 | 10,423 | 13% |
| Rest of the World | | | | | | |
| Catalog subscriptions | 268 | 257 | 4% | 813 | 727 | 12% |
| Catalog professional services | 2 | 81 | (98%) | 5 | 145 | (97%) |
| Subtotal | 270 | 338 | (20)% | 818 | 872 | (6%) |
| Total Revenue | | | | | | |
| Catalog subscriptions | 2,703 | 2,760 | (2%) | 8,277 | 8,438 | (2%) |
| Catalog professional services | 313 | 410 | (24%) | 925 | 1,068 | (13%) |
| Marketing services | 588 | 536 | 10% | 1,705 | 1,047 | 63% |
| Marketing professional services | 373 | 230 | 62% | 1,201 | 230 | 422% |
| Dealer & distributor communications | 181 | 165 | 10% | 496 | 512 | (3%) |

| | | | | | | | | | | |
|-------|----|-------|----|-------|----|----|--------|----|--------|-----|
| Total | \$ | 4,158 | \$ | 4,101 | 1% | \$ | 12,604 | \$ | 11,295 | 12% |
|-------|----|-------|----|-------|----|----|--------|----|--------|-----|

North America

Catalog Subscriptions

North American catalog subscription revenues are derived from software license fees, license renewal fees, software maintenance and support fees, catalog subscription fees, hosting and other miscellaneous subscription fees charged to dealers, distributors and manufacturers for the use of the Company's catalog products in the United States and Canada. Catalog subscription revenues decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to the non-renewal of two significant OEM customers, who subscribed in bulk on behalf of their dealers. Catalog subscription renewals from the Company's North American dealers were approximately 89% for the nine months ended April 30, 2008. Management expects revenues from catalog subscriptions in North America to decline for the remainder of fiscal 2008 compared to the prior year due to these lost bulk subscriptions.

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Catalog Professional Services

Revenues from the Company's North American catalog professional services are derived from software customization labor, data conversion labor, data conversion replication fees, travel and shipping fees primarily charged to manufacturers in the United States and Canada. Revenues from catalog professional services in North America decreased slightly for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to less professional services revenue for catalog updates. Management expects revenues from catalog professional services in North America to decrease somewhat for the remainder of fiscal 2008 compared to the prior year as the Company focuses more of its sales efforts in marketing services.

Marketing Services

Revenues from the Company's North American marketing service subscriptions are derived from set-up, postage, hosting, access fees and commissions for on-line sales charged to dealers, distributors and manufacturers in the United States and Canada for the Company's website products and services. Revenues from marketing services in North America increased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to increased sales of the Company's Website Smart Pro™ (acquired as part of the OC-Net transaction) as a result of the Company's investments in sales and marketing for the marketing services business. Revenues from Website Smart Pro™ are included in Marketing services beginning January 27, 2007. Management expects revenues from marketing services in North America to continue to increase for the remainder of fiscal 2008, compared to the prior year, due to new sales as the Company continues to focus its resources in this market.

Marketing Professional Services

Revenues from the Company's North American marketing professional services are derived from website customization labor primarily charged to manufacturers, distributors and other customers in the United States. Revenues from marketing services in North America increased primarily from customization of websites related to contracts acquired with OC-Net. Management believes that this area represents an opportunity for growth in the future through selling new contracts.

Dealer and Distributor Communications

Revenues from dealer and distributor communications are derived from license renewal fees, software maintenance, customization labor and other communication fees charged for dealers and distributors to communicate with manufacturers in the manufactured equipment industry and the agricultural inputs industry. Dealer and distributor communication revenues increased for the three month period ended April 30, 2008 primarily due to the settlement of a previously uncollectible receivable but decreased for the nine month period ended April 30, 2008, compared to the same periods last year, primarily due to a decline in the base of customers as the Company focused the business primarily on its catalog products in the equipment industry. Management expects revenues from dealer and distributor communication products will be a declining percentage of total revenue for the remainder of fiscal 2008, compared to the prior year.

Rest of the World

Catalog Subscriptions

Catalog subscription revenues from the rest of the world are derived from software license fees, license renewal fees, software maintenance and support fees, catalog subscription fees, and other miscellaneous subscription fees charged to

dealers, distributors and manufacturers outside of North America for the use of the Company's catalog products. Catalog subscription revenues for the rest of the world increased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to delays in fiscal 2007 of two manufacturer renewals. These manufacturers canceled, then re-subscribed, resulting in the associated revenues not being recorded last year and retroactive revenues being recorded this year. Management expects catalog subscription revenues from the rest of the world to continue to increase for the remainder of fiscal 2008, compared to the prior year, due to the timing of renewals.

Catalog Professional Services

Revenues from the Company's rest of the world catalog professional services are derived from software customization labor, data conversion labor, data conversion replication fees, travel and shipping fees primarily charged to manufacturers that do not reside in North America. Revenues from catalog professional services in the rest of the world has decreased significantly for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to the lack of sales to manufacturers. Management expects revenues from catalog professional services in the rest of the world to continue at approximately the current rate for the remainder of fiscal 2008 unless a new manufacturer sale is completed.

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Cost of Products and Services Sold

The following table sets forth, for the periods indicated, certain information regarding revenue and cost of products and services sold which is derived from the Company's unaudited financial statements.

Cost of Products and Services Sold as a Percent of Revenue by Revenue Type
(In thousands)

| | Three months ended | | | Nine months ended | | |
|--|--------------------|------------------|-------|-------------------|------------------|-------|
| | 2008 | April 30 2007 | % Chg | 2008 | April 30 2007 | % Chg |
| Catalog subscriptions | | | | | | |
| Revenue | \$ 2,703 | \$ 2,760 | (2%) | \$ 8,277 | \$ 8,438 | (2%) |
| Cost of revenue | 265 | 286 | (7%) | 923 | 859 | 7% |
| Cost of revenue as a percent of revenue | 10% | 10% | | 11% | 10% | |
| Catalog professional services | | | | | | |
| Revenue | 313 | 410 | (24%) | 925 | 1,068 | (13%) |
| Cost of revenue | 138 | 210 | (34%) | 389 | 448 | (13%) |
| Cost of revenue as a percent of revenue | 44% | 51% | | 42% | 42% | |
| Marketing services subscriptions | | | | | | |
| Revenue | 588 | 536 | 10% | 1,705 | 1,047 | 63% |
| Cost of revenue | 139 | 244 | (43%) | 487 | 511 | (5%) |
| Cost of revenue as a percent of revenue | 24% | 46% | | 29% | 49% | |
| Marketing professional services | | | | | | |
| Revenue | 373 | 230 | 62% | 1,201 | 230 | 422% |
| Cost of revenue | 129 | 75 | 72% | 391 | 75 | 421% |
| Cost of revenue as a percent of revenue | 35% | 33% | | 33% | 33% | |
| Dealer and distributor communications | | | | | | |
| Revenue | 181 | 165 | 10% | 496 | 512 | (3%) |
| Cost of revenue | 4 | 16 | (75%) | 10 | 68 | (85%) |
| Cost of revenue as a percent of revenue | 2% | 10% | | 2% | 13% | |
| Total | | | | | | |
| Revenue | \$ 4,158 | \$ 4,101 | 1% | \$ 12,604 | \$ 11,295 | 12% |
| Cost of revenue | \$ 674 | 831 | (19%) | 2,201 | 1,961 | 12% |
| | 16% | 20% | | 17% | 17% | |

Cost of revenue as a percent
of revenue

Cost of catalog subscriptions consists primarily of reseller fees, software amortization costs, catalog replication and distribution costs. Cost of catalog subscriptions as a percentage of revenue remained relatively the same for the three and nine month periods ended April 30, 2008, compared to the same periods last year. Management expects gross margins may, as a percent of revenue from catalog subscriptions, vary slightly from quarter to quarter due to the timing of data shipments and to variations in the recognition of revenue which does not directly correlate to software amortization expense, which is generally on a straight-line basis.

Cost of catalog professional services consists of customization and catalog production labor. Cost of professional services as a percentage of revenue decreased for the three month period ended April 30, 2008, compared to the same period last year, primarily due to an increase in non-billable catalog production costs in the third quarter of fiscal 2008. Cost of professional services as a percentage of revenue remained relatively the same for the nine month period ended April 30, 2008, compared to the same period last year. Management expects cost of catalog professional services to fluctuate from year to year depending on the mix of services sold, the portion of customizations which are billable and on the Company's performance towards the contracted amount for customization projects.

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Cost of revenue for marketing service subscriptions consists primarily of website setup labor, software amortization costs, postcards, printing and distribution costs. Cost of marketing services as a percentage of revenue decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to increased revenue from the Company's Website products, which have a higher margin than the Company's MailSmart™ products. Management expects gross margins, as a percent of revenue from marketing services, to increase over the prior year for the remainder of fiscal 2008, as customers renew their Website products, without incurring one-time start-up costs which are charged in the first year of sale.

Cost of revenues for marketing professional services consists of website customization labor associated primarily with new contracts acquired with OC-Net in January 2007. Cost of revenues for marketing professional services as a percentage of revenue remained relatively the same for the three and nine month periods ended April 30, 2008, compared to the same periods last year. Management expects cost of marketing professional services to fluctuate from year to year depending on the Company's performance towards the contracted amount for customization projects and the actual labor rates negotiated in customer contracts.

Cost of dealer and distributor communications revenue consists primarily of telecommunication costs, royalties and software customization labor. Cost of dealer and distributor communications as a percentage of revenue decreased significantly for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to a decrease in telecommunication costs and software customization labor. Management expects gross margins, as a percent of revenue from dealer and distributor communications, to remain relatively the same as the current quarter for the remainder of fiscal 2008.

Operating Expenses

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

Operating Expenses
(In thousands)

| | Three months ended | | | Nine months ended | | |
|--|--------------------|------------------|-------|-------------------|------------------|-------|
| | 2008 | April 30 2007 | % Chg | 2008 | April 30 2007 | % Chg |
| Customer operations and support | \$ 252 | \$ 298 | (15%) | \$ 788 | \$ 842 | (6%) |
| Selling, general and administrative | 2,292 | 2,491 | (8%) | 6,976 | 6,577 | 6% |
| Software development and technical support | 333 | 450 | (26%) | 1,021 | 1,178 | (13%) |
| Depreciation and amortization | 180 | 203 | (11%) | 561 | 419 | 34% |
| Net operating expenses | \$ 3,057 | \$ 3,442 | (11%) | \$ 9,346 | \$ 9,016 | 4% |

Customer operations and support consists primarily of server room operations, software maintenance agreements for the Company's core network and customer support costs. Customer operations and support costs decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to a

decrease in temporary help used to support the Company's products. Management expects customer operations and support costs to continue to be lower than the previous year for the remainder of fiscal 2008, due to the use of temporary help to support a new release of the Company's catalog software in fiscal 2007.

Selling, general and administrative expenses ("SG&A") decreased for the three month period ended April 30, 2008, compared to the same period last year, as the Company reduced its expenses in the Netherlands office. SG&A increased for the nine month period ended April 30, 2008, compared to the same period last year, as a result of the Company's investment in the outsourced finance & insurance ("F&I") sales initiative in the North American market and operating costs for the California location in the first half of fiscal 2008. The California location was added to the Company with the OC-Net acquisition and provides website development, customization and support for the Company's new WebsiteSmart Pro™ product. SG&A, as a percentage of revenue, decreased from 58% for the nine month period ended April 30, 2007 to 55% for the same period this year, as the growth in revenue more than offset the increase in costs. The Company discontinued the F&I operation in December, 2007 but incurred no significant costs associated with the closing, and expects to incur no additional costs related to this operation for the remainder of fiscal 2008. Management expects SG&A costs as a percentage of revenue to be lower than the previous year for the remainder of fiscal 2008, as the operating costs of the OC-Net acquisition will be included in both years and due to the discontinuation of the F&I initiative. An acquisition, if one were to occur, could have a material impact on these results.

The Company's technical staff (in-house and contracted) performs software development, technical support, software customization and data conversion services for customer applications. Software development and technical support costs decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to an increase in the allocation to cost of sales for professional services revenue driven, in turn, by demand for marketing professional services. Management expects fluctuations from quarter to quarter, as the mix of development and customization activities will change based on customer requirements even if the total technical staff cost remains relatively constant.

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Depreciation and amortization expense decreased for the three month period ended April 30, 2008, compared to the same period last year, primarily due to software and equipment purchased in previous years becoming fully amortized. Depreciation and amortization expense increased for the nine month period ended April 30, 2008, compared to the same period last year, primarily due to the amortization of intangible assets associated with the OC-Net acquisition. Management expects depreciation and other amortization to remain relatively the same as last year for the remainder of fiscal 2008.

Other Items

Interest expense includes both cash and non-cash interest. Interest paid was approximately \$14,000 and \$88,000 for the three and nine month periods ended April 30, 2008, and \$45,000 and \$137,000 for the three and nine month periods ended April 30, 2007, respectively. In addition, excess debt principal was amortized to offset interest expense by approximately \$4,000 and \$22,000 for the three and nine month periods ended April 30, 2008 and \$11,000 and (\$22,000) for the three and nine month periods ended April 30, 2007, respectively.

Net income increased from a loss of \$205,000 for the three month period ended April 30, 2007, to net income of \$427,000 for the three month period ended April 30, 2008 and from net income of \$268,000 for the nine month period ended April 30, 2007, to \$1,005,000 for the nine month period ended April 30, 2008 primarily due to the increase in revenue, offset in part, by increased overhead. Management expects earnings to continue to increase over the prior year for the remainder of fiscal 2008.

Liquidity and Capital Resources

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

Cash Flow Information
(In thousands)

| | Three months ended | | | Nine months ended | | |
|--|--------------------|------------------|-------|-------------------|------------------|-------|
| | 2008 | April 30 2007 | % Chg | 2008 | April 30 2007 | % Chg |
| Net income | \$ 427 | \$ (205) | 308% | \$ 1,005 | \$ 268 | 275% |
| Amortization of software products | 187 | 213 | (12%) | 568 | 598 | (5%) |
| Amortization of deferred finance costs and debt discount | 4 | 11 | (64%) | 22 | (22) | 200% |
| Depreciation and other amortization | 159 | 203 | (22%) | 561 | 419 | 34% |
| Stock based compensation related to stock options | 19 | 41 | (54%) | 65 | 109 | (40%) |
| Stock issued as contribution to 401(k) plan | - | - | - | 37 | 42 | (12%) |
| Net change in working capital | 165 | 506 | (67%) | (683) | (367) | (86%) |
| Net cash provided by operating activities | 961 | 769 | 25% | 1,575 | 1,047 | 50% |
| | (173) | (501) | 65% | (428) | (2,055) | 79% |

| | | | | | | |
|---|--------|----------|------|--------|------------|------|
| Net cash used in investing activities | | | | | | |
| Net cash used in financing activities | (311) | (439) | 29% | (966) | (1,108) | 13% |
| Effect of foreign currency exchange rate change on cash | 6 | - | 100% | 13 | - | 100% |
| Net change in cash | \$ 483 | \$ (171) | 382% | \$ 194 | \$ (2,116) | 109% |

Net cash provided by operating activities increased for the three month period ended April 30, 2008, compared to the same period last year, primarily due to the increase in net income, offset in part by changes in working capital. The effect of net changes in working capital is dependent on the timing of payroll and other cash disbursements, accruals and the timing of invoices and may vary significantly from quarter to quarter. Net cash provided by operating activities increased for the nine month period ended April 30, 2008, compared to the same period last year, primarily due to the increase in net income. Management expects net cash provided by operating activities to continue to increase over the prior year for the remainder of fiscal 2008.

Net cash used in investing activities decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to the acquisition of OC-Net in January, 2007 and the decrease in equipment expenditures in fiscal 2008. Cash used in investing activities may fluctuate from quarter to quarter, depending on the timing of capital expenditures and acquisitions.

Net cash used in financing activities decreased for the three and nine month periods ended April 30, 2008, compared to the same periods last year, primarily due to the decrease in debt, as described in Note 5 to the financial statements. Management believes that funds generated from operations will be adequate to fund the Company's operations, investments and debt payments for the foreseeable future, although additional financing may be necessary if the Company were to complete a material acquisition or to make a large investment in its business.

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At April 30, 2008, the Company had cash and cash equivalents of approximately \$1,244,000 compared to approximately \$1,050,000 at July 31, 2007.

Acquisitions

Since December 1995, the Company has had a formal business development program aimed at identifying, evaluating and closing acquisitions that augment and strengthen the Company's market position, product offerings, and personnel resources. Since the program's inception, six business acquisitions and one software asset acquisition have been completed, all of which have been fully integrated into the Company's operations as of April 30, 2008.

The business development program is still an important component of the Company's long-term growth strategy and the Company expects to continue to pursue it aggressively.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as of June 7, 2008.

Forward Looking Statements

Certain statements contained in this Form 10-Q are forward looking statements including revenue growth, future cash flows and cash generation and sources of liquidity. Expressions such as "believes," "anticipates," "expects," and similar expressions are intended to identify such forward looking statements. Several important factors can cause actual results to materially differ from those stated or implied in the forward looking statements. Such factors include, but are not limited to the factors listed on Exhibit 99.1 of the Company's annual report on Form 10-KSB for the year ended July 31, 2007, which is incorporated herein by reference. The forward-looking statements are made only as of the date hereof, and the Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK– Not Applicable.

ITEM 4T. CONTROLS AND PROCEDURES

The Company maintains a set of disclosure controls and procedures that are designed to ensure that information required to be disclosed by it in the reports filed by it under the Securities Exchange Act of 1934, as amended ("Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and acting Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, the Company's Chief Executive Officer and acting Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of April 30, 2008.

There have been no changes in the Company's internal control over financial reporting identified in connection with the evaluation discussed above that occurred during the quarter ended April 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, the Company may be involved in litigation relating to claims arising out of our operations in the usual course of business. The Company had no litigation relating to claims arising out of its operations in the usual course of business for the nine month period ended April 30, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended April 30, 2008, the Company did not sell any equity securities which were not registered under the Securities Act or repurchase any of its equity securities.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES – None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS – None.

ITEM 5. OTHER INFORMATION – None.

ITEM 6. EXHIBITS

| | |
|-------------|--|
| <u>10.1</u> | 2000 Stock Option Plan, as amended. |
| <u>31.1</u> | Section 302 Certification of Chief Executive Officer. |
| <u>31.2</u> | Section 302 Certification of Acting Chief Financial Officer. |
| <u>32.1</u> | Section 906 Certification of Chief Executive Officer. |
| <u>32.2</u> | Section 906 Certification of Acting Chief Financial Officer. |

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARI Network Services, Inc.
(Registrant)

Date: June 16, 2008

/s/ Roy W. Olivier
Roy W. Olivier, Chief Executive Officer

/s/ Brian E. Dearing
Brian E. Dearing, Chairman of the Board and Acting
Chief Financial Officer