

Net Element, Inc.
Form 10-K
April 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from _____ to _____

Commission file number: **001-34887**

Net Element, Inc.

(Exact name of registrant as specified in its charter)

Delaware **98-0668024**
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3363 NE 163rd Street, Suite 705

North Miami Beach, FL 33160 **33160**
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(305) 507-8808**

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.0001 per share	NASDAQ Capital Market

Securities registered under Section 12(g) of the Exchange Act:

Warrants, each exercisable for one share of Common Stock
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO

The aggregate market value of the registrant's common equity, other than shares held by persons who may be deemed affiliates of the registrant, as of April 1, 2014 was approximately \$23,826,835 (based upon the reported closing price of \$3.36 per share on April 1, 2014. For purposes of calculating the aggregate market value of shares of our common stock held by non-affiliates, we have assumed that all outstanding shares are held by non-affiliates, except for shares held by each of our executive officers, directors and Mike Zoi, who owns approximately 47.8% of the outstanding shares of our common stock as of April 1, 2014. These assumptions should not be deemed to constitute an admission that all executive officers, directors and Mike Zoi are, in fact, affiliates of our company, or that there are not other persons who may be deemed to be affiliates of our company.

The registrant had 32,273,298 shares of common stock outstanding as of April 1, 2014.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

Defined Terms; Share Amounts and Consideration for Shares

Net Element, Inc. (formerly known as Net Element International, Inc.) is a corporation organized under the laws of the State of Delaware. As used in this Annual Report on Form 10-K (this “Report”), unless the context otherwise requires, the terms “Company,” “we,” “us,” and “our” refer to Net Element, Inc. and, as applicable, its majority-owned and consolidated subsidiaries.

All amounts of shares and consideration for shares (including, without limitation, purchase prices, exercise prices and conversion prices) described in this Report for periods prior to October 2, 2012 (which was the closing date of the Company’s merger with Net Element, Inc.) have been adjusted to give effect to the conversion ratio for shares of Net Element, Inc. common stock that were cancelled and converted into shares of the Company’s common stock pursuant to the Merger Agreement. Pursuant to the terms of the Merger Agreement, upon completion of the Merger, each share of then-issued and outstanding common stock of Net Element, Inc. was automatically cancelled and converted into the right to receive one-fortieth (1/40) of a share of the Company’s common stock. For additional information regarding the Merger, see “Development of Business” in Part I, Item 1 of this Report and Note 4 of the accompanying Notes to Consolidated Financial Statements.

Forward-Looking Statements

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

- the impact of any new or changes made to laws, regulations, card network rules or other industry standards affecting our business;
- the impact of any significant chargeback liability and liability for merchant or customer fraud, which we may not be able to accurately anticipate and/or collect;
- our ability to secure or successfully migrate merchant portfolios to new bank sponsors if current sponsorships are terminated;
- our and our bank sponsors’ ability to adhere to the standards of the Visa and MasterCard payment card associations;
- our reliance on third-party processors and service providers;
- our dependence on independent sales groups (“ISGs”) that do not serve us exclusively to introduce us to new merchant accounts;
- our ability to pass along increases in interchange costs and other costs to our merchants;
- our ability to protect against unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems or otherwise;
- the effect of the loss of key personnel on our relationships with ISGs, card associations, bank sponsors and our other service providers;
- the effects of increased competition, which could adversely impact our financial performance;
- the impact of any increase in attrition due to an increase in closed merchant accounts and/or a decrease in merchant charge volume that we cannot anticipate or offset with new accounts;
- the effect of adverse business conditions on our merchants;
- our ability to adopt technology to meet changing industry and customer needs or trends;
- the impact of any decline in the use of credit cards as a payment mechanism for consumers or adverse developments with respect to the credit card industry in general;
- the impact of any adverse conditions in industries in which we obtain a substantial amount of our bankcard processing volume;
- the impact of seasonality on our operating results;
- the impact of any failure in our systems due to factors beyond our control;
- the impact of any material breaches in the security of third-party processing systems we use;
- the impact of any new and potential governmental regulations designed to protect or limit access to consumer information;

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- the impact on our profitability if we are required to pay federal, state or local taxes on transaction processing;
- the impact on our growth and profitability if the markets for the services that we offer fail to expand or if such markets contract;
- our ability (or inability) to continue as a going concern;
- the willingness of the Company's majority stockholders, and/or other affiliates of the Company, to continue investing in the Company's business to fund working capital requirements;
- the Company's ability (or inability) to obtain additional financing in sufficient amounts or on acceptable terms when needed;
- the impact on our operating results as a result of impairment of our goodwill and intangible assets;

our material weaknesses in internal control over financial reporting and our ability to maintain effective controls over financial reporting in the future; and
the other factors identified in the section of this Report entitled “Risk Factors.”

If these or other risks and uncertainties (including those described in Part I, Item 1A of this Report and the Company’s subsequent filings with the U.S. Securities and Exchange Commission (the “Commission”)) materialize, or if the assumptions underlying any of these statements prove incorrect, the Company’s actual results may be materially different from those expressed or implied by such statements. We undertake no obligation to publicly revise any forward-looking statement to reflect circumstances or events after the date of this Report to reflect the occurrence of unanticipated events. You should, however, review the factors and risks described in the reports we file from time-to-time with the Commission after the date of this Report.

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

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PART I

Item 1. Business.

Company Overview

Net Element, Inc. (“Net Element”) is a financial technology-driven group specializing in mobile payments and value-added transactional services in emerging countries and in the United States. The Company operates in a single operating segment, that being a provider of transactional services and mobile payment solutions. The Company’s operating segment is based on geographic location. Geographic areas in which the Company operates include the United States, where through its U.S. based subsidiaries it generates revenues from transactional services and valued-added payment technologies for small and medium-sized businesses (“SME”). Through TOT Group Russia and Net Element Russia, we operate the Company’s international segment focused on transactional services, mobile payments transactions and value-added payment technologies in emerging countries including Russian Federation and the Commonwealth of Independent States (“CIS”).

General Business Developments

In 2013, we completed a number of acquisitions and dispositions in pursuit of our strategy to reposition our business activities with the goal of enhancing financial results, creation of a strong operational foundation and competitive advantage. We believe these transactions have realigned our company into a strong financial technology driven service company with a more balanced and stable business mix.

Our primary acquisitions and dispositions during 2013 were as follows (see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Significant Developments in Our Business in 2013”):

On April 16, 2013, newly formed TOT Group and its subsidiaries acquired substantially all of the business assets of Unified Payments, LLC, a Delaware limited liability company (“Unified Payments”). Unified Payments provides comprehensive turnkey, payment-processing solutions to small and medium size business owners (“Merchants”), independent sales agents and independent sales groups (“ISGs”) across the United States. See Note 4 of the accompanying Notes to Consolidated Financial Statements for additional information regarding this acquisition.

On June 24, 2013, TOT Group, through its newly formed subsidiary Aptito, LLC (“Aptito”) acquired substantially all of the business assets of Aptito.com, Inc., a New York corporation. Aptito is a new generation of smart, customer engaged, patent-pending, cloud-based payments platform, mobile Point of Sale (“mPOS”), mobile commerce application and self-ordering Apple® iPad®-based kiosk. See Note 4 of the accompanying Notes to Consolidated Financial Statements for additional information regarding this acquisition.

During the third quarter of 2013, in order to reposition our business activities and focus on financial technology and transactional services, the Company divested its ownership in non-core assets, which included its subsidiaries Openfilm, LLC, Motorsport, LLC, Splinx, LLC, LegalGuru, LLC and MUSIC 1 LLC (a/k/a OOO Music1) (collectively, the "Disposed Subsidiaries") by contributing to T1T Lab, LLC, a Florida limited liability company ("T1T Lab") all of its membership and participation interests in such subsidiaries in exchange for a 10% membership interest in T1T Lab. T1T Lab is a wholly owned subsidiary of T1T Group, LLC, a Delaware limited liability company ("T1T Group"). T1T Group was issued a 90% membership interest in T1T Lab in exchange for contributions that will be made to T1T Lab from time to time when requested by T1T Lab of such services and/or cash as determined by T1T Group in its sole and absolute discretion in order to manage and operate the Disposed Subsidiaries and their respective businesses. T1T Group is wholly-owned by Enerfund, LLC (which is wholly-owned by Mike Zoi, a director and majority stockholder of the Company). Openfilm, LLC, which develops technology and a website that supports the advancement of independent film on the Internet, was originally acquired in 2010. Motorsport, LLC, which is an online news and information service that distributes content related to the motor sports industry, was originally acquired in 2011. Splinx, LLC, which develops technology and web services focused in the areas of three dimensional (3D) imagery and video, was formed by the Company in 2011. LegalGuru, LLC, which is developing a video-centric, legal information portal, was originally acquired in 2012. MUSIC1 LLC, which operates an online music distribution platform in the Commonwealth of Independent States (CIS) countries, was acquired by the Company in 2011. The Disposed Subsidiaries constituted all of the Company's interests in online media businesses and operations (referred to herein collectively as the Company's "entertainment assets"). Operations of the divested businesses are presented as discontinued operations in the audited consolidated financial statements.

Subsequent to the 2013 fiscal year, during the first quarter of 2014, Company further reduced its liabilities by divesting its 10% ownership interest in T1T Lab, LLC in exchange for termination of its obligation to commit funding of T1T Lab, LLC associated with its equity ownership.

The Company changed its name to Net Element, Inc. on December 15, 2013.

Our Corporate Organization

Our Company was formed in 2010 and incorporated as a Cayman Islands exempted company with limited liability under the name Cazador Acquisition Corporation Ltd. (Cazador). Cazador was a blank check company incorporated for the purpose of effecting a merger; share capital exchange; asset acquisition; share purchase; reorganization or similar business combination with one or more operating businesses or assets. In 2012, Cazador completed a merger (the “Merger”) with Net Element, Inc., a Delaware corporation (“Net Element”), which was a company with businesses in the online media and mobile commerce payment processing markets. Immediately prior to the effectiveness of the Merger, the Company (then known as Cazador Acquisition Corporation Ltd.) changed its jurisdiction of incorporation by discontinuing as an exempted company in the Cayman Islands and continuing and domesticating as a corporation incorporated under the laws of the State of Delaware. Effective upon consummation of the Merger, (i) Net Element was merged with and into the Company, resulting in Net Element ceasing to exist and the Company continuing as the surviving company in the Merger, and (ii) the Company changed its name to Net Element International, Inc. In 2013, Company divested its non-core entertainment assets. In December 2013, the Company changed its name to Net Element, Inc. We entered the mobile payments business through the launch of TOT Money in Russian in 2012. We entered the financial technology and value-added transactional service business through the acquisitions of Unified Payments in April 2013 and Aptito in June 2013. Our principal office is located at 3363 NE 163rd Street, Suite 705, North Miami Beach, Florida 33160, and our main telephone number is (305) 507-8808.

Our Industry Segment

The Company manages one segment consisting of transactional processing and mobile payment solutions.

TOT Payments, our transactional processing group for the SME business provides technology and services that businesses require to accept cashless transactions. TOT Payments processes cashless transactions for card-present (or “swipe”) or card-not-present transactions, including point-of-sale (“POS”), mobile POS (“mPOS”), Internet businesses, service-oriented businesses, and mail order / telephone order (“MOTO”) merchants. TOT Payments also processes other cashless transactions including checks and direct debits. TOT Payments markets its services in United States under the brand Unified Payments (www.unifiedpayments.com). Our United States operations also include Aptito. Aptito, our mPOS and value-added services technology, helps restaurants drive consumer engagement via tablet, mobile and all other cloud-connected devices. Aptito’s proprietary, patent-pending, cloud-based mPOS platform provides hospitality merchants with tools to increase sales, productivity and customer loyalty (www.aptito.com).

Our mobile payments business provides carrier-integrated mobile payments solutions. TOT Money's relationships with mobile operators give the Company substantial geographic coverage, a strong capacity for innovation in mobile payments and messaging, and the ability to offer its clients In-App, P-SMS, Online and Carrier Billing (www.totmoney.ru). In addition, we have engineering services located in Russia and Ukraine that provide engineering services to our payment processing and mobile payment solutions business.

Our Services

TOT Payments. TOT Payments under the brand Unified Payments, provides technology and services that businesses require to accept cashless transactions at the point of sale. We process cashless transactions for card-present or card-not-present transactions, including point-of-sale, mobile POS, Internet businesses, service-oriented businesses, and mail order / telephone order merchants. TOT Payments services are distributed in most part through independent sales groups (“ISGs”), value-added resellers, system integrators and affinity partners.

We provide merchants with turnkey payment acceptance solutions, which include: the necessary hardware and software as well as the necessary technology to integrate into their existing point of sale systems, applications and websites. We also provide transaction processing, training, on-going customer and technical support, risk management to help detect and prevent fraudulent transactions, real-time online reporting, analytics and administrative tools. For these services, we charge our merchants a discount fee, or the “Merchant Discount”, which is based primarily on a percentage of the dollar amount of each transaction we process. The Merchant Discount may vary based on several factors, including the type of merchant, the type of card used and whether the transaction process is a swipe transaction or a card-not-present transaction.

A transaction is initiated when a consumer purchases a product or service at a merchant using his or her card. At the point of sale, the consumer’s credit card information is submitted to our processing vendor, which then communicates with the card-issuing bank through the proper association network (such as Visa or MasterCard) to authorize the transaction. After authorization, we instruct our processing vendor to route funds from the card-issuing bank to our sponsoring bank. Our sponsoring bank, which sponsors us for membership in the Visa, MasterCard or other card association, settles the transaction with the merchant. We pay interchange fees and assessment fees to the card-issuing bank and the credit card association, respectively, which are typically passed through in the Merchant Discount. We outsource certain services to third parties, including the receipt and settlement of funds and after-hours customer and technical support. We believe this structure allows us to maintain an efficient operating structure and enables us to expand our operations without significantly increasing our fixed costs or capital expenditures.

The following table provides an example of a typical transaction in the United States, including amounts paid to the card-issuing bank, Visa, MasterCard or other card association, the processing vendor, the sponsoring bank and us. This table also presents our other costs of services, which include sales related costs, merchant losses and various other expenses.

	US Dollars
Purchase amount	\$ 100.00
Less: cash to merchant	(97.00)
	\$ 3.00

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TOT's gross revenue (Merchant Discounts)		
Less: interchange fees	(1.84)
Less: network dues and bank processing fees	(0.12)
TOT's net settlement	\$ 1.04	
Less: other transactional costs	(0.21)
TOT's processing margin	\$ 0.83	

Relationships with Sponsors and Processors

In order to provide transaction-processing services for Visa and MasterCard transactions, a financial institution that is a principal member of the Visa and MasterCard card association must sponsor us. Additionally, we must be registered with Visa and MasterCard as a member service provider.

Sponsoring Banks. Because we are not a member bank as defined by Visa and MasterCard rules and regulations, in order to authorize and settle bankcard transactions for our merchants, we must be sponsored by a financial institution that holds a member bank status. We have agreements with several banks that sponsor us for membership in the Visa and MasterCard card associations and settle card transactions for our merchants. The principal sponsoring bank through which we process the majority of our transaction in the United States is BMO Harris Bank. From time to time, we may enter into agreements with additional banks. See “Risk Factors – Risk Factors Relating to Our Business – We rely on bank sponsors, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are not able to secure or successfully migrate merchant portfolio to new bank sponsors, we will not be able to conduct our business.”

Processing Vendors. We have agreements with several processing vendors to provide us with, on a non-exclusive basis transaction processing and transmittal, transaction authorization and data capture, and access to various reporting tools. Our primary processing vendor in the United States is Cynergy Data, LLC (“Cynergy”), which provides us with the processing conduit to Total System Services, Inc. (“TSYS”) authorization and settlement network. We have entered into several service agreements with Cynergy. Each of the Cynergy service agreements may be terminated by Cynergy if, among other things, (i) certain insolvency events occur with respect to us or (ii) we fail to maintain our good standing in the Visa or MasterCard associations. We may terminate each of the agreements if, among other things, (i) certain insolvency events occur with respect to Cynergy, (ii) Cynergy materially breaches any of the terms, covenants or conditions of the agreements and fails to cure such breach within 30 days following receipt of written notice thereof, or (iii) under certain circumstances, Cynergy is unable to perform services described in the agreement.

As an example of processing an electronic payment, the below diagram illustrates the participants involved in a credit card transaction. There are four main participants, the merchant, the service provider (TOT payments) the sponsoring bank and the data processor. Merchants are primarily business owners that accept credit card payment in exchange for their merchandise and services.

Our Merchant Base

In the United States, we have developed significant expertise in industries that we believe present relatively low risks as the customers are generally present and the products or services are generally delivered at the time the transaction is processed. These include:

- Professional service providers
- Restaurants
- Brick and mortar retailers
- Educational service providers
- Food stores
- Automotive sales and repair shops
- Hotel and lodging establishments

Merchants we serve typically process on average \$10,000 a month in credit card transactions and have an average transaction value of approximately \$50.00 per transaction. Larger payment processors have traditionally underserved these merchants. As a result, these merchants have historically paid higher transaction fees than larger merchants and have not been provided with tailored solutions and on-going services those larger merchants typically receive from larger payment processing providers.

As of December 31, 2013, approximately 26% of our SME merchants were professional services providers, approximately 21% were restaurants, approximately 19% were brick and mortar retailers, approximately 14% were educational services, approximately 10% were food stores, approximately 9% were automotive sales and repair shops, and approximately 3% were hotel and lodging establishments.

No single SME accounted for more than .7% of our total SME Visa and MasterCard processing volume in 2013 and during 2013 our top 25 SME merchants represented only 7.7% of our SME Visa and Mastercard processing volume. This merchant diversification makes us less sensitive to changing economic conditions in any particular industry. We believe our loss of any single merchant would not have a material adverse effect on our financial condition or results of operations.

In December 2013, SME merchants located in the following states represented the following percentage of our SME card processing volume: New York represented 21.4%, California represented 9.3%, New Jersey represented 9.2%, Florida represented 7.6% and Texas represented 5.9%, respectively. No other state represented more than 4% of our total SME card processing volume. Our geographic concentration tends to reflect the state where we have historically maintained a stronger sales force.

Merchant and Transaction Risk Management

We focus our sales efforts on low-risk bankcard merchants and have developed systems and procedures designed to minimize our exposure to potential merchant losses.

Effective risk management helps us minimize merchant losses for the mutual benefit of our merchants, ISGs and ourselves. Our risk management procedures also help protect us from fraud perpetrated by our merchants. We believe our knowledge and experience in dealing with attempted fraud has resulted in our development and implementation of effective risk management and fraud prevention systems and procedures for the types of fraud discussed in this section. In 2013, we experienced losses of .02% of our SME card processing volume.

We employ the following systems and procedures to minimize our exposure to merchant and transaction fraud:

Application Evaluation Underwriting. There are varying degrees of risk associated with different merchant types based on their industry, the nature of the merchant's business, processing volumes and average transaction size. As such, varying levels of scrutiny are needed to evaluate a merchant application and to underwrite a prospective merchant account. These range from basic due diligence for merchants with low risk profiles to more comprehensive review for higher risk merchants. The results of this assessment serves as the basis for decisions regarding acceptance of the merchant account, criteria for establishing reserve requirements, processing limits, average transaction amounts and pricing. Once aggregated, these factors also assist TOT Payments in monitoring transactions for those accounts when pre-determined criteria have been exceeded.

Merchant Monitoring. We employ several levels of merchant account monitoring to help us identify suspicious transactions and trends. Daily merchant activity is sorted into a number of customized reports by our systems. Our risk management team reviews any unusual activity highlighted by these reports, such as larger than normal transactions or credits, and monitors other parameters that are helpful in identifying suspicious activity. We have daily windows to decide if any transactions should be held for further review, which provides us time to interview a merchant or issuing bank to determine the validity of suspicious transactions. We also place merchants who require special monitoring on alert status and have engaged a third-party web crawling solution that scans all merchant websites for content and integrity.

Investigation and Loss Prevention. If a merchant exceeds any parameters established by our underwriting and/or risk management staff or violates regulations established by the applicable bankcard network or the terms of our merchant agreement, one of our investigators will identify the incident and take appropriate action to reduce our exposure to loss and the exposure of our merchant. This action may include requesting additional transaction information, withholding or diverting funds, verifying delivery of merchandise or even deactivating the merchant account. Additionally, Relationship Managers may be instructed to retrieve equipment owned by us. In addition, to protect ourselves from unexpected losses we maintain a reserve account with our sponsoring bank, which can be used to offset any losses incurred at a given time. As of December 31, 2013, our reserve balance was \$63,525, our reserve is capped at \$250,000 at any given time and replenished by funding 0.03% of bankcard processing volume in the event we need to use it to fund an unexpected loss. This reserve is accounted for on our balance sheet under restricted cash account.

Reserves. Some of our merchants are required to post reserves (cash deposits) that are used to offset chargebacks incurred. Our sponsoring banks hold such reserves related to our merchant accounts as long as we are exposed to loss resulting from a merchant's processing activity. In the event that a small company finds it difficult to post a cash reserve upon opening an account with us, we may build the reserve by retaining a percentage of each transaction the merchant performs until the reserve is established. This solution permits the merchant to fund our reserve requirements gradually as its business develops. As of December 31, 2013, our total reserve deposits were approximately \$30,000. We have no legal title to the cash accounts maintained at the sponsor bank in order to cover potential chargeback and related losses under the applicable merchant agreements. We also have no legal obligation to these merchants with respect to these reserve accounts. Accordingly, we do not include these accounts and the corresponding obligation to the merchants in our consolidated financial statements.

Market Overview

The financial technology and transaction processing industry is an integral part of today's worldwide financial structure. The industry is continually evolving, driven in large part by technological advances. The benefits of card-based payments allow merchants to access a broader universe of consumers, enjoy faster settlement times and reduce transaction errors. By using credit or debit cards, consumers are able to make purchases more conveniently, whether in person, over the Internet, or by mail, fax or telephone, while gaining the benefit of loyalty programs, such as frequent flyer miles or cash back, which are increasingly being offered by credit or debit card issuers.

Consumers are also beginning to use card-based and other electronic payment methods for purchases at an earlier age in life, and increasingly for small dollar amount purchases. Given these advantages of card-based payment systems to merchants and consumers, favorable demographic trends, and the resulting proliferation of credit and debit card usage, we believe businesses will increasingly seek to accept card-based payment systems in order to remain competitive.

Our management believes that cash transactions are becoming progressively obsolete. The proliferation of bankcards has made the acceptance of bankcard payments a virtual necessity for many businesses, regardless of size, in order to remain competitive. In addition, the advent and growth of e-commerce have marked a significant new trend in the way business is being conducted. E-commerce is dependent upon credit and debit cards, as well as other cashless payment processing methods.

The payment processing industry continues to evolve rapidly, based on the application of new technology and changing customer needs. We intend to continue to evolve with the market to provide the necessary technological advances to meet the ever-changing needs of our market place. Traditional players in the industry must quickly adapt to the changing environment or be left behind in the competitive landscape.

Competition

The payment processing industry is highly competitive. We compete with other providers of payment processing services on the basis of the following factors:

- quality and reliability of service;
- ability to evaluate, undertake and manage risk;
- ability to attract and retain independent sales organizations;
- ability to offer differentiating products and services;
- speed in approving merchant applications and deploying equipment; and
- cost to the customer.

We are committed not only to servicing clients' current processing needs, but also to being amongst the first to make available new technologies that may improve our merchants' respective competitive positions. We are committed to gaining the expertise and relationships to adopt and implement new technologies that we believe may differentiate our service offerings.

Many large and small companies compete with us in providing payment processing services and related services to a wide range of merchants. Many of our current and prospective competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, more developed infrastructures, greater name recognition and/or more established relationships in the industry than we have. Because of this our competitors may be able to adopt more aggressive pricing policies than we can, develop and expand their service offerings more rapidly, adapt to new or emerging technologies and changes in customer requirements more quickly, take advantage of acquisitions and other opportunities more readily, achieve greater economies of scale, and devote greater resources to the marketing and sale of their services. There are also many smaller transaction processors that provide various services to small and medium sized merchants. See “Risk Factors - Risk Factors Relating to Our Business - The payment processing industry is highly competitive and such competition is likely to increase, which may further adversely influence our prices to merchants, and as a result, our profit margins.”

We believe that our specific focus on smaller merchants, in addition to our understanding of the needs and risks associated with providing payment processing services to small merchants and ISGs, gives us a competitive advantage over larger competitors, which have a broader market perspective and priorities. We also believe that we have a competitive advantage over competitors of a similar or smaller size that may lack our extensive experience, value-added product offering and resources.

Our Business Strategy

To continue to grow our business, our strategy is to focus on providing merchants with the ability to process a variety of electronic transactions, including both card-present and card-not-present credit and debit transactions.

Key elements of our business strategy include:

- continuing to strive to enhance our risk management capabilities and solutions for our merchants;
- expanding our merchant customer base in our payment processing for the SME business segment;
 - expanding into high growth segments and verticals;
 - broaden and deepen our distribution channels; and
- expanding the geographical availability of our payment processing services and value-added product offering into new territories.

With our existing infrastructure and supplier relationships, we believe that we can accommodate expected industry growth. We believe that our available capacity and infrastructure will allow us to take advantage of operational efficiencies as we grow our processing volume and expand to other geographical territories.

Sales and Marketing

We market and sell our services to merchants throughout the United States primarily through a network of ISGs, which are non-employee, external sales organizations with which we have contractual relationships, partnerships with various associations, value-added resellers and technology integrators, through the use of electronic media, telemarketing and other programs utilizing partnerships with other companies that market products and services to small businesses. Our relationships with ISGs are typically mutually non-exclusive, permitting us to establish relationships with multiple ISGs and permitting our groups to enter into relationships with other providers of transaction processing services. We believe that this sales approach provides us with access to an experienced sales force to market our services with limited investment in sales infrastructure and management time. We believe our focus on the unique needs of small and medium size merchants allows us to develop compelling offerings for our sales channels to bring to prospective merchants and provides us with a competitive advantage in our target market. Among the services and capabilities we provide are rapid application response time, merchant application acceptance by fax or on-line submission, superior customer service, merchant reporting and robust analytics. In addition, by controlling the underwriting process we believe we offer the ISGs more rapid and consistent review of merchant applications than may be available from other service providers. Additionally, in certain circumstances, we offer our sales organizations tailored compensation programs and unique technology applications to assist them in the sales process. We keep an open dialogue with our sales partners to address their concerns as quickly as possible and work with them in investigating chargebacks or potentially suspicious activity with the aim of ensuring our merchants do not unduly suffer downtime or the unnecessary withholding of funds.

As compensation for their referral of merchant accounts, we pay our ISGs an agreed-upon residual, or percentage of the income we derive from the transactions we process from the merchants they refer to us. The amount of the residuals we pay to our ISGs varies on a case-by-case basis and depends on several factors, including but not limited to the number and type of merchants each group refers to us. We provide additional incentives to our ISGs, including, from time to time, advances and merchant acquisition bonuses that are secured by income earned from the referred merchant and repayable from future compensation that may be earned by the groups in respect to the merchant they have referred to us. As of December 31, 2013, we had provided merchant acquisition incentives to ISGs in an aggregate amount of \$0.5 million. Our organic growth plan calls for future incentives to be funded to our ISGs for referred merchants.

Value-Added Technology and Services

Our Services

Aptito – Aptito is a new generation of proprietary, smart, customer engaged, patent-pending payments platform, mPOS, mobile commerce application and self-ordering Apple® iPad®-based kiosk. Through its disruptive, cloud-based payments platform Aptito offers merchants an innovative, socially driven, all-in-one digital software solution that offers a complete package of features for the food-service industry. Aptito’s Restaurant mPOS solution provides restaurants with tools to increase sales, productivity, and customer loyalty. Aptito’s suite of fully linked tools enables inventory management, complete payroll, staff scheduling, patron reservations and digital menus.

We believe the Aptito all-in-one digital solution is the next evolutionary step for restaurants that are seeking to increase customer awareness and loyalty, offer their valued customers a modern and interactive way to order food, and receive personalized and interactive service. Aptito’s all-in-one social solution will drive traffic to restaurants via deals, specials, promotions, and rewards. We expect our social media integration to propel Aptito above platforms that lack social integration and position Aptito to achieve a substantial market share.

Payment Browser – We have developed, what we believe is the industry’s first customizable, fully integrated front end payment application, known as Payment Browser. Our unique, Internet browser-based software platform allows rapid integration of secure, payment processing services into existing web application or Microsoft® Windows-based point-of-sale software without any programming or time consuming PA-DSS and PCI-DSS compliance validation. The Payment Browser application runs alongside of your application, allowing the user to process PA-DSS validated electronic transactions. Payment Browser software turns any PC or PC-based POS system into a secure payment-accepting device. It supports a wide range of peripherals, making it easy to accept all payment types including credit, debit, checks, stored value/loyalty, purchasing cards (level II), and more. Payment Browser is currently integrated into many practice management systems in the healthcare sector.

TOT Platform – Our omni-channel transactional platform and mobile payments billing system makes payment solutions possible across multiple channels. TOT Platform provides the latest mobile payment solutions including premium SMS billing, mobile subscriptions, direct carrier-billing and WAP billing to allow users to easily and securely pay for web or mobile content. Leveraging our extensive mobile operator relationships and market expertise, our transactional platform and mobile billing system offers customers a variety of mobile payment solutions through an extensive network of mobile operator networks and any device type. TOT Platform is currently utilized in our international business segment.

Research and Development

We recognize the importance of having access to leading technology in order to develop advanced products for our customers, independent sales agents and for our own internal use. To this end, we maintain two teams of development engineers, quality assurance professionals and technical code writers dedicated to financial services and value-added technology business. Financial services development team is located in Yekaterinburg, Russia. As of December 31, 2013, approximately 15 persons were engaged in such activity. Value-added technology team is located in Kharkov, Ukraine. As of December 31, 2013, approximately 14 independent contractors were engaged in such activity.

Intellectual Property

We have several trademarks and service marks, all of which are material importance to us. The following trademarks and service marks are the subject of trademark registrations and are used in our financial services business:

1. Unified Payments
2. Unified Payments - experience, confidence, growth
3. Process Pink
4. Process Pink for a cure
5. Process Pink Bankcard Processing
6. Pink Pay

We regard our software as proprietary and attempt to protect it, where applicable, with copyrights, trade secret measures and non-disclosure agreements. Despite these protections, it may be possible for competition or users to copy aspects of our intellectual property or to obtain information that we regard as trade secrets. Existing copyright laws afford only limited practical protection for computer software. The laws of foreign countries generally do not protect our proprietary rights in our products to the same extent as the laws of the United States. In addition, we may experience more difficulty in enforcing our proprietary rights in certain foreign jurisdictions. Patent Application number 13/471,717 was filed with United States Patent and Trademark Office on May 15, 2012 for “Restaurant Communication System and Method Utilizing Digital Menus.” Application for patent was assigned to Aptito, LLC on June 26, 2013.

Integrated Mobile Payments and Transaction Services

Our Services

The following services are provided outside the United States and include: value-added mobile payments; mobile billing; SMS messaging; integrated mobile payments; and transaction processing services in card-present and card-not-present environments.

TOT Group (Emerging Markets). In 2013 TOT Group has established presence in Russian Federation and Ukraine to provide transactional card services to merchants in these regions. Such services include: card-present or card-not-present transactions, including point-of-sale, mobile POS, Internet businesses, service-oriented businesses, and mail order / telephone order merchants. Due to the startup nature of this business as of the date of this report the Company has limited number of trial merchants in these regions.

TOT Money. TOT Money is a provider of mobile messaging and mobile billing solutions in emerging markets. We offer targeted billing solutions via premium SMS (“P-SMS”), direct carrier billing, in-app purchases, Wireless Access Protocol (“WAP”) payments and mobile commerce. Instead of using traditional credit cards, TOT Money uses mobile devices as payment methods and allows third-party content or services providers to charge its customers for goods and services using customers pre-paid or post-paid mobile credit.

Relationships with Mobile Operators, Sponsors and Processors

Mobile Operators. In order for us to provide payment and SMS messaging services to mobile subscribers and debit their accounts for payments we need to have contractual agreements with mobile operators, which allow us to bill its subscribers. We have direct and indirect agreements with mobile operators and mobile operator aggregators in over 40 countries. The three largest mobile operators through which we process the majority of our transactions are: Mobile TeleSystems OJSC (“MTS”), MegaFon OJSC (“MegaFon”) and OJSC VimpelCom (“VimpelCom”), these contracts allow us to facilitate payments using Short Message Services (“SMS”), Multimedia Messaging Services (“MMS”) and WAP for their mobile phone subscribers. From time to time, we may enter into agreements with additional mobile operators and mobile operator aggregators.

Sponsoring Banks. Because we are not a member bank as defined by Visa and MasterCard rules and regulations, in order to authorize and settle bankcard transactions for our merchants, we must be sponsored by a financial institution, which holds a member bank status. We have agreements with several banks that sponsor us for membership in the Visa and MasterCard card associations and settle card transactions for our merchants. Sponsoring bank through which we are able to process transactions in Russian Federation is Sviaz-Bank, whereby in Ukraine it is PrivatBank. From time to time, we may enter into agreements with additional banks. See “Risk Factors – Risk Factors Relating to Our Business – We rely on bank sponsors, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are not able to secure or successfully migrate merchant portfolio to new bank sponsors, we will not be able to conduct our business.”

Processing Vendors. We have agreements with several service processing vendors to provide us with, on a non-exclusive basis SMS gateway, carrier billing, transaction processing and transmittal, transaction authorization and data capture, and access to various reporting tools. Our primary processing vendors for period ending December 31, 2013 TOT Money business were SDSP Group, which provides us with a mobile billing and support platform in Russian Federation and NTH Group, leading European Application and Infrastructure Services Provider (“AISP”), which provides us with a mobile billing platform for Europe and other regions. In order for us to be able to process to bankcard transactions internationally, we have entered into a partnership agreement with PAY.ON AG (“PAYON”). PAYON’s multi-channel payment infrastructure system allows us to directly connect to the banks we have sponsorship agreements with and provide transactional services to the merchants in these regions.

Customers

Everything we do is to ensure that our customers experience first-rate services. TOT Money’s current customers span across variety of industries and operate across different markets. Our clients include mobile operators, merchants, content and service providers.

We believe there are many ways to use TOT Money’s services, including the following:

Mobile Operators – Mobile operators partner with us to generate revenues for incoming traffic. Mobile operators increase revenues via additional subscription and transactional services used by its subscribers.

Broadcast Media – SMS billing is becoming an increasingly popular communication tool on both radio & TV. It provides interactivity for the viewer/listener through voting/polls/competitions, and can generate revenues for the stations/production companies.

Portals/Content providers – SMS billing adds a further dimension to the offering of portals and content providers. It enables information alerts, ringtones and logos, SMS sending facility for end-users, all of which can generate revenues for the company.

Marketing/Sales Promotion – SMS billing is being used as a new marketing channel. It's immediacy; directness and 2-way communication lends itself to effective measurable marketing and promotion. Integration with existing media adds a new dimension to marketing campaigns (e.g. outdoor, press, on-pack, and direct mail).

Other industries using mobile messaging and mobile billing solutions include banking, retailing, brokering, tourism, transportation, gaming, and education.

Competition

TOT Money primarily competes with other companies operating in the SMS payment processing market in Russia, which market is primarily controlled by four companies, Pervii Alternativni, Incore Media, iFree and TOT Money. Certain of TOT Money's competitors have been in business longer than TOT Money and have significantly greater financial and other resources than TOT Money. In order to successfully increase its business in that market, the Company must convince mobile phone carriers and content providers to use TOT Money's services over competitive platforms that may already be in use. The Company believes that TOT Money will be able to effectively compete in the SMS payment processing market in Russia based primarily upon industry relationships of certain of its directors and officers, as well as on the basis of services offered, functionality and ease of use of features offered. Failure to successfully continue developing TOT Money's payment processing operations, maintain TOT Money's existing contracts with mobile phone carriers and content providers and enter into additional contracts with mobile phone carriers and content providers to use TOT Money's services may harm the Company's revenue and business prospects.

Employees

The total number of the Company's employees at March 15, 2014 was 58 people. Of such 58 people, 25 were full-time consultants and 33 were full-time employees.

Regulation

Various aspects of our business are subject to U.S. and non-U.S. federal, state and local regulation. The operations of the Company's subsidiary, TOT Money, are subject to regulation in Russia and may become subject to the laws and regulations of additional foreign jurisdictions as and when its business expands into additional markets. Many domestic and foreign laws and regulations that affect companies conducting business on the Internet and companies transmitting user information and payments via text message or other electronic means are still evolving and the interpretation of such laws and regulations are often uncertain. Failure to comply with applicable laws and regulations may result in the suspension or revocation of licenses or registrations, the limitation, suspension or termination of services and/or the imposition of civil and criminal penalties and/or fines. The services of TOT Money to mobile phone carriers also are subject to certain of the rules and policies of such carriers and ongoing contractual covenants with such carriers, the violation of which may result in penalties and/or fines and possible termination of TOT Money's services. Certain of our services are also subject to rules set by various payment networks, such as Visa and MasterCard, as more fully described below.

Laws and Rules of the Russian Federation

The relationships between TOT Money and telecommunications carriers in Russia are governed by the general rules of civil law for the provision of services (Chapter 39 of the Civil Code of the Russian Federation). In addition, because the "information and entertainment services" (content services) provided by TOT Money are inextricably linked with the networks of telecommunications carriers, these services are subject to the requirements of the Rules of Mobile Communications Services Provision, approved by the Decree of the Russian Federation Government dated May 25, 2005 No. 328. These Rules govern the relationship between a customer using mobile communication services and a telecommunications carrier in respect of mobile radio communications services, mobile radiotelephone services and/or mobile satellite radio services in the public network. Although TOT Money is not a telecommunications carrier, many requirements of such Rules are present in TOT Money's contracts with telecommunications carriers, and such contracts impose responsibility and liability on TOT Money for violations.

TOT Money has a license for the provision of telematics services in Russia. TOT Money is considered an operator of telematic services in Russia because it has a direct connection to equipment of telecommunications carriers and it effects electronic communications (i.e., receiving, processing and/or transmitting electronic messages). Operators of telematics services in Russia are regulated by the Federal Law “On Communication” dated July 2, 2003 No. 126-FZ. This Federal Law provides the legal basis for activity in the field of communications in the Russian Federation and territories under the Russian Federation jurisdiction, defines the powers of public authorities in the field of communications, as well as the rights and responsibilities of persons involved in such activities or using communication services. TOT Money also is subject to the Rules of Telematics Services Provision approved by the Decree of the Russian Federation Government dated September 10, 2007 No. 575. These Rules govern the relationship between a customer or a user, on the one hand, and a telecommunications carrier providing telematic communication services, on the other hand, in the provision of telematic communication services.

The activity of TOT Money to some extent is regulated by the Federal Law “On Operational and Investigative Activities” dated August 12, 1995 No. 144-FZ. This Federal Law determines the content of the operational and investigative activities in the Russian Federation, and provides for a system of guarantees in the process of operational and investigative operations. Operational and investigative activities include activities carried out openly and secretly by operational branches of certain government bodies in order to protect life, health, rights and freedoms of the person and the citizen, property, security of the society and the state from criminal attacks.

In carrying out activities on the Internet in Russia, TOT Money is subject to the Federal Law “On Advertising” dated March 13, 2006 No. 38-FZ. The objectives of this Federal Law are the development of markets for goods and services based on the principles of fair competition, ensuring the common economic space in the Russian Federation, the realization of the rights of consumers to receive fair and accurate advertising, creating favorable conditions for the production and distribution of public service announcements, preventions of violations of the Russian Federation on advertising, as well as the suppression of improper advertising. TOT Money’s activities on the Internet in Russia also are subject to the Federal Law “On Protection of Children from Information Harmful to Health” dated December 29, 2010 No. 436-FZ. This Federal Law provides regulations protecting children from information harmful to their health and/or development.

Rules and Policies of and Contractual Covenants with Mobile Phone Carriers

While not governmental regulation, TOT Money is subject to certain of the rules and policies of mobile phone carriers to which TOT Money provides payment processing services and ongoing contractual covenants with such mobile phone carriers. The mobile phone carriers may from time to time update or otherwise modify or supplement their rules and policies. TOT Money periodically is subject to the imposition of fines or penalties as a result of failure to comply with such rules, policies and/or contractual covenants. TOT Money’s failure to comply with the mobile phone carriers’ respective requirements or to pay the fines or penalties they impose could result in the termination of TOT Money’s services.

Other Laws and Regulations

Since TOT Money collects certain information from members and users on its platform, it will be subject to current and future government regulations regarding the collection, use and safeguarding of consumer information over the Internet and mobile communication devices. These regulations and laws may involve taxation, tariffs, user privacy, rights of publicity, data protection, content, intellectual property, distribution, electronic contracts and other communications, consumer protection and electronic payment services. In many cases, it may be unclear how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet or mobile communication services as the vast majority of these laws were adopted prior to the advent of these technologies and do not contemplate or address the unique issues raised by the Internet and e-commerce.

There are a number of legislative proposals that are anticipated or pending before the U.S. Congress, various state legislative bodies, and foreign governments concerning data protection which could affect the Company. Many states, for example, have already passed laws requiring notification to subscribers when there is a security breach of personal data. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with the Company’s data practices. If so, in addition to the possibility of fines, this could result in an order requiring that the Company change its data practices, which could have an adverse effect on its business.

Legislation could be passed that limits the Company's ability to use or store information about the Company's users. The Federal Trade Commission (the "FTC") and various states have established regulatory guidelines issued under the Federal Trade Commission Act and various state acts, respectively, that govern the collection, use and storage of consumer information, establishing principles relating to notice, consent, access and data integrity and security. The Company's practices are designed to comply with these guidelines. For example, the Company discloses that it collects a range of information about its users, such as their names, email addresses, search histories and activity on the Company's platform. The Company also uses and stores such information primarily to personalize the experience on its platforms, provide customer support and display relevant advertising. While the Company does not sell or share personally identifiable information with third parties for direct marketing purposes, the Company does have relationships with third parties that may allow them access to user information for other purposes.

The Company believes its policies and practices comply with the FTC privacy guidelines and other applicable laws and regulations. However, if the Company's belief proves incorrect, or if these guidelines, laws or regulations or their interpretations change or new legislation or regulations are enacted, the Company may be compelled to provide additional disclosures to its users, obtain additional consents from its users before collecting or using their information or implement new safeguards to help its users manage the Company's (or others') use of their information, among other changes.

Dodd-Frank Act

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was signed into law in the United States. The Dodd-Frank Act has resulted in significant structural and other changes to the regulation of the financial services industry. Among other things, the Dodd-Frank Act established the Consumer Financial Protection Bureau, or CFPB, to regulate consumer financial services, including many offered by our clients.

The Dodd-Frank Act provided two self-executing statutory provisions limiting the ability of payment card networks to impose certain restrictions that became effective in July 2010. The first provision allows merchants to set minimum dollar amounts (not to exceed \$10) for the acceptance of a credit card (and allows federal governmental entities and institutions of higher education to set maximum amounts for the acceptance of credit cards). The second provision allows merchants to provide discounts or incentives to entice consumers to pay with cash, checks, debit cards or credit cards, as the merchant prefers.

Separately, the so-called Durbin Amendment to the Dodd-Frank Act provided that interchange fees that a card issuer or payment network receives or charges for debit transactions will now be regulated by the Federal Reserve and must be "reasonable and proportional" to the cost incurred by the card issuer in authorizing, clearing and settling the transaction. Payment network fees, such as switch fees assessed by our Jeanie network, may not be used directly or indirectly to compensate card issuers in circumvention of the interchange transaction fee restrictions. In July 2011, the Federal Reserve published the final rules governing debit interchange fees. Effective in October 2011, debit interchange rates for card issuing financial institutions with more than \$10 billion of assets are capped at \$0.21 per transaction with an additional component of five basis points of the transaction's value to reflect a portion of the issuer's fraud losses plus, for qualifying issuing financial institutions, an additional \$0.01 per transaction in debit interchange for fraud prevention costs. The debit interchange fee would be \$0.24 per transaction on a \$38 debit card transaction, the average transaction size for debit card transactions. In July 2013, the U.S. District Court for the District of Columbia determined that the Federal Reserve's regulations implementing the Durbin Amendment were invalid. The Federal Reserve has appealed the decision. Regardless of the outcome of the litigation, the cap on interchange fees is not expected to have a material direct impact on our results of operations.

In addition, the new rules contain prohibitions on network exclusivity and merchant routing restrictions. Beginning in October 2011, (i) a card payment network may not prohibit a card issuer from contracting with any other card payment network for the processing of electronic debit transactions involving the issuer's debit cards and (ii) card issuing financial institutions and card payment networks may not inhibit the ability of merchants to direct the routing of debit card transactions over any card payment networks that can process the transactions. Since April 2012, most debit card issuers have been required to enable at least two unaffiliated card payment networks on each debit card. We do not expect the prohibition on network exclusivity to impact our ability to pass on network fees and other costs to our clients. These regulatory changes create both opportunities and challenges for us. Increased regulation may add to the complexity of operating a payment processing business, creating an opportunity for larger competitors to differentiate themselves both in product capabilities and service delivery.

Association and Network Rules

While not legal or governmental regulation, we are subject to the network rules of Visa, MasterCard and other payment networks. The payment networks routinely update and modify their requirements. On occasion, we receive notices of non-compliance and fines, which might be related to excessive chargebacks by a merchant or data security failures. Our failure to comply with the networks' requirements or to pay the fines they impose could cause the termination of our registration and require us to stop providing payment services.

Federal Trade Commission Act and Other Laws Impacting our Customers' Business

All persons engaged in commerce, including, but not limited to, us and our merchant and financial institution customers are subject to Section 5 of the Federal Trade Commission Act prohibiting unfair or deceptive acts or practices, or UDAP. In addition, there are other laws, rules and or regulations, including the Telemarketing Sales Act, that may directly impact the activities of our merchant customers and in some cases may subject us, as the merchant's payment processor, to investigations, fees, fines and disgorgement of funds in the event we are deemed to have aided and abetted or otherwise provided the means and instrumentalities to facilitate the illegal activities of the merchant through our payment processing services. Various federal and state regulatory enforcement agencies including the Federal Trade Commission, or FTC, and the states' attorneys general have authority to take action against nonbanks that engage in UDAP or violate other laws, rules and regulations and to the extent we are processing payments for a merchant that may be in violation of laws, rules and regulations, we may be subject to enforcement actions and as a result may incur losses and liabilities that may impact our business.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934 and file or furnish reports, proxy statements, and other information with the U.S. Securities and Exchange Commission, or SEC. You can read our SEC filings over the Internet at the SEC's website at www.sec.gov. Our filings with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports, also are available free of charge on the investors section of our website at <http://investor.netelement.com> when such reports are available on the SEC's website. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of business conduct and ethics, is also available on the investors section of our website.

You may also read and copy any document we file with the SEC at its public reference facilities at 100 F Street, N.E., Room 1580, Washington, DC 20549. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section at the SEC at 100 F Street, NE, Room 1580, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities. The contents of the websites referred to above are not incorporated into this filing or in any other report or document we file with the SEC, and any references to these websites are intended to be inactive textual references only.

Item 1A. Risk Factors.

Investing in our securities involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Report, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes, as well as the preceding "Business" section of this Report, before engaging in any transaction in our securities. Any of the following risks could materially and adversely affect our business, financial condition, results of operations and/or prospects, and cause the value of our securities to decline, which could cause you to lose all or part of your investment.

Risks Related to Our Business Generally:

Our financial condition creates doubt as to whether we will continue as a going concern. If we do not continue as a going concern, investors may lose their entire investment.

Since our inception, we have incurred significant operating losses. We had negative cash flows from operating activities of \$10.8 million for the year ended December 31, 2013 and an accumulated deficit of \$119 million at December 31, 2013. While we had negative working capital of \$8.0 million at December 31, 2013, our current assets at December 31, 2013 included \$10.6 million of accounts receivable and \$1.1 million of advances to aggregators. The independent auditors' report on our consolidated financial statements for the year ended December 31, 2013 contains an explanatory paragraph expressing substantial doubt as to our ability to continue as a going concern. As of the date this Report was filed with the Commission, management expects that our cash flows from operations and remaining unrestricted cash will not be sufficient to fund our current operations through 2014. We will require significant additional capital in order to continue our existing business operations and to fund our obligations assumed by the Company as a result of our acquisition of Unified Payments. We currently believe that we will require an additional \$10 million in financing to continue operations as currently conducted, continue our payment processing businesses and to pay for other currently anticipated capital expenditures over the next 12 months.

We have historically been dependent upon our directors and majority stockholders (including entities directly or indirectly controlled by them), and/or other affiliates of the Company, to fund our operations and we are exploring additional sources of financing in order to meet our financial requirements. Additional funds may be raised through debt financing and/or the issuance of equity securities, there being no assurance that any type of financing on terms satisfactory to us will be available or otherwise occur.

Debt financing must be repaid regardless of whether we generate revenues or cash flows from operations and may be secured by substantially all of our assets. Any equity financing or debt financing that requires the issuance of equity securities or warrants to the lender would cause the percentage ownership by our current stockholders to be diluted, which dilution may be substantial. Also, any additional equity securities issued may have rights, preferences or privileges senior to those of existing stockholders. If such financings are not available when required or are not available on acceptable terms, we may be unable to implement our business plans or take advantage of business opportunities, any of which could have a material adverse effect on our business, financial condition, results of operations and/or prospects and may ultimately require us to suspend or cease operations, which could cause investors to lose the entire amount of their investment.

We have a significant amount of outstanding receivables, which, if not collected, may have material adverse effects on our financial condition, results of operations and future business prospects.

Our current assets as of December 31, 2013 totaled \$12,689,171. This amount includes approximately \$10.6 million of outstanding receivables (representing 84% of our total current assets at December 31, 2013), and \$1.1 million of outstanding advances to aggregators. Aggregators are businesses that contract for content from content providers and provide aggregated processing volume to TOT Money. As of the date of filing this Report with the Commission, we were not aware of any additional potential issues with the collectability of our outstanding receivables, if any significant portion of our outstanding receivables were not collected it may have material adverse effects on our financial condition and results of operations and, as a result, our future business prospects.

Our management has identified a material weakness over payments to aggregators.

Historically, we did not maintain appropriate control surrounding the billing and advances to aggregators in our TOT Money Russian operation. As a result, we are migrating our billing system from SDSP Group to a TOT Platform, our proprietary billing system. Our former General Director is no longer providing any further support or assisting us with retrieval of information from the current billing system.

We have a limited operating history upon which an evaluation of our prospects can be made. For that reason, it would be difficult for a potential investor to judge our prospects for success.

We launched the operations of our mobile payment processing business during the third quarter of 2012. As a result, there is limited historical information available upon which you can base your evaluation of our business and prospects. Our limited operating history also makes the prediction of our future operating results, operating costs, and prospects difficult.

If we cannot compete effectively, we will lose business.

We believe our mobile payment processing business is positioned to be competitive in our target markets. We cannot guarantee that we will be able to maintain or increase revenues from our existing operations, or that our proposed future operations will be implemented successfully. Our principal competitive considerations include:

- financial resources to allocate to proper marketing and sales efforts;
- the ability to develop and maintain our operations, applications and technologies;
- the ability to effectively implement our business plans and strategies;
- establishing our brand name; and
- financial resources to support working capital needs and required capital investments.

The markets in which we operate are very competitive, and many of our competitors and potential competitors are larger, more established and better capitalized than we are.

The markets for mobile payment processing are very competitive and have been characterized by rapid technological change. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses, and failure to increase, or the loss of, market share or expected market share, any of which would likely seriously harm our business, operating results and financial condition.

Some of our competitors and potential competitors are substantially larger and have greater financial, technical, marketing and other resources than we do. Given their capital resources, the large companies with which we compete, or may compete in the future, are in a better position to substantially increase their research and development efforts or to withstand any significant reduction in orders by customers in our markets. Such larger companies typically have broader product lines and market focus and thus are not as susceptible to downturns in a particular market. In addition, some of our competitors have been in operation much longer than we have and therefore may have more long-standing and established relationships with our current and potential domestic and foreign customers.

We would be at a competitive disadvantage if our competitors bring their products to market earlier, if their products are more technologically capable than ours, or if any of our competitors' products or technologies becomes preferred in the industry. Moreover, we cannot assure you that existing or potential customers will not develop their own products, or acquire companies with products that are competitive with our products. Any of these competitive threats could have a material adverse effect on our business, operating results or financial condition.

Our operations are conducted primarily in Russia, making them subject to political uncertainties relating to Russia and U.S.-Russian relations.

Much of our present operations are being conducted in Russia. Our electronic payments operations conducted in Russia are subject to various political risks and uncertainties inherent in Russia. If U.S.-Russia relations deteriorate, including, without limitation, over a conflict related to Ukraine; the U.S. government may decide to impose sanctions or other legal restrictions on U.S. businesses doing business in Russia. If this should happen, our electronic payments operations conducted in Russia could be scaled back or shut down, which may require additional funding to penetrate or expand alternative electronic payments markets outside of Russia. In addition, if U.S.-Russia relations deteriorate, including, without limitation, over a conflict related to Ukraine, general economic conditions in Russia, or increases in interest rates in Russia, could adversely affect our results of operations by reducing the number or average purchase amount of transactions in Russia made using electronic payments. Further, consumer purchases of discretionary items could generally decline in Russia due to potential adverse effect on disposable income in Russia. A reduction in the amount of consumer spending in Russia could result in a decrease in our revenue and negatively affect our business prospects, financial condition and results of operations.

Our management has identified continued material weaknesses in our internal controls as of December 31, 2013, which, if not properly remedied, could result in material misstatements in our financial statements.

A material weakness is defined as a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As described in Item 9A of this Report, management has identified the following material weaknesses in our internal control over financial reporting as of December 31, 2013: (i) inadequate policies and procedures regarding the design of the control and formal written documentation; (ii)

inadequate segregation of duties related to job responsibilities for initiating, authorizing, and recording of certain transactions; (iii) because we recently added certain new directors and executive management and recently changed the composition of our subsidiaries, there has been insufficient time to establish adequate Best of Practice procedures; (iv) as a result of our relatively small accounting staff and not having the required infrastructure for meeting the demands of being a U.S. public company, we have identified deficiencies in our internal controls within our key business processes, particularly with respect to the design of quarterly accounting, financial statements close, consolidation and external financial reporting procedures; (v) we lack general computer controls surrounding the billing and financial reporting system in one of our Russian subsidiaries; and (vi) our management has limited ability to monitor the design and operating effectiveness of our internal controls. These material weaknesses impede the ability of management to adequately oversee our internal control over financial reporting on a consistent basis. Management intends to focus its remediation efforts in the near term on designing revised accounting and financial reporting policies and procedures that will help ensure that adequate internal controls over financial reporting are met. Additionally, these revised procedures will be formally documented and procedures will focus on transaction processing, period-end account analyses and providing for additional review and monitoring procedures and periodically assess the need for additional accounting resources as our business develops and resources permit. If we are not able to adequately address the material weaknesses in our internal controls, it is possible that a material misstatement of our annual or interim financial statements will not be timely prevented or detected. Any failure in preventing or detecting a material misstatement of our annual or interim financial results could have a material adverse effect on our stock price and on our results of operations, could make it more difficult for us to obtain additional financing as needed and could have additional material adverse consequences.

Acquisition activities could result in operating difficulties, dilution to our stockholders and other harmful consequences.

We have built our current business primarily through acquisitions of intellectual property and other assets, and we intend to selectively pursue strategic acquisitions in the future. On April 16, 2013, certain subsidiaries of TOT Group acquired substantially all of the business assets of Unified Payments, LLC, a Delaware limited liability company (“Unified Payments”), a provider of comprehensive turnkey, payment-processing solutions to small and medium size business owners (merchants) and independent sales organizations across the United States. See Note 4 for additional information regarding this acquisition. Most recently, on June 24, 2013, TOT Group, through its newly formed subsidiary Aptito, LLC (“Aptito”) acquired substantially all of the business assets of Aptito.com, Inc, a New York corporation, a new generation of smart, customer engaged, patent-pending payments platform, mobile Point of Sale (“mPOS”), mobile commerce application and self-ordering Apple® iPad®-based kiosk. See Note 4 for additional information regarding this acquisition. . Future acquisitions could divert management’s time and focus from operating our business. In addition, integrating an acquired company, business or technology is risky and may result in unforeseen operating difficulties and expenditures. Foreign acquisitions also involve unique risks related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries. We may not accurately assess the value or prospects of acquisition candidates, and the anticipated benefits from our future or even past acquisitions may not materialize. In addition, future acquisitions or dispositions could result in potentially dilutive issuances of our equity securities, including our common stock, the incurrence of significant amounts of debt, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could negatively affect our financial condition.

We are dependent upon certain key relationships. If any of our key relationships were to deteriorate, our business prospects, financial condition and results of operations could be materially adversely affected.

Our success, particularly the success of our payment processing business, is dependent, in part, upon industry relationships of certain of our directors, including our director, Kenges Rakishev and our chief executive officer Mr. Firer. If we were to lose the services of Mr. Rakishev and/or Mr. Firer, or if the industry relationships of Mr. Firer on which we rely were to deteriorate, our business prospects, financial condition and results of operations could be materially adversely affected. To our knowledge, Mr. Rakishev and/or Mr. Firer currently do not have any plans to retire or leave us in the near future, and we are not aware of any material adverse developments in Mr. Firer’s industry relationships. We do not have “key person” insurance on the lives of Mr. Rakishev and/or Mr. Firer or any other member of our management team.

If we fail to adequately protect or enforce our intellectual property rights, competitors may create and market products and services similar to ours. In addition, we may be subject to intellectual property litigation and infringement claims by third parties.

Our ability to compete effectively is dependent in part upon the proprietary nature of our technologies and software platforms. We generally rely on a combination of trade secret, copyright, trademark and patent law to protect our proprietary rights in our intellectual properties. . Although we attempt to protect our proprietary technologies through trade secrets, trademarks, patents and license and other agreements, these may be insufficient. In addition, if we license our software to non-U.S. countries, because of differences in foreign laws concerning proprietary rights, our intellectual properties may not receive the same degree of protection in non-U.S. countries as they would in the United States. We may not always be able to successfully protect or enforce our proprietary properties against competitors, which may materially adversely affect our business prospects, financial condition and results of operations. In addition, there can be no assurance that our competitors will not independently utilize existing technologies to develop products that are substantially equivalent or superior to ours, which also could materially adversely affect our business prospects, financial condition and results of operations.

In addition, although we do not believe that our intellectual properties infringe the rights of others and while to date we have not been subject to such claims, we may be exposed to, or threatened with, future litigation by other parties alleging that our technologies infringe their intellectual property rights. Any intellectual property claims, regardless of their merit, could be time consuming, expensive to litigate or settle and could divert management resources and attention. An adverse determination in any intellectual property claim could require us to pay damages and/or stop using our technologies and other material found to be in violation of another party's rights and could prevent us from licensing our technologies to others. In order to avoid these restrictions, we may have to seek a license. Such a license may not be available on reasonable terms, could require us to pay significant license fees and may significantly increase our operating expenses. A license also may not be available to us at all. As a result, we may be required to use and/or develop non-infringing alternatives, which could require significant effort and expense. If we cannot obtain a license or develop alternatives for any infringing aspects of our business, we may be forced to limit our technologies and may be unable to compete effectively. Any of these adverse consequences could have a material adverse effect on our business prospects, financial condition and results of operations.

Further, from time to time we may be engaged in disputes regarding the licensing of our intellectual property rights, including matters related to the terms of our licensing arrangements. These types of disputes can be asserted by our licensees or prospective licensees or by other third parties as part of negotiations with us or in private actions seeking monetary damages or injunctive relief or in regulatory actions. Requests for monetary and injunctive remedies asserted in claims like these could be material and could have a significant impact on our business prospects. Any disputes with our licensees, potential licensees or other third parties could materially adversely affect our business prospects, financial condition and results of operations.

Fluctuations in foreign currency exchange rates could negatively affect our financial results.

We earn revenues and interest income, pay expenses, own assets and incur liabilities in countries using currencies other than the U.S. dollar. In the year ended December 31, 2013, we used two functional currencies - the Ukraine hryvnia and the Russian ruble - in addition to the U.S. dollar and derived more than 21% of our total net revenues from operations outside the United States. Because our consolidated financial statements are presented in U.S. dollars, we must translate net revenues, interest income and expenses, as well as assets and liabilities, into U.S. dollars at exchange rates in effect during or at the end of each reporting period. Therefore, increases or decreases in the value of the U.S. dollar against other major currencies will affect the amounts of our net revenues, interest income, operating expenses and the value of balance sheet items, including intercompany assets and obligations. Because our operations are concentrated in Russia and Ukraine, our exchange rate risk is highly sensitive to the prevailing value of the U.S. dollar relative to the Ukraine hryvnia and the Russian ruble. As a result, fluctuations in foreign currency exchange rates, particularly the U.S. dollar against the Ukraine hryvnia and the Russian ruble, may materially adversely affect our financial results.

Our business is subject to complex and evolving U.S. and foreign laws and regulations regarding privacy, data protection and other matters. Many of these laws and regulations are subject to change and uncertain interpretations, and could result in claims, changes to our business practices, increased cost of operations or

declines in user growth or engagement, or otherwise harm our business.

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business on the Internet and companies transmitting user information and payments via text message or other electronic means, many of which are still evolving and the interpretation of which are often uncertain. Failure to comply with applicable laws and regulations may result in the suspension or revocation of licenses or registrations, the limitation, suspension or termination of services and/or the imposition of civil and criminal penalties and/or fines. The services of TOT Money to mobile phone carriers also are subject to certain of the rules and policies of such carriers and ongoing contractual covenants with such carriers, the violation of which may result in penalties and/or fines and possible termination of TOT Money's services. For additional information, see "Business Description - Regulation" in Part I, Item 1 of this Report.

Poor perception of our brand, business or industry could harm our reputation and adversely affect our business prospects, financial condition and results of operations.

The success of our business depends in part on our reputation within our industries and with our clients and consumers. We may be the subject of unflattering reports in blogs, video blogs and the media about our business and our business model. Any damage to our reputation could harm our ability to obtain and retain contracts with mobile phone carriers, content providers, advertisers and other customers, which could materially adversely affect our results of operations, financial condition and business.

Our business is subject to the risks of hurricanes, floods, fires and other natural catastrophic events and to interruption by man-made problems such as computer viruses or terrorism.

Our systems and operations are vulnerable to damage or interruption from hurricanes, floods, fires, power losses, telecommunications outages, terrorist attacks, acts of war, human errors, break-ins and similar events. Our U.S. corporate offices are located in Miami, Florida, which is an area that is at high risk of hurricane and flood damage. In addition, acts of terrorism, which may be targeted at metropolitan areas that have higher population density than rural areas, could cause disruptions in our business or the economy as a whole. The servers that we use through various third party service providers are not located in Miami, Florida but may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could lead to interruptions, delays, loss of critical data or the unauthorized disclosure of confidential information. Such service providers may not have sufficient protection or recovery plans in certain circumstances, and our insurance may not be sufficient to compensate us for losses that may occur. As we rely heavily on our servers, computer and communications systems and the Internet to conduct our business, such disruptions could negatively impact our ability to run our business and either directly or indirectly disrupt our customers' respective businesses, which could have an adverse effect on our business prospects, operating results and financial condition.

We are effectively controlled by Mike Zoi, our majority stockholder and a member of our Board of Directors. Mr. Zoi's interests may conflict with the interests of our outside stockholders, who may be unable to influence management and exercise control over our business.

Mike Zoi, our majority stockholder and a member of our Board of Directors, owns, in combination with the holdings of entities that he controls, approximately 47.8% of our issued and outstanding common stock as of April 1, 2014. As a result, and in addition to having de-facto control over all key elements of our business, Mr. Zoi can be viewed as having de-facto control over corporate actions requiring stockholder approval, including but not limited to: (i) electing and removing directors; (ii) amending or preventing amendment of our certificate of incorporation or bylaws; (iii) selling all or substantially all of our assets; and (iv) merging with another entity. This concentration of ownership could be disadvantageous to stockholders with interests that might vary from those of Mr. Zoi and adversely affect the price that investors might be willing to pay in the future for our securities.

We incur increased costs as a result of being a public company.

As a public company, we currently incur significant legal, accounting and other expenses not incurred by private companies. It may be time consuming, difficult and costly for us to develop, implement and maintain the additional internal controls, processes and reporting procedures required by federal statutes, Commission rules, other government regulations affecting public companies and/or stock exchange compliance requirements. We may need to hire additional financial reporting, internal auditing and other finance staff in order to develop, implement and maintain appropriate internal controls, processes and reporting procedures, which will increase our expenses and adversely affect our operating results and financial condition.

Risks Related to Our Mobile Payments and Transaction Processing Business:

Failure to successfully continue developing and expand our payment processing business may harm our revenue and business prospects.

We recently launched our mobile payment processing operations in Russia during the third quarter of 2012 through our Russian subsidiary TOT Money. Certain of TOT Money's competitors have been in business longer than TOT Money and have significantly greater financial and other resources than TOT Money. In addition, in order to successfully increase our business in the payment processing market in Russia and expand our payment processing business into other emerging markets, we must convince mobile phone carriers and content providers to use TOT Money's services over competitive platforms that may already be in use. Many potential clients may worry about potential disadvantages associated with switching payment processing vendors, such as a loss of accustomed functionality, increased costs and business disruption. Failure to successfully continue developing TOT Money's payment processing operations, maintain TOT Money's existing contracts with mobile phone carriers and content providers and enter into additional contracts with mobile phone carriers and content providers to use TOT Money's services may harm our revenue and business prospects.

Our future growth depends, in part, upon our continued expansion within the markets in which we currently operate, the further expansion into new markets, the emergence of additional markets for payment processing, and our ability to penetrate these markets. Our expansion into new markets is also dependent upon our ability to apply our existing technology or to develop new applications to meet the particular service needs of each new market. We may not have adequate financial or technological resources to develop effective and secure services or distribution channels that will satisfy the demands of these new markets. If we fail to expand into new and existing payment processing markets, we may not be able to continue to grow our revenues. Furthermore, in response to market developments, we may expand into new geographical markets and foreign countries in which we do not currently have any operating experience. We cannot assure you that we will be able to successfully expand in such markets due to our lack of experience and the multitude of risks associated with global operations or lack of appropriate regulatory approvals.

We may not recoup our advances to aggregators. Our advances to aggregators are unsecured and we do not have financial statements or bank references to complete a full credit review of each aggregator, which increases our risk of not recouping such advances.

At December 31, 2013, our outstanding advances to aggregators were \$1.1 million net. Aggregators are businesses that contract for content from hundreds or thousands of content providers and provide aggregated processing volume to TOT Money. Our advances to aggregators are unsecured and, while we have a history of transaction volume with most of our aggregators, we do not obtain financial statements or bank references to complete a full credit review of each aggregator. In addition, we transact business with new aggregators from time to time with whom we do not have a history of transaction volume. Financial problems with a particular aggregator could result in our not recouping

advances that we have made to that aggregator. Furthermore, if we discontinue our business with a particular aggregator and the aggregator does not provide sufficient transaction volume to repay advances made to that aggregator, we have increased risk of not recouping the advances made to that aggregator. For these and/or other reasons, we may not recoup our advances made to aggregators. If we do not recoup all of our advances to aggregators, it will result in our incurring losses.

We rely on third-party processors and service providers; if they fail or no longer agree to provide their services, our merchant relationships could be adversely affected and we could lose business.

We rely on agreements with several large payment processing organizations to enable us to provide card authorization, data capture, settlement and merchant accounting services and access to various reporting tools for the merchants we serve. We also outsource to third parties other services, such as reorganizing and accumulating daily transaction data on a merchant-by-merchant and card issuer-by-card issuer basis and forwarding the accumulated data to the relevant bankcard associations. Many of these organizations and service providers are our competitors, and we do not have long-term contracts with most of them. Typically, our contracts with these third parties are for one-year and are subject to cancellation upon limited notice by either party. The termination by our service providers of their arrangements with us or their failure to perform their services efficiently and effectively may adversely affect our relationships with the merchants whose accounts we serve and may cause those merchants to terminate their processing agreements with us.

We rely on bank sponsors, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are not able to secure or successfully migrate merchant portfolios to new bank sponsors, we will not be able to conduct our business.

Because we are not a bank, we are unable to belong to and directly access the Visa and MasterCard bankcard associations. Visa and MasterCard operating regulations require us to be sponsored by a bank in order to process bankcard transactions. We are currently registered with Visa and MasterCard through the sponsorship of banks that are members of the card associations. The principal sponsoring bank through which we process the significant majority of our transactions is BMO Harris Bank.

If we or our bank sponsors fail to adhere to the standards of the Visa and MasterCard payment card associations, our registrations with these associations could be terminated, and we could be required to stop providing payment processing services for Visa and MasterCard.

Substantially all of the transactions we process involve Visa or MasterCard. If we or our bank sponsors fail to comply with the applicable requirements of the Visa or MasterCard payment card associations, Visa or MasterCard could suspend or terminate our registration. The termination of our registration or any changes in the Visa or MasterCard rules that would impair our registration could prevent us from providing transactional processing services.

We periodically experience increases in interchange and other related costs, and if we cannot pass these increases along to our merchants, our profit margins will decline.

We pay interchange fees and assessments to issuing banks through the card associations for each transaction we process using their credit and debit cards. From time to time, the card associations increase the interchange fees that they charge processors and the sponsoring banks. At their sole discretion, our sponsoring banks have the right to pass any increases in interchange fees on to us. In addition, our sponsoring banks may seek to increase their Visa and MasterCard sponsorship fees to us, all of which are based upon the dollar amount of the payment transactions we process. If we are not able to pass these fee increases along to merchants through corresponding increases in merchant discount, our profit margins will decline.

Our products and services could become less competitive or obsolete if we fail to keep pace with rapidly changing technology.

The markets for our products and services are characterized by technological changes, frequent introductions of new products and services and evolving industry standards. Advances in technology may result in changing customer preferences for products and services and delivery formats and any such change in preferences may be rapid. Clients may choose to move or develop equivalent services in-house. If we fail to enhance our current products and services and develop new products and services in response to changes in technology, industry standards or customer preferences, our business could rapidly become less competitive or obsolete. We could experience delays while developing and introducing new products and services and product and service enhancements, due to difficulties developing models, acquiring data or adapting to particular operating environments. Software errors or other defect errors in our products and services could affect the ability of our products and services to work with other hardware or software products, could delay the development or release of new products or services or new versions of our products or services and could materially adversely affect our reputation and our business prospects, financial condition and/or results of operations.

To acquire and retain merchant accounts, we depend on ISGs that do not serve us exclusively.

We rely on the efforts of ISGs to market our services to merchants seeking to establish a credit card processing relationship. ISGs are companies that seek to introduce to us, as well as our competitors, newly established and existing small merchants, including retailers, restaurants and other service providers. Generally, our agreements with ISGs are not exclusive and they have the right to refer merchants to other providers of transaction payment processing services. Our failure to maintain our relationships with our existing ISGs and to recruit and establish new relationships with other ISGs could adversely affect our revenues and internal growth and increase our merchant attrition.

Unauthorized disclosure of data, whether through cybersecurity breaches, computer viruses or otherwise, could expose us to liability, protracted and costly litigation and could damage our reputation.

We process, store and/or transmit sensitive data, such as names, addresses, credit or debit card numbers and bank account numbers, and we may have liability if we fail to protect this data in accordance with applicable laws and our client's specifications. The loss of data could result in significant fines and sanctions by our clients or governmental bodies, which could have a material adverse effect on our business, financial condition and results of operations. These concerns about security are increased when we transmit information over the Internet. Computer viruses can be distributed and spread rapidly over the Internet and could infiltrate our systems, which might disrupt our services and make them unavailable. In addition, a significant cybersecurity breach could result in payment networks prohibiting us from processing transactions on their networks or the loss of clients. We have been in the past and could be in the future, subject to breaches of security by hackers. It is possible that our encryption of data and other protective measures may not prevent unauthorized access. Although we have not to date incurred material losses or liabilities as

a result of those breaches, a future breach of our system may subject us to material losses or liability, including payment of fines and claims for unauthorized purchases with misappropriated credit or debit card or bank account information or other similar fraud claims. A misuse of such data or a cybersecurity breach could harm our reputation and deter clients from using electronic payments generally and our services specifically, increase our operating expenses in order to correct the breaches or failures, expose us to uninsured liability, increase our risk of regulatory scrutiny, subject us to lawsuits and/or result in the imposition of material penalties and fines under applicable laws or by our clients.

We are subject to economic and political risk, the business cycles and credit risk of our clients and the overall level of consumer, business and government spending, which could negatively impact our business, financial condition and results of operations.

The electronic payments industry depends heavily on the overall level of consumer, business and government spending. We are exposed to general economic conditions that affect consumer confidence, consumer spending, consumer discretionary income and consumer purchasing habits. Deterioration in general economic conditions in the markets where we operate, or increases in interest rates in such markets, may adversely affect our results of operations by reducing the number or average purchase amount of transactions made using electronic payments. Consumer purchases of discretionary items generally decline during recessionary periods and other periods in which disposable income is adversely affected. A reduction in the amount of consumer spending could result in a decrease in our revenue and negatively affect our business prospects, financial condition and results of operations.

Our operating results are subject to seasonality, and, if our revenues are below our seasonal norms during our historically stronger quarters, our financial results could be adversely affected.

We have experienced in the past, and expect to continue to experience, seasonal fluctuations in our revenues as a result of consumer spending patterns. Historically, revenues have been weaker during the first quarter of the calendar year and stronger during the second, third and fourth quarters. If, for any reason, our revenues are below seasonal norms during the second, third or fourth quarter, our business, financial condition and results of operations could be materially adversely affected.

New and potential governmental regulations designed to protect or limit access to consumer information could adversely affect our ability to provide, or the value of, the services we currently provide to our merchants.

Due to the increasing public concern over consumer privacy rights, governmental bodies in the United States and abroad have adopted, and are considering adopting, additional laws and regulations restricting the purchase, sale and sharing of personal information about customers. For example, the Gramm-Leach-Bliley Act requires non-affiliated third-party service providers to financial institutions to take certain steps to ensure the privacy and security of consumer financial information. We believe our present activities fall under exceptions to the consumer notice and opt-out requirements contained in this law for third-party service providers to financial institutions. However, the laws

governing privacy generally remain unsettled. Even in areas where there has been some legislative action, such as the Gramm-Leach-Bliley Act and other consumer statutes, it is difficult to determine whether and how existing and proposed privacy laws or changes to existing privacy laws will apply to our business. Limitations on our ability to access and use customer information could adversely affect our ability to provide the services we currently offer to our merchants or impair the value of these services.

Several states have proposed legislation that would limit the use of personal information gathered using the Internet. Some proposals would require proprietary online service providers and website owners to establish privacy policies. Congress has also considered privacy legislation that could further regulate the use of consumer information obtained over the Internet or in other ways. Our compliance with these privacy laws and related regulations could materially affect our operations.

Changes to existing laws or the passage of new laws could:

- create uncertainty in the marketplace that could reduce demand for our services;
- restrict or limit our ability to sell certain products and services to certain customers;
- limit our ability to collect and to use merchant and cardholder data; or
- increase the cost of doing business as a result of litigation costs or increased operating costs;

Any of which could have a material adverse effect on our business, financial condition and results of operations.

If we are required to pay federal, state or local taxes on transaction processing, it could negatively impact our profit margins.

Transaction processing companies may become subject to federal, state or local taxation of certain portions of their fees charged to merchants for their services. Application of these taxes is an emerging issue in our industry and taxing jurisdictions have not yet adopted uniform positions on this topic. If we are required to pay such taxes and are unable to pass this tax expense through to our merchant clients, or are unable to produce increased cash flow to offset such taxes, these taxes would negatively impact our profit margins.

We are the subject of various legal proceedings which could have a material adverse effect on our business, financial condition or operating results.

We are involved in various litigation matters. The Company may, from time to time, also be involved in or be the subject of governmental or regulatory agency inquiries or investigations. If the Company is unsuccessful in its defense in the litigation matters, or any other legal proceeding, it may be forced to pay damages or fines and/or change its

business practices, any of which could have a material adverse effect on the Company's business, financial condition and results of operations. For more information about the Company's legal proceedings, see "Legal Proceedings."

Risks Related to Our Securities:

The historic price of our common stock has been volatile and the future market price of our common stock is likely to continue to be volatile. Further, the limited trading volume in our common stock contributes significantly to the high volatility in the market price of our common stock. This may make it difficult for you to sell our common stock for a positive return on your investment.

The public market for our common stock has historically been very volatile. Since trading began in the common stock of the Company on October 3, 2012 (the trading day following the closing of our merger with Net Element) and through April 11, 2014, the per-share market price for our common stock has ranged from \$1.90 to \$12.25. Any future market price for our common stock is likely to continue to be very volatile. This price volatility may make it more difficult for holders of our common stock to sell shares when they want and at prices they find attractive. We do not know of any one particular factor that has caused volatility in our stock price. However, the trading volume in our common stock is limited, which contributes significantly to that volatility, and we cannot assure you that a larger or more liquid market will ever be developed or maintained. In addition, the stock market in general has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies. Broad market factors and the investing public's negative perception of our business may reduce our stock price, regardless of our operating performance. Market fluctuations and volatility, as well as general economic, market and political conditions, could reduce the market price of our common stock. These fluctuations may also cause short sellers to periodically enter the market in the belief that we will have poor results in the future. As a result, this may make it difficult or impossible for holders of our common stock to sell shares when they want and at prices they find attractive.

Our operating results and financial condition may fluctuate which could negatively affect the market price of our common stock.

Our operating results could vary significantly from quarter to quarter and year to year because of a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful and the market price of our common stock may be negatively affected. The following factors, among others, may contribute to the variability of our quarterly and annual results and negatively affect the market price of our common stock:

- the fact that our payment processing business first launched operations and began generating revenue during the third quarter of 2012;
- our ability to maintain existing, and secure additional, contracts with mobile phone carriers and content providers to use our payment processing services;
- the effects of increased competition on our business;
- our ability to successfully expand in existing markets and enter new markets;

- the impact of worldwide economic conditions, including the resulting effect on consumer spending;
- our ability to protect our intellectual property;
- our ability to keep pace with changes in technology;
- the success of our sales and marketing efforts;
- costs associated with defending intellectual property infringement and other claims and related judgments or settlements;
- changes in government licensing and regulation affecting our business;
- interruptions in service and any related impact on our reputation;
- the attraction and retention of qualified employees and key personnel;
- our ability to choose and effectively manage third-party service providers;
- the impact of fluctuations in currency exchange rates;
- our ability to successfully manage and integrate any acquisitions of businesses, solutions or technologies;
- the effects of natural or man-made catastrophic events;
- changes in consumer behavior;
- our ability to increase the effectiveness of our internal controls; and
- changes in our tax rates or exposure to additional tax liabilities.

We may sell equity securities in the future, which would cause dilution.

We may sell equity securities in the future to obtain funds for general corporate, working capital, acquisitions or other purposes. We may sell these securities at a discount to the market price. Any future sales of equity securities will dilute the holdings of existing stockholders, possibly reducing the value of their investment.

We may not be able to continue to meet the continued listing requirements for The NASDAQ Capital Market. If our common stock is delisted from The NASDAQ Capital Market, our business, financial condition, results of operations and stock price could be adversely affected, and the liquidity of our stock reduced and our ability to obtain financing could be impaired.

We are currently in compliance with all of the listing standards for listing on The NASDAQ Capital Market, but we cannot provide any assurance that we will continue to be in compliance in the future. Any delisting of our common stock from The NASDAQ Capital Market could adversely affect our ability to attract new investors, reduce the liquidity of our outstanding shares of common stock, reduce our flexibility to raise additional capital, reduce the price at which our common stock trades and increase the transaction costs inherent in trading such shares with overall negative effects for our stockholders. In addition, delisting of our common stock could deter broker-dealers from making a market in or otherwise seeking or generating interest in our common stock, and might deter certain institutions and persons from investing in our securities at all. For these reasons and others, delisting could adversely affect our business, financial condition and results of operations.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

On May 10, 2013, the Company entered into a new lease agreement, which is dated as of May 1, 2013, for approximately 5,200 square feet of office space located at 3363 N.E. 163rd Street, Suites 705 through 707, North Miami Beach, Florida 33160. The Company moved its corporate headquarters and principal executive office to this location in June 2013. The term of the lease agreement is from May 1, 2013 through December 31, 2016, with monthly rent at the rates of \$16,800 per month (or \$134,400 for the initial eight-month period) for the period from May 1, 2013 through December 31, 2013, \$17,640 per month (or \$211,680 per year) for the period from January 1, 2014 through December 31, 2014, \$18,522 per month (or \$222,264 per year) for the period from January 1, 2015 through December 31, 2015 and \$19,448.10 per month (or \$233,377 per year) for the period from January 1, 2016 through December 31, 2016.

Until May 31, 2013 we leased approximately 6,500 square feet of office space in Miami, Florida at annual rent of \$201,695. Beginning in January 2013 until the lease term expired, Enerfund, LLC, which is wholly owned by our director and majority stockholder, Mike Zoi, used part of this office space and paid a pro-rata amount of the rent in an amount equal to \$8,500 per month (or \$102,000 per year). The lease term expired May 31, 2013 and we relocated to Unified Payments' office in North Miami Beach (described in the preceding paragraph) upon the expiration of the

lease.

Netlabs Systems, LLC, through its Ukrainian representative office, leases approximately 1,750 square feet of office space in Dnepropetrovsk, Ukraine where it primarily conducted website development activities, at annual rent of approximately \$20,000. The current lease term expires December 1, 2014. Effective February 1, 2014, 24 Hour Technology, LLC, a company controlled by Mike Zoi, began paying the rent in Ukraine as 24 Hour Technology also began employing our former employees given we terminated operations in this location effective on that date. This facility primarily supported divested entertainment assets and was no longer required for current operations.

Netlabs Systems, LLC, through its Russian representative office, leases approximately 1,150 square feet of office space in Yekaterinburg, Russia, where it conducted website development activities, at annual rent of approximately \$34,000. The current lease term expires April 1, 2014 and we are currently in process of finding a new space of about 325 square feet. The current facility is too large for our current needs, given we have divested website assets, and effective February 1, 2014 we have agreed to split the facility and associated rent 50/50 with T1T Lab, LLC until the lease expires April 1, 2014.

Net Element Russia leases approximately 356 square feet of office space in Moscow, Russia at annual rent of \$150,000, as well as one corporate apartment at annual rent of \$52,500. The current lease term for the office space expires on August 14, 2014 and we expect to renew this lease at that time. The current lease term for corporate apartment expires on June 30, 2014. We believe that these facilities are adequate for our anticipated needs. TOT Money leases approximately 671 square feet of office space in Saint Petersburg, Russia at annual rent of \$139,000. The current lease term expires on March 22, 2014.

Item 3. Legal Proceedings.

First Data Corporation

On July 30, 2013, TOT Payments, LLC, brought an action against First Data Corporation in the State of New York Supreme Court (Index No. 652663-2013). The amount of damages being sought is \$10,000,000 per cause. In its complaint, TOT Payments claims that the defendant breached its obligations pursuant to a 2006 Marketing Agreement entered into between Money Movers of America, Inc. (MMOA) and Paymentech, Inc. (the "MMOA Agreement") to pay MMOA monthly residual income on various merchant accounts boarded with Paymentech pursuant to the MMOA Agreement. TOT Payments, through a series of historic transactions, is the successor in interest to the rights and obligations of MMOA in the MMOA Agreement. The defendant is the successor in interest to Paymentech. On July 15, 2013, the defendant failed to pay to TOT Payments the monthly residuals otherwise due as the defendant alleges that the MMOA Agreement was lawfully terminated in April 2012 and that the defendant had 180 days after the termination notice to move the MMOA merchants to a new platform failing which the defendant could withhold residual payments and that the defendant would own all merchant accounts boarded under the MMOA Agreement. The amount of the unpaid residuals, are between \$150,000 and \$250,000 net of all interchange charges. TOT Payments disputes receiving proper notice and is disputing the rights of the defendant to withhold monthly residuals due. There was an adjournment because of the motions made in the appellate division. Plaintiffs' opposition to First Data's motion to dismiss (for lack of standing) was filed on Oct. 24. Defendant's Reply to Plaintiff's opposition was due Oct. 31. Defendant filed both a memorandum in support and an affirmation in support to dismiss and oral argument was heard Nov. 1, 2013. The case was subsequently dismissed and the Company has requested legal counsel to preserve its rights to Appeal the dismissal.

OOO-RM Invest

On March 17, 2014, the Company was served with a lawsuit brought by OOO-RM Invest in the US District Court, Southern District of Florida. In its complaint, OOO-RM Invest claims that on or about July 11, 2012 it entered into an "oral agreement" with the Company allegedly agreeing: (a) to form a new entity, TOT Money International, LTD that would continue the operations of Plaintiff; (b) that the Company would provide TOT Money International, LTD financing in the amount of 600,000,000 Russian rubles; (c) that the Company would assume certain liabilities of Plaintiff; (d) that the Company would be responsible for all business operations of Plaintiff and TOT Money International, LTD; (e) that the Company would deliver the Digital SkyTechnologies ("DST") account and stated key DST structures to TOT Money International, LTD; (f) that Plaintiff would receive a 30% ownership stake in TOT Money International, LTD and/or receive shares of stock in the Company; (g) that Tcahai Hairullaevich Katcaev would hold the position of General Director of TOT Money; (j) Plaintiff would provide TOT Money International, LTD with access to Plaintiff's operating accounts; and (h) Plaintiff would transfer client accounts and contracts to TOT Money. Plaintiff claims that the Company breached its obligations pursuant to that alleged oral agreement, and is seeking, among other things, compensatory damages in excess of \$50 million. The Company strongly denies the allegations referenced in the complaint and will vigorously defend its interests, but the outcome cannot be predicted.

C&H Financial Services

During February 2014, the Company was served with a lawsuit filed in the 11th Judicial Circuit Court for Miami-Dade County, Florida, (the “Lawsuit”) by C&H Financial Services, Inc., (“C&H”), Anthony Holder, (“Holder”) and James Costanzo (“Costanzo”) - (hereinafter C&H, Holder, and Costanzo are collectively referred to as “Plaintiffs”). The Plaintiffs allege inter alia that that the Company breached a certain agreement dated July 31, 2013 between the parties relating to certain merchant payment processing accounts and are seeking judgment and unspecified compensatory damages from the Company. Plaintiffs are also seeking certain other relief from the Court arising from the said agreement as well as declaratory relief regarding a disputed non-compete agreement entered into by Holder and Costanzo as former employees of the Company. The Company vigorously disputes the allegations of the Plaintiffs and has engaged legal counsel to defend the lawsuit. The Parties have entered into settlement negotiations.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

The Company’s common stock began trading on The NASDAQ Capital Market under the symbol “NETE” on October 3, 2012. From October 22, 2010 through October 2, 2012, the ordinary shares of the Company (then known as Cazador Acquisition Corporation Ltd.) traded on The NASDAQ Capital Market under the symbol “CAZA.” For the periods indicated, the following table sets forth the high and low sales prices per share of the Company’s common equity.

Quarter Ended	Fiscal 2013		Fiscal 2012	
	High	Low	High	Low
March 31	3.43	2.00	9.91	9.76
June 30	6.20	2.38	9.94	9.80

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September 30	6.47	4.26	11.00	9.41
December 31	4.99	2.24	12.25	2.85