ARI NETWORK SERVICES INC /WI
Form 10-Q
March 19, 2001

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2001

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 000-19608

ARI Network Services, Inc.

(Exact name of registrant as specified in its charter.)

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

330 E. Kilbourn Avenue, Milwaukee, Wisconsin 53202
(Address of principal executive office)

Registrant's telephone number, including area code (414) 278-7676

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 twelve 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 ninety days.

YES |X| NO ______

As of March 15, 2001 there were 6,168,270 shares of the registrant's shares outstanding.

ARI NETWORK SERVICES, INC.

FORM 10-Q

FOR THE THREE MONTHS ENDED JANUARY 31, 2001

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ARI NETWORK SERVICES, INC.
BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

ASSETS	JANUARY 31 2001	JULY 31 2000

Current assets:		
Cash and cash equivalents	$ 810	$ 563
Trade receivables, less allowance for doubtful accounts of $754 at January 31, 2001 and $697 at July 31, 2000	3,045	3,282
Prepaid expenses and other	107	109
Total current assets	3,962	3,954
Equipment and leasehold improvements:		
Computer equipment	4,394	4,389
Leasehold improvements	239	239
Furniture and equipment	992	846
	5,625	5,474
Less accumulated depreciation and amortization	5,193	5,038
Net equipment and leasehold improvements	432	436
Goodwill, less accumulated amortization of $1,742 at January 31, 2001 and $1,413 at July 31,2000	1,547	1,876
Deferred financing costs, less accumulated amortization of $126 at January 31, 2001 and $59 at July 31, 2000	293	321
Capitalized software development:		
Network platform	11,467	11,467
Software products	30,257	29,317
	41,724	40,784
Less accumulated amortization	30,841	28,883
Net capitalized software development	10,883	11,901
TOTAL ASSETS	$17,117	$18,488

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ARI NETWORK SERVICES, INC.
BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

LIABILITIES AND SHAREHOLDERS' EQUITY	JANUARY 31 2001	JULY 31 2000
Current liabilities:		
Current portion of notes payable to shareholder	$ 361	$ 361
Current portion of notes payable	422	461
Accounts payable	651	836
Unearned income	3,600	3,117

Accrued payroll and related liabilities	1,730	1,182
Other accrued liabilities	1,331	1,310
Current portion of capital lease obligations	151	111
Total current liabilities	8,246	7,378
Long term liabilities:		
Notes payable to shareholder (net of discount)	164	313
Notes payable (net of discount)	2,360	2,168
Capital lease obligations	214	233
Total long term liabilities	2,757	2,695
Shareholders' equity:		
Cumulative preferred stock, par value $.001 per share, 1,000,000 shares authorized; 20,350 shares issued and outstanding at January 31, 2001 and July 31, 2000	-	-
Common stock, par value $.001 per share, 25,000,000 shares authorized; 6,168,270 shares issued and outstanding at January 31, 2001 and July 31, 2000	6	6
Common stock warrants and options	2,459	2,459
Additional paid-in-capital	91,781	91,781
Accumulated deficit	(88,132)	(85,831)
Total shareholders' equity	6,114	8,415
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 17,117	$ 18,488

See notes to unaudited condensed financial statements.

Note: The balance sheet at July 31, 2000 has been derived from the audited balance sheet at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

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ARI NETWORK SERVICES, INC.
STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED JANUARY 31		SIX MONTHS ENDED JANUARY 31	
	2001	2000	2001	2000
Net revenues:				
Subscriptions, support and transaction fees	$ 2,550	$ 2,479	$ 5,102	$ 4,979

Software licenses and renewals	616	733	2,038	1,160
Professional services	694	637	1,525	1,095
	3,860	3,849	8,665	7,234
Operating expenses:				
Cost of products and services sold:				
Subscriptions, support and transaction fees	317	403	690	721
Software licenses and renewals *	907	981	1,874	1,893
Professional services	402	408	904	772
	1,626	1,792	3,468	3,386
Depreciation and amortization (exclusive of amortization of software products included in cost of sales)	370	412	770	856
Customer operations and support	409	541	813	1,025
Selling, general and administrative	2,200	2,115	4,433	3,920
Software development and support	830	822	1,675	1,478
Operating expenses before amounts capitalized	5,435	5,682	11,159	10,665
Less capitalized portion	(508)	(447)	(940)	(819)
Net operating expenses	4,927	5,235	10,219	9,846
Operating loss	(1,067)	(1,386)	(1,554)	(2,612)
Other expense:				
Interest expense	(396)	(180)	(767)	(278)
Other, net	21	(2)	20	(6)
Total other expense	(375)	(182)	(747)	(284)
Net loss	$ (1,442)	$ (1,568)	$ (2,301)	$ (2,896)
Average common shares outstanding	6,168	5,974	6,168	5,843
Basic and diluted net loss per share	($0.23)	($0.26)	($0.37)	($0.50)

See notes to unaudited condensed financial statements.

* includes amortization of software products of $793, $820, $1,672 and $1,575 and excluding other depreciation and amortization shown separately

ARI NETWORK SERVICES, INC.
STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	SIX MONTHS ENDED JANUARY 31	
	2001	2000

OPERATING ACTIVITIES		
Net loss	$ (2,301)	$ (2,896)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of network platform	286	348
Amortization of software products	1,672	1,575
Amortization of goodwill	329	327
Amortization of deferred financing costs and debt discount	476	-
Depreciation and other amortization	155	181
Net change in receivables, prepaid expenses and other	239	(50)
Net change in accounts payable, unearned income and accrued liabilities	867	265
Net cash provided by (used in) operating activities	1,723	(250)
INVESTING ACTIVITIES		
Purchase of equipment and leasehold improvements	(10)	(40)
Software products capitalized	(940)	(819)
Net cash provided by (used in) investing activities	(950)	(859)
FINANCING ACTIVITIES		
Net borrowings under line of credit	-	500
Repayments under notes payable	(405)	(330)
Deferred financing costs	(39)	-
Payments of capital lease obligations	(82)	(56)
Proceeds from issuance of common stock	-	1,264
Net cash provided by (used in) financing activities	(526)	1,378
Net increase (decrease) in cash	247	269
Cash at beginning of period	563	127
Cash at end of period	$ 810	$ 396
Cash paid for interest	$ 291	$ 278
NONCASH INVESTING AND FINANCING ACTIVITIES		
Capital lease obligations incurred for:		
Furniture and equipment	$ 141	$ -
Issuance of common stock as payment of line of credit	-	1,000
Conversion of line of credit to note payable	-	1,000

See notes to unaudited condensed financial statements.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

JANUARY 31, 2001

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared and reviewed in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended January 31, 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2001. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended July 31, 2000.

2. BASIC AND DILUTED NET LOSS PER SHARE

Dilutive earnings per share is not shown as the impact is antidilutive.

3. PREFERRED STOCK

The Series A preferred stock accrues dividends on a quarterly basis, cumulatively, at a rate per annum equal to the product of the stated value thereof and 2% above the prime rate (minimum dividend rate of 10% and maximum of 14%). All Series A preferred stock must be redeemed at $100 per share plus accrued and unpaid dividends prior to any payment of dividends on, or repurchases by the Company of, the Company's common stock. Prior to August 1, 2002, dividends, if declared by the Board of Directors, can be paid in either cash or additional shares of Series A preferred stock. The total amount of dividends in arrears on the Series A preferred stock is $887,000 at January 31, 2001.

4. NOTES PAYABLE

The convertible debentures, issued on April 27, 2000, and accrued interest thereon are convertible into common stock at a rate of $4 per share, subject to certain conditions and adjustments. Concurrent with the issuance of the debentures, the Company issued the investors 600,000 common stock purchase warrants expiring April 27, 2005 and 800,000 investment options expiring October 27, 2001. Each of the warrants and options are exercisable for one share of common stock at a price of $6 per share. The warrants and options, which were estimated to have a value of $2,354,000 at the time of issuance, less accumulated amortization, reduce the carrying amount of the debt.

5. DERIVATIVES

Effective August 1, 2000, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133, as amended, requires the recognition of all derivative instruments as either assets or liabilities in the statement of financial position measured at fair value. The impact of the adoption of SFAS 133 was immaterial to the Company's financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Total revenue for the quarter ended January 31, 2001 increased less than 1% from $3,849,000 in fiscal 2000 to $3,860,000 in fiscal 2001, representing the

nineteenth of the past twenty consecutive quarters of year-over-year revenue improvement. Management expects total revenue for the full fiscal 2001 year to increase between 20% and 30% from fiscal 2000. Earnings improved by 9%, from a net loss of $1,568,000, or $0.26 per share for the quarter ended January 31, 2000 to a net loss of $1,442,000 or $0.23 per share for the quarter ended January 31, 2001. Management believes that, due to non-cash amortization of goodwill and other intangibles from its acquisitions, full profitability will not be achieved until fiscal 2003. Should the Company complete additional acquisitions, non-cash amortization of intangibles could further delay full profitability. See "Forward Looking Statements."

REVENUES

The Company is a leading provider of Partner Relationship Management and business-to-business Internet e-Commerce solutions for sales, service and life-cycle product support in the manufactured equipment market. The Company currently serves over 100 manufacturers and 20,000 dealers in more than 100 countries in 12 segments of the worldwide manufactured equipment market including outdoor power, recreation vehicles, auto and truck parts aftermarket, marine, construction, power sports, floor maintenance and others. The Company builds and supports a full suite of multi-media electronic catalog publishing and viewing software for the Web or CD. The Company's communications systems provide a global electronic pathway for parts orders, product registrations, warranty claims and other transactions between manufacturers and their networks of sales and service points.

The Company also has a supplemental business that provides a variety of electronic commerce services to non-Equipment industries such as: transportation, agribusiness and publishing. The non-Equipment industries generate positive cash flows for the Company but have not shown significant growth over the past three years.

Management reviews the Company's recurring vs. non-recurring revenue in the aggregate and within the U.S. and Canadian Equipment, International Equipment and non-Equipment markets.

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

REVENUE BY INDUSTRY SECTOR
(IN THOUSANDS)

INDUSTRY SECTOR	THREE MONTHS ENDED JANUARY 31 2001	THREE MONTHS ENDED JANUARY 31 2000	PERCENT CHANGE	SIX MONTHS ENDED JANUARY 31 2001	SIX MONTHS ENDED JANUARY 31 2000	PERCENT CHANGE
EQUIPMENT INDUSTRY						
U.S. and Canadian						
Recurring	$ 2,273	$ 1,398	63%	$ 4,156	$ 2,783	49%
Non-recurring	320	895	(64%)	1,702	1,462	16%

Subtotal	2,593	2,293	13%	5,858	4,245	38%
International						
Recurring	359	110	226%	664	184	261%
Non-recurring	-	258	(100%)	17	342	(95%)
Subtotal	359	368	(2%)	681	526	29%
Total Equipment Industry						
Recurring	2,632	1,508	75%	4,820	2,967	62%
Non-recurring	320	1,153	(72%)	1,719	1,804	(5%)
Subtotal	2,952	2,661	11%	6,539	4,771	37%
NON-EQUIPMENT INDUSTRY						
Recurring	908	1,181	(23%)	2,082	2,323	(10%)
Non-recurring	-	7	(100%)	44	140	(69%)
Subtotal	908	1,188	(24%)	2,126	2,463	(14%)
TOTAL REVENUE						
Recurring	3,540	2,689	32%	6,902	5,290	30%
Non-recurring	320	1,160	(72%)	1,763	1,944	(9%)
Grand Total	$ 3,860	$ 3,849	0%	$ 8,665	$ 7,234	20%

Recurring revenues are derived from catalog subscription fees, software maintenance and support fees, software license renewals, network traffic and support fees and other miscellaneous subscription fees. Non-recurring revenues are derived from initial software license fees and professional services fees. Recurring revenue, as a percentage of total revenue, increased from

70% to 92% for the three months ended January 31, 2000 and 2001, respectively, due to an increase in annual renewal revenues and lower than expected new software license revenues in the Equipment Industry. The decrease in recurring revenue in the U.S. and Canadian markets were primarily due to heavy turnover in the Company's sales force and a "lag time" to hire new salespeople. The lack of recurring revenues in the International markets was primarily due to the Company's shift from the Equipment markets to other more lucrative markets and the establishment of new sales leads. On a year to date basis, recurring revenue is 80% of total revenue compared to 73% of total revenue for the same period last year. Management believes that the remainder of the year will be more in line with the Company's ideal relationship of approximately two thirds recurring revenue to one third non-recurring revenue. Management believes that this "target" ratio establishes an appropriate level of base revenue while the Company continues to add new sales to drive future increases in recurring revenue. This ratio is expected to fluctuate from quarter to quarter and year to year, depending on the size and timing of new business.

Equipment Industry

The Equipment Industry comprises several vertical markets including outdoor power, recreation vehicles, motorcycles, auto and truck parts after-market, manufactured housing, farm equipment, marine, construction, power sports, floor maintenance and others primarily in the U.S., Canada, Europe and Australia. Management's strategy is to expand the Company's electronic parts catalog and

dealer communications software and services business with manufacturers and distributors and their dealers in the existing vertical markets and to expand to other similar markets in the future.

U.S. and Canada

Recurring revenues in the U.S. and Canadian Equipment Industry increased for the three and six month periods ended January 31, 2001, compared to the same periods last year, primarily due to increased catalog license, maintenance and subscription renewals from the Company's growing base of customers and the renegotiation of prior agreements from a fixed price structure to the Company's time and materials based business model. Non-recurring revenues in the U.S. and Canadian Equipment Industry decreased for the three month period ended January 31, 2001, compared to the same period last year, due to lower than expected new software license revenues, but increased for the six month period ended January 31, 2001 compared to the same period last year, due to new software licenses and professional services sold to dealers and manufacturers in the first quarter of this fiscal year. Revenues in the U.S. and Canadian Equipment Industry increased, as a percentage of total revenues, from 59% for the six months ended January 31, 2000 to 68% for the six months ended January 31, 2001. Management expects recurring and non-recurring revenues in the U.S. and Canadian Equipment Industry to increase at a higher rate than total revenues for the remainder of fiscal 2001, as management continues to focus attention and resources in this industry.

International (Europe and Australia)

Recurring revenues in the International Equipment Industry increased for the three and six month periods ended January 31, 2001, compared to the same periods last year, primarily due to catalog license, maintenance and subscription renewals from new business added last year. Non-recurring revenues in the International Equipment Industry decreased for the three and six month periods ended January 31, 2001 compared to the same periods last year, due to a lack of new software sales in the first half of fiscal 2001. Revenues in the International Equipment Industry increased, as a percentage of total revenues, from 7% for the six months ended January 31, 2000 to 8% for the six months ended January 31, 2001. Management expects recurring and non-recurring revenues in the International Equipment Industry to increase at a higher rate than total revenues for the remainder of fiscal 2001, as management continues to focus attention and resources in this industry.

Non-Equipment Industry

The Company's business outside of the Equipment Industry includes sales of database management services to the agricultural inputs and railroad industries, electronic communications services to the agricultural inputs industry, and the on-line provision of information for republication to the non-daily newspaper publishing industry. The non-Equipment Industry business is characterized by a base of customers with long-term relationships with the Company. Revenues in the non-Equipment Industry decreased for the three and six month periods ended January 31, 2001, compared to the same periods last year, due to the Company's focus in the Equipment Industry. Management expects revenues in the non-Equipment Industry will decline for the remainder of fiscal 2001. Management expects that consolidation in the agricultural customer base is the reason for the decline in recurring revenues from the agricultural inputs industry and management believes that revenue from this market will continue to decrease in the future as the Company reaches saturation in this market. The Company's five-year contract with the Association of American Railroads expired on December 31, 2000. Per quarter, the Association of American Railroads represented approximately $250,000 of non-Equipment Industry recurring revenues. The Company's five year contract with the Associated Press, on which its

business in the non-daily newspaper publishing industry depends, was up for renewal in January 2001 and is currently operating on a short term renewal while contract renegotiations are taking place.

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The Company has maintained good relations with the Associated Press, and, based on discussions with the Associated Press, management believes that it is likely that the contract will be renewed, although there is no assurance that this will be the case.

COST OF PRODUCTS AND SERVICES SOLD

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

COST OF PRODUCTS AND SERVICES SOLD AS A PERCENT OF REVENUE BY REVENUE TYPE
(IN THOUSANDS)

	THREE MONTHS ENDED JANUARY 31		PERCENT	SIX MONTHS ENDED JANUARY 31	
	2001	2000	CHANGE	2001	2000
Subscriptions, support and transaction fees					
Revenue	$ 2,550	$ 2,479	3%	$ 5,102	$ 4,979
Cost of revenue	317	403	(21%)	690	721
Cost of revenue as a percent of revenue	12%	16%		14%	14%
Software licenses and renewals					
Revenue	616	733	(16%)	2,038	1.160
Cost of revenue	907	981	(8%)	1,874	1,893
Cost of revenue as a percent of revenue	147%	134%		92%	163%
Professional services					
Revenue	694	637	9%	1,525	1,095
Cost of revenue	402	408	(1%)	904	772
Cost of revenue as a percent of revenue	58%	64%		59%	71%
Total					
Revenue	$ 3,860	$ 3,849	0%	$ 8,665	$ 7,234
Cost of revenue	1,626	1,792	(9%)	3,468	3,386
Cost of revenue as a percent of revenue	42%	47%		40%	47%

Cost of subscriptions, support and transaction fees consists primarily of Associated Press royalties, telecommunications and catalog replication and distribution costs. Cost of subscriptions, support and transaction fees as a percentage of revenue decreased for the three month period ended January 31, 2001, compared to the same period last year, primarily due to lower telecommunications costs and remained relatively consistent for the six month period ended January 31, 2001, compared to the same period last year. Management expects gross margins from subscriptions, support and transaction fees to

fluctuate somewhat from quarter to quarter based on the mix of products and services sold.

Cost of software licenses and renewals consists primarily of amortization of software products, royalties, and software distribution costs. Cost of software licenses and renewals as a percentage of revenue varies significantly due to the variability of new software license revenues with relatively fixed cost of sales, primarily amortization of software costs. Cost of software licenses and renewals as a percentage of revenue increased for the three month period ended January 31, 2001, compared to the same period last year, primarily due to lower software license revenues with relatively consistent amortization costs, but decreased for the six month period ended January 31, 2001, compared to the same period last year, due to higher software license revenues in the first quarter of fiscal 2001. Management expects gross margins from software licenses and renewals to fluctuate significantly from quarter to quarter based on the number of licenses sold.

Cost of professional services consists of customization and catalog production labor. Cost of professional services as a percentage of revenue decreased for the three and six month periods ended January 31, 2001, compared to the same periods last year, primarily because professional services revenue increased from the conversion of old "fixed bid" contracts to time and materials contracts without a corresponding increase in the cost needed to provide those services. Management expects cost of

professional services to fluctuate from quarter to quarter depending on the mix of services sold and on the Company's performance towards the estimate given to customers for customization projects.

OPERATING EXPENSES

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

OPERATING EXPENSES
(IN THOUSANDS)

	THREE MONTHS ENDED JANUARY 31		PERCENT	SIX MONTHS ENDED JANUARY 31		PERCE
	2001	2000	CHANGE	2001	2000	CHANG
Cost of products and services sold	$ 1,626	$ 1,792	(9%)	$ 3,468	$ 3,386	2%
Customer operations and support	409	541	(24%)	813	1,025	(21%
Selling, general and administrative	2,200	2,115	4%	4,433	3,920	13%
Software development and support	830	822	1%	1,675	1,478	13%
	5,065	5,270	(4%)	10,389	9,809	6%
Depreciation and amortization	370	412	(10%)	771	856	(10%
Less capitalized portion	(508)	(447)	14%	(940)	(819)	15%
Net operating expenses	$ 4,927	$ 5,235	(6%)	$10,220	$ 9,846	4%

Customer operations and support consists primarily of data center operations,

software maintenance agreements for the Company's core network, catalog data maintenance and customer support costs. Customer operations and support costs decreased for the three and six month periods ended January 31, 2001, compared to the same periods last year, due to classifying direct labor costs, which were not tracked prior to the integration of the NDI acquisition, to direct cost of sales in the catalog production area of professional services.

The increase in selling, general and administrative expenses ("SG&A") for the three and six month periods ended January 31, 2001, compared to the same periods last year, was primarily due to increased bonuses and commissions associated with the increased sales and to the addition of a senior level financial consultant. SG&A, as a percentage of revenue, decreased from 54% for the six month period ended January 31, 2000 to 51% for the six month period ended January 31, 2001. Management expects costs to continue to increase in SG&A for the remainder of fiscal 2001, as the Company's revenues grow, but the increase is expected to be at a slower rate than revenues.

The Company's technical staff (in-house and contracted) performs both software development and support and software customization services for customer applications. Therefore, management expects fluctuations between software customization services and development expenses quarter to quarter, as the mix of development and customization activities will change based on customer requirements. Software development and support costs increased for the six month period ended January 31, 2001, compared to the same period last year, primarily due to an increase in resources focused on development of Web-based communications and cataloging software. Management expects software development and support costs to continue to increase for the remainder of fiscal 2001, but at a slower rate than revenues.

Depreciation and amortization expense decreased slightly for the three and six month periods ended January 31, 2001, compared to the same periods last year. Management expects depreciation and amortization to remain relatively consistent for the remainder of fiscal 2001, providing there are no additional acquisitions.

Capitalized software development costs represented 56% of software development and support for the six month period ended January 31, 2001, compared to 55% for the same period last year. Management expects capitalized software development to fluctuate from quarter to quarter depending on the deployment of the Company's resources between software development available for capitalization and customer customizations.

OTHER ITEMS

Net loss decreased for the three and six month periods ended January 31, 2001, compared to the same periods last year, due to revenues increasing at a higher rate than costs. As the Company continues its acquisition program, non-cash amortization of goodwill and other intangible assets from the Company's acquisitions may cause net losses to continue even if net cash provided by operations and used in investing activities is positive.

Cash paid for interest increased for the three and six month periods ended January 31, 2001, compared to the same periods last year, primarily due to increased utilization of the RFC Facility. Non-cash interest expense was incurred for the three and six month periods ended January 31, 2001 as the Company accrued interest and amortized debt discount for the Debenture sold to Rose Glen in April 2000. Management expects cash paid for interest to decrease as the Company continues to pay off debt and non-cash interest expense to increase, compared to the prior year, as the Company accrues and amortizes

non-cash interest expense associated with the Debenture. See "Liquidity and Capital Resources."

LIQUIDITY AND CAPITAL RESOURCES

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

CASH FLOW INFORMATION (IN THOUSANDS)

	THREE MONTHS ENDED JANUARY 31		PERCENT	SIX MONTHS ENDED JANUARY 31		PER
	2001	2000	CHANGE	2001	2000	CHA
Net cash provided by (used in) operating activities before changes in working capital	$ (43)	$ (336)	87%	$ 617	$ (465)	
Net cash provided by (used in) investing activities	(500)	(480)	(4%)	(950)	(859)	
Subtotal	(543)	(816)	33%	(333)	(1,324)	
Effect of net changes in working capital	1,356	(1,063)	228%	1,106	215	
Net cash provided by (used in) operating and investing activities	$ 813	$(1,879)	143%	$ 773	$(1,109)	

Management analyzes the Company's cash flow by breaking it down into three components: (i) net cash provided by (used in) operating activities before changes in working capital, which is a measure of the cash generating capability of the Company's business; (ii) net cash used in investing activities, which is a measure of the Company's investment in products and infrastructure for the future; and (iii) effect of changes in working capital, which is primarily driven by the timing of payments and invoicing relative to the end of a reporting period.

Total cash flows from operating and investing activities improved for the three and six month periods ending January 31, 2001, compared to the same periods last year, because of increased cash flows from operations before working capital changes. The analysis reveals that the primary reason for the Company's cash flow performance is the performance of its underlying business, rather than changes in investment or working capital timing.

Net cash provided by operating activities before changes in working capital increased for the three and six months ended January 31, 2001, compared to the same periods last year, due to revenues increasing at a higher rate than expenses. Net cash used in investing activities increased for the three and six months ended January 31, 2001, compared to the same periods last year, primarily due to increased costs attributable to the development of the Company's Web-based software. The effect of net changes in working capital is dependent on the timing of payroll and other cash disbursements and accruals and may vary significantly from quarter to quarter. Management expects cash provided by operating activities to remain positive for the remainder of fiscal 2001, however, there can be no assurance that these results will be ultimately achieved.

The Company expects to continue to incur operating losses for the fiscal year ending July 31, 2001 due to non-cash expenses. Although there can be no assurance that profitability will be achieved thereafter, management expects to achieve full profitability before the end of fiscal 2003, provided there are no additional acquisitions.

At January 31, 2001, the Company had cash and cash equivalents of approximately $810,000 compared to approximately $563,000 at July 31, 2000.

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

DEBT SCHEDULE
(IN THOUSANDS)

	JANUARY 31 2001 (UNAUDITED)	JULY 31 2000 (AUDITED)	NET CHANGE
Debt to Shareholder:			
Current portion of notes payable	$ 361	$ 361	$ -
Long-term portion of notes payable	222	389	(167)
Debt discount (common stock warrants)	(58)	(76)	18
Total Debt to Shareholder	525	674	(149)
Subordinated Debenture:			
Long-term notes payable other	4,000	4,000	-
Debt discount (common stock warrants and options)	(1,767)	(2,158)	391
Total Subordinated Debenture	2,233	1,842	391
Other Debt:			
Current portion of notes payable other	422	461	(39)
Long-term notes payable other	127	326	(199)
Total Other Debt	549	787	(238)
Total Debt	$ 3,307	$ 3,303	$ 4

On April 27, 2000, the Company issued and sold pursuant to a Securities Purchase Agreement, dated as of April 25, 2000, by and among the Company and RGC International Investors, LDC (the "Investor"), (i) a convertible subordinated debenture in the amount of Four Million Dollars ($4,000,000) due on April 27, 2003 (the "Debenture"), and convertible into shares of the Company's common stock, $.001 par value per share (the "Common Stock"), (ii) warrants to purchase Six Hundred Thousand (600,000) shares of Common Stock (the "Warrants"), and (iii) an investment option to purchase Eight Hundred Thousand (800,000) shares of Common Stock (the "Investment Option"). The Investment Option expires on October 27, 2001 and the Warrants expire on April 27, 2005. The Debenture is convertible into Common Stock at $4 per share and the Warrants and Investment Option are exercisable at $6 per share. At any time after October 27, 2000, the

Company can require the Investor to convert the amount owed under the Debenture into Common Stock at $4.00 per share provided that: (i) the closing bid price of the Common Stock has been greater than $6.60 for twenty (20) consecutive trading days and (ii) the Company's resale registration statement has been effective for at least three (3) months. The resale registration became effective on September 1, 2000. At any time after April 27, 2001, the Company can require the Investor to exercise the Investment Option if the closing bid price of the Common Stock is greater than $9.90 for twenty (20) consecutive trading days and the Company's resale registration statement has been effective for at least three (3) months. If exercised, the Investment Option would contribute an additional Four Million Eight Hundred Thousand Dollars ($4,800,000) of working capital to the Company.

ARI has a $1.0 million line of credit with WITECH (the "WITECH Line") that has been in place since October 4, 1993. The WITECH Line expires on December 31, 2001. The WITECH Line bears interest at prime plus 2.0%. As of January 31, 2001 there were no amounts outstanding under the WITECH Line. In conjunction with obtaining the WITECH Line, since 1993, ARI has issued to WITECH 350 shares of its non-voting cumulative preferred stock and total warrants for the purchase of up to 280,000 shares of its common stock, including (i) warrants for the purchase of 250,000 shares at $2.125 per share and (ii) warrants for the purchase of 30,000 shares of its common stock at $4.00 per share. The exercise price under the warrants is reduced if ARI issues stock at less than the then current exercise price. WITECH also purchased 20,000 shares of non-voting cumulative preferred stock on July 15, 1997. Of the 280,000 warrants to purchase shares of Common Stock issued to WITECH; (i) warrants to purchase 175,000 shares of Common Stock at $2.125 expired on October 1, 2000; (ii) warrants to purchase 75,000 shares of Common Stock at $2.125 expire on January 1, 2002; and (iii) warrants to purchase 30,000 shares of Common Stock at $4.000 expire on October 1, 2006.

The only financial covenant in the WITECH Credit Facility is that ARI must maintain a net worth (calculated in accordance with generally accepted accounting principles) of at least $5.3 million. ARI has been, and is currently, in compliance with the financial covenant in the Agreement and currently expects to comply with such covenant or obtain any required waivers or raise additional equity, if necessary.

In connection with both the subordinated debenture and the WITECH Line, the Company recognizes amortization of a debt discount, the gross amount of which is the value of the warrants and options issued as partial consideration for the terms of the

debt instrument. The amortization of the debt discount appears as non-cash interest expense on the statement of operations and the net value of the debt discount reduces the carrying value of the debt on the balance sheet.

On September 28, 1999, ARI and RFC Capital Corporation ("RFC") executed a Receivables Sales Agreement (the "Sale Agreement") establishing a $3.0 million working capital facility (the "RFC Facility"). The three year Sale Agreement allows RFC to purchase up to $3.0 million (the "Purchase Commitment") of ARI's accounts receivable. The Purchase Commitment may be increased in increments of $1.0 million upon mutual agreement and a payment by ARI of $10,000 for each $1.0 million increase. Under the Sale Agreement, RFC purchases 90% of eligible receivables. ARI is obligated to pay a monthly program fee equal to the greater of (a) $3,000 or (b) the amount of the purchased but uncollected receivables times the prime rate plus 2%. ARI may terminate the Sale Agreement prior to three years by paying: 3.0% of the Purchase Commitment during the first year; 2.0% of the Purchase Commitment during the second year; and 1.0% of the Purchase

Commitment during the third year. The balance of the RFC Facility at January 31, 2001 was $973,000.

Management believes that funds generated from operations and proceeds from the Debenture, the WITECH Line and the RFC Facility will be adequate to fund the Company's operations and investments through fiscal 2001. Management may consider the acquisition of strategic investment partners and the sale of additional securities as sources of funding for investment opportunities that may arise. On a long-term basis, management believes that cash for operations as well as for capital expenditures will come principally from cash generated from operations.

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

EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION
(IN THOUSANDS)

	THREE MONTHS ENDED JANUARY 31		PERCENT	SIX MONTHS ENDED JANUARY 31		P
	2001	2000	CHANGE	2001	2000	C
Net loss	$(1,442)	$(1,568)	8%	$(2,301)	$(2,896)	
Interest (cash)	230	180	28%	291	278	
Interest (non-cash)	166	-	100%	476	-	
Amortization of software products	793	820	(3%)	1,672	1,575	
Other depreciation and amortization	370	412	(10%)	770	856	
Earnings before interest, taxes, depreciation and amortization	$ 117	$ (156)	174%	$ 908	$ (187)	

The Company believes that earnings before interest, taxes, depreciation and amortization ("EBITDA") is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA increased for the three and six month periods ended January 31, 2001, compared to the same periods last year, due primarily to the Company's improvement in earnings. Management expects EBITDA to continue to remain positive for the remainder of fiscal 2001, although there can be no assurance that these results will be ultimately achieved. As the Company continues its acquisition program, non-cash amortization of goodwill and other intangible assets from the Company's acquisitions may cause net losses to continue even if EBITDA is positive.

We have included data with respect to EBITDA because it is commonly used as a measurement of financial performance and by investors to analyze and compare companies on the basis of operating performance. EBITDA is not a measurement of financial performance under generally accepted accounting principles and should not be considered an alternative to operating income, as determined in accordance with generally accepted accounting principles, as an indictor of our operating performance, or to cash flows from operating activities, as determined in accordance with generally accepted accounting principles, as a measure of our liquidity. EBITDA is not necessarily comparable with similarly titled measures for other companies.

ACQUISITIONS

Since December 1995, the Company has had a formal and aggressive business development program aimed at identifying, evaluating and closing acquisitions that augment and strengthen the Company's market position, product offerings, and personnel resources. Since the program's inception, approximately 300 acquisition candidates have been evaluated, resulting in four completed acquisitions.

ACQUISITION DATE	ACQUIRED COMPANY AND LOCATION	DESCRIPTION OF ACQUIRED COMPA
November 4, 1996	cd*.IMG, Inc. ("CDI") New Berlin, WI	CDI developed the Plus(1)(R) ele parts catalog, which featured pa information from over 20 manufacturers in the outdoor pow marine, motorcycle and power spo industries.
September 30, 1997	Empart Technologies, Inc. ("EMPART") Foster City, CA	EMPART provided us with the EMPARTpublisher and EMPARTviewer software.
September 15, 1998	POWERCOM-2000 ("POWERCOM"), a subsidiary of Briggs & Stratton Corporation Colorado Springs, CO	POWERCOM provided electronic cat and communication services to a number of manufacturers in North America, Europe, and Australia i the outdoor power, power tools, power sports industries.
May 13, 1999	Network Dynamics Incorporated ("NDI") Williamsburg, VA	NDI provided us with the PartSma electronic catalog, which was us over 10,000 dealers to view cata from 50 different manufacturers sectors of the Equipment Industr

FORWARD LOOKING STATEMENTS

Certain statements contained in the Management's Discussion and Analysis of Results of Operations and Financial Condition are forward looking statements, including, without limitation, statements with respect to growth plans, projected sales, revenues, earnings and costs and product development schedules and plans. Other forward looking information includes (i) information included or incorporated by reference in our future filings with the Commission including, without limitation, statements with respect to growth plans, projected sales, revenues, earnings and costs, and product development schedules and plans and (ii) information contained in written material, releases and oral statements issued by us, or on our behalf, including, without limitation, statements with respect to growth plans, projected sales, revenues, earnings and costs, and product development schedules and plans. Generally, the words "anticipates," "believes," "expects," "intends" and similar expressions identify forward looking statements. The Company's actual results may differ materially from those contained in the forward looking statements identified above. Factors which may cause such a difference to occur, include, but are not limited to, those factors set forth in the section entitled "Risk Factors," in the Company's registration statement on Form S-3 filed on May 12, 2000, as amended.

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PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Company held its 2000 Annual Meeting of Shareholders on December 14, 2000.

(b) Votes cast for the election of directors to serve until the 2003 Annual Shareholder's Meeting were as follows:

Nominee	Votes For	Votes Against
Gordon J. Bridge	4,893,960	0
Ted C. Feierstein	4,902,965	0

Votes cast for the ratification of the appointment of D. Bruce Merrifield, Jr. to serve as a director until the 2002 Annual Shareholder's meeting were as follows:

For	4,897,014
Against	0
Abstained	223,883
Broker Non-Vote	0

Directors whose terms of office continue past the 2000 Annual Meeting of Shareholders are: Francis Brzezinski, Brian E. Dearing, D. Bruce Merrifeld, Jr. and Richard W. Weening.

Votes cast to approve the 2000 Stock Option Plan were as follows:

For	3,154,643
Against	270,607
Abstained	19,269
Broker Non-Vote	1,676,378

Votes cast to approve the 2000 Employee Stock Purchase Plan were as follows:

For	3,354,753
Against	71,354
Abstained	18,412
Broker Non-Vote	1,676,378

Votes cast to ratify the appointment of Ernst & Young LLP as the Company's

auditors for the year ending July 31, 2000 were as follows:

For	5,083,860
Against	15,185
Abstained	21,852

ITEM 5. OTHER INFORMATION

On January 18, 2001 Mr. Fran Brzezinski tendered his resignation as a director, effective February 28, 2001, in light of other pressing business commitments. On March 15, 2001, the Board appointed Mr. David C. Storm to fill the vacancy created by Mr. Brzezinski's resignation.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

b) Reports on Form 8-K.

On November 13, 2000, a Report on Form 8-K with respect to Item 9 of Form 8-K was filed.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARI Network Services, Inc.
(Registrant)

Date: March 19, 2001 /s/ Brian E. Dearing
Brian E. Dearing, Chairman --
of the Board (and acting CFO)