

ARI NETWORK SERVICES INC /WI

Form 10-K

October 28, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended
July 31, 2016

TRANSITION
REPORT
UNDER
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 (State or other jurisdiction or organization) | 39-1388360 (IRS Employer Identification No.) |
|---------------------------------------------------------------|----------------------------------------------------|

| | |
|-------------------------------------------------------------------------------------------------------|---------------------|
| 10850 West Park Place, Suite 1200, Milwaukee, Wisconsin (Address of principal executive office) | 53224 (Zip Code) |
|-------------------------------------------------------------------------------------------------------|---------------------|

(414) 973-4300
Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|----------------------------------------------|----------------------------------------------|
| Common Stock, par value \$0.001 per share | NASDAQ Capital Market |

Securities registered pursuant to Section 12(g) of the Act: None

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 15(d) of the Exchange Act. Yes No

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (S229.405 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):

| | |
|--------------------------------------------------|----------------------------------------------------|
| <input type="checkbox"/> Large accelerated filer | <input type="checkbox"/> Accelerated filer |
| <input type="checkbox"/> Non-accelerated filer | <input type="checkbox"/> Smaller reporting company |
| (Do not check if a smaller reporting company) | |

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

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price of the registrant's common stock on January 31, 2016 as reported on the NASDAQ Capital Market, was \$59,000,000.

As of October 20, 2016, there were 17,446,816 shares of the registrant's shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed within 120 days of July 31, 2016 are incorporated by reference in this Annual Report on Form 10-K in response to Part III, Items 10, 11, 12, 13 and 14.

ARI Network Services, Inc.

FORM 10-K

FOR THE FISCAL YEAR ENDED JULY 31, 2016

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Statements

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This Annual Report on Form 10-K, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7, contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. All statements other than statements of historical facts are statements that could be deemed to be forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and the beliefs and assumptions of our management. Words such as “expects,” “anticipates,” “targets,” “goals,” “projects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “endeavors,” “strives,” “may,” variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, estimate, or verify, including those identified below under “Item 1A. Risk Factors” and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

PART I

Item 1. Business

Overview

ARI Network Services, Inc. offers an award-winning suite of Lead Generation and eCommerce Websites, eCatalog Solutions, Business Management Systems and Digital Marketing Services that help dealers, equipment manufacturers and distributors in select vertical markets Sell More Stuff!TM – online and in-store. Our innovative products are powered by a proprietary library of enriched electronic product content including OEM parts, aftermarket parts, garments and accessories (PG&A) and whole goods from more than 1,800 manufacturers. Business is complicated, but we believe our customers’ technology tools don’t have to be. We remove the complexity of selling and servicing new and used whole goods inventory and PG&A. More than 23,500 equipment dealers, distributors and manufacturers worldwide leverage our solutions to Sell More Stuff!TM

We go to market under the “ARI Network Services, Inc.” brand name in the powersports, outdoor power equipment (OPE), marine, home medical equipment (HME), recreational vehicles (RV) and appliance industries. We service customers in the automotive tire and wheel aftermarket (ATW) under the “TCS Technologies, an ARI Company” brand name; and we service the automotive aftermarket parts and service (AAPS) market under the “DCi, an ARI Company” brand name.

We were incorporated in Wisconsin in 1981. Our principal executive office and headquarters is located in Milwaukee, Wisconsin. The office address is 10850 West Park Place, Suite 1200, Milwaukee, WI 53224, and our telephone number at that location is (414) 973-4300. Our principal website address is www.arinet.com. ARI also maintains operations in Cypress, California; Floyds Knobs, Indiana; Des Moines, Iowa; Duluth, Minnesota; Wexford, Pennsylvania; Cookeville, Tennessee; Salt Lake City, Utah; Leiden, The Netherlands and Gurgaon, India.

Our Solutions

Our primary solutions include: (i) Lead Generation and eCommerce Websites, giving dealers and wholesalers an online presence optimized for today’s digital path to purchase and serving as a platform to drive in-bound lead generation and eCommerce sales; (ii) eCatalogs, offering access to our proprietary library of enriched electronic

product content via a suite of SaaS and DaaS solutions to enable the sale of whole goods inventory and PG&A; (iii) Business Management Software designed to streamline every aspect of a dealer's operation, drive profitability and allow them to provide better customer service; and (iv) Digital Marketing Services designed to generate leads and drive traffic both to the dealer's website and brick-and-mortar location.

Our solutions also improve our dealers' overall customer satisfaction through a highly efficient and accurate data lookup experience at the parts counter and a quicker response time to online inquiries, both of which serve to significantly improve a customer's overall experience with the dealer.

Our solutions are sold through our internal sales force and are composed primarily of recurring licenses and subscriptions and, in the case of business management software, perpetual licenses and maintenance contracts. Customers typically sign annual, auto-renewing contracts. Today, more than 90% of our revenues are recurring.

Lead Generation and eCommerce Websites

Our online solutions are tailored to each of the vertical markets we serve and are tightly integrated with our proprietary library of enriched electronic product content for major unit inventory and PG&A. Our website platform development teams continually innovate our platforms to keep up with the ever-evolving demands of our customers, online shoppers and search engines to ensure we can provide dealers with websites that perform well in search and convert online visits into leads, eCommerce sales and in-store visits. We offer a full menu of website add-ons, including a mobile inventory management application, third-party inventory integrations and business management integrations. Our lead generation tools are designed to efficiently manage and nurture leads through email campaigns, automated responses, sales team reminders and other lead generating activities, increasing conversion rates and ultimately revenues for our customers.

Lead Generation and eCommerce Websites are sold through our internal sales teams, which are aligned by vertical market. The sales process typically includes a live demo of the site and may include a free trial period (we refer to these as “test drives”). We typically charge monthly recurring subscription fees, and may charge a one-time set up fee to develop a new dealer website, as well as variable transaction fees. Our website solutions are typically sold under one-year, renewable contracts with monthly payment terms. We estimate that as of July 31, 2016, we host and maintain more than 7,500 websites for dealers across all of our vertical markets.

eCatalog Platform Solutions

Our eCatalog solutions offer access to our proprietary library of enriched electronic product content via a suite of SaaS and DaaS solutions including dealer-facing manufacturer parts lookup portals and parts counter solutions; consumer-facing online parts lookup; and DaaS subscription access to our content library all designed to enable the sale of whole goods inventory and PG&A.

Our eCatalog solutions are sold through our dedicated internal sales team. Fees charged for the use of our eCatalog products include a recurring license fee, subscription fees for subscribed catalogs and, in some cases, page view fees.

Business Management Software

Our business management software solutions are designed to streamline every aspect of a dealer’s operations to allow them to provide improved customer service. These products are sold through our dedicated internal sales team, and fees charged include perpetual one-time license or installation fees, maintenance and support fees, as well as hosting fees for our SaaS version. These solutions are currently only offered in the ATW aftermarket under the “TCS Technologies, an ARI Company” brand name.

Digital Marketing Services

ARI complements our suite of data-driven SaaS and DaaS solutions with digital marketing services that deliver the engaging experiences that today's consumers expect, as well as meet the demands of leading search engines like Google. ARI's Digital Marketing Services include search engine optimization, email marketing, search engine marketing (PPC), online reputation management and online directory management to help dealers drive more online leads, eCommerce sales and in-store traffic. Digital marketing services are sold through our dedicated internal sales team.

Other Solutions

We also offer a suite of complementary solutions, which include software, website customization, professional services and hosting services.

Our Growth Strategy

ARI's goal is to become the leading provider of SaaS and DaaS solutions and complementary services that help our customers efficiently and effectively sell more major units, replacement parts, accessories and service – in other words, Sell More Stuff!TM Our continued goal is to grow revenues at a double-digit rate and to grow earnings through scalability. We intend to accomplish this goal by delivering our solutions to dealers, distributors, manufacturers, service providers and consumers in selected vertical markets where the finished goods are complex equipment requiring service and which are primarily sold and serviced through an independent dealer channel which typically carries multiple brands. We believe this strategy will drive increased value to our shareholders, employees and customers.

We also believe that the execution of the following strategic pillars will enable us to achieve the growth and profitability needed to drive long-term sustainable value for our shareholders:

- drive organic growth through expanded service offerings to grow both our subscriber customer base and our average revenue per dealer;
- differentiate our content;
- enter new markets;
- expand geographically;
- nurture and retain existing customers through world-class customer service and value-added product feature updates;
- lead the market with open integration to related platforms; and
- successfully execute acquisitions that align with our core strategy.

These strategic foundations are primarily centered on enhancing the value proposition to our customers, which will lead to additional revenues through pricing actions, product and feature upsells, reduced customer churn rates, and expansion by leveraging our core competencies in new complementary markets. Each of these strategic pillars is a long-term foundation for the Company's growth; within each we have established near-term goals, as discussed below.

Drive organic growth through expanded service offerings to grow both our subscriber customer base and our average revenue per dealer.

As a subscription-based, recurring revenue (RR) business, the most important drivers of future growth are nurturing and defending our customer base; developing and selling additional products to our existing customer base; and acquiring new customers. We define RR as revenue from products and services which are subscription-based and renewable, including software access fees, data content fees, maintenance fees, support fees and hosting fees. We define churn as the percentage of RR that does not renew. RR increased 20.4%, or \$7,428,000 to 92.1% of total revenue for the year ended July 31, 2016, compared to the same period last year. To experience further growth in RR, we will continue to develop and deploy innovative new solutions. We have resources assigned to each of our core products that continue to research and develop new value-added features and functionality for our existing products. The introduction of new solutions, upgrades to existing products, and new feature sets are all designed to grow our subscriber base of dealers and our average revenue per dealer (ARPD), an important measure for a subscription-based business. We have recently developed a number of new features, upgrades and products, including the following:

Lead Generation and eCommerce Website Platforms

- o Vertical Market Expansion – We have tailored the ARI website platform to address the unique needs of the RV market. Supporting the release of our platform in this market, we are completing an integration with Sys2K™, a leading provider of dealer management software for RV dealers and manufacturers. The DMS provider has additionally named ARI as its preferred website partner.
- o Expanded and Improved Lead Forms – We have added two new lead generation capabilities for powersports, OPE, marine and RV dealers to help consumers request a quote for trade-ins and schedule unit test drives. We have additionally refined all core lead generation workflows to increase conversions, resulting in more than a 40% average increase in lead conversion rates.

o

- Dealer Management System Integrations – We have developed advanced proprietary integration capabilities with the leading providers for Dealer Management Software in the powersports, marine, OPE and RV markets.
- o Major Unit Shopping Tools and eCommerce Functionality – We expanded the options available to help consumers shop for major unit inventory, including automatically providing notifications of new in-stock inventory matching their search criteria and the ability to purchase units online via eCommerce checkout.
 - o Point of Sale Integration – We developed an integration between our TCS-branded ATW website platform and Tire Works HD Wholesale, the point of sale offering that joined ARI’s product portfolio as part of the April 2015 acquisition of TASC Corporation. This integration enables two-way, real-time quantity, pricing and ordering updates between the system and a user’s website.
 - o Wheel Visualizer Integration – We developed an integration with a leading wheel visualizer application to enable the technology on our tire and wheel dealer websites, increasing the value of the toolset we offer to dealers in this marketplace.

- o Product Features and Benefits Marketing – We have added real-time updates on feature and benefit product content from tire manufacturers to our business-to-business platform. This allows an end user of the site to see all the available manufacturer information about the tire, not just the technical specs. This is important to dealers and end users as it is one more reason for them to stay on a dealer’s site and not visit another site for this information.
- o Price and Quote Calculator Enhancement – We released an updated version of our pricing calculator for business-to-consumer sites in the tire and wheel industry. The updated tool allows our customers to offer more diverse upsell options to their customers.

eCatalog Platforms

- o Data Manager® Development – We continued development and launched customer Alpha testing of the next generation of Data Manager®, our OEM parts product information management software. This next-generation platform is designed to reduce OEM publishing costs and time to market through real-time publishing, ensuring end users have access to the most accurate and rich part and service content across ARI’s software ecosystem.
- o AccessorySmart® Development – We developed an enhanced integration with CDK’s Lightspeed Business Management Software in support of a collaborative sales and marketing program with this leading powersports industry software provider.

Business Management Software

- o MyCARFAX Reseller Agreement – This agreement gives the Company’s tire and wheel dealers the ability create myCARFAX accounts for their customers. When a dealership enrolls its customers, the dealership is set to the customer’s favorite shop within their myCARFAX app. The app’s alerts and reminders will automatically include a reference to the customer’s favorite shop to help drive repeat business and customer loyalty. Dealers receive the additional benefit of gaining access to vehicle recall information and recent service history from inside TCS’ Tire Power™ business management system.
- o My Car Care Rewards Integration – The integration of My Car Care Rewards (MCCR) with Tire Power allows tire and wheel dealers to register a customer for the MCCR loyalty program and apply the program’s bonuses, promotions and bonus discount points to the customer’s invoice via a web service.
- o SMS Service/Customer Notes Feature Enhancements – Tire Power now gives tire and wheel dealers multiple ways to communicate with and record information about their customers in addition to the ability to view and/or print these communication records.
- o Tire Pros Branded User Interface – The Company has developed a Tire Pros branded instance of Tire Power. The software features a user interface that’s been branded with Tire Pros graphics to give Tire Pros Network dealers a fully branded software experience.
- o Michelin Interface – Tire Works HD™ now supports Michelin National Account transactions, including end-to-end submission processing via Michelin’s Bibnet portal. TireWorks HD users can also view available inventory from Michelin and place tire orders electronically.

- o Support for Wheels – TireWorks HD added support for wheel inventory, including wheel specifications and wheel images. This is vital information that helps the dealer Sell More Stuff!TM

- o System Alert Feature Upgrade – TireWorks HD now allows its users to send their dealer networks alerts for specials announcements and promotions. Users can additionally share links to other resources, including manufacturer rebates.

- o Reason For Repair – TireWorks HD now helps the user collect important regulatory and liability information with regards to Reason For Repair. This new feature allows users to collect repair information that is consistent with MAP (Motorist Assurance Program) standards.

Digital Marketing Services

° New Digital Marketing Services Packages – We developed and launched innovative, new Digital Marketing Services packages, which offer dealers a curated blend of services targeted for unique customer segments that increase online and in-store traffic and drive sales opportunities. The new solutions recently earned two prestigious industry awards. These product enhancements are designed to automate and enhance the marketing, sales and servicing activities for our customers in order to help them sell and service more parts, garments, accessories and whole goods.

Differentiate our content.

We believe we have the largest library of replacement part, major unit, and PG&A content in the vertical markets we serve. However, simply offering the largest content library in the markets we serve is not sufficient to drive the long-term revenue growth we desire. We strive to deliver more value to our customers through the enrichment of our content and during fiscal 2016 have made the following enhancements:

- o New Market Product Information – We completed the addition of RV major unit information and floorplans encompassing all major RV manufacturers in support of the entry of the ARI dealer website platform into the RV market.
- o Domestic and International Catalog Expansion – We’ve continued securing new manufacturer catalogs in both the domestic and international markets.
- o PG&A Content Addition and Expansion – We’ve released two new powersports catalogs, adding more than 35,000 new products available to the market.

Enter new markets.

ARI currently maintains a significant share in our core vertical markets of OPE, powersports, marine, RV and appliances. Accordingly, we anticipate low single-digit growth in these markets. ARI maintains a lower share in our growth vertical markets of HME, ATW and AAPS. Accordingly, we anticipate double-digit growth in these markets. As we continue to increase our share in our current markets, leveraging our technology in new and underserved markets will be important to maintaining high single digit to low double digit organic growth rates. ARI currently has more than 3,000 dealer websites in the ATW market. We estimate that the total addressable market includes approximately 18,000 dealers. Further, the broader AAPS market, which we entered via our acquisition of DCi, comprises nearly 80,000 independent service providers, more than all of our other markets combined. We intend to continue to invest heavily in this growth market, including seeking opportunities to leverage our products and services in the broader AAPS. We are one of the first website providers to service the HME market. We estimate that this market comprises nearly 25,000 service providers and believe the market to be in the early stages of eCommerce adoption.

Expand geographically.

Although we maintain relationships with dealers throughout the world, we have low penetration into international markets. Growing our international business will require us to secure and publish electronic content from manufacturers outside the U.S. and make changes to our existing product suite that will allow us to rapidly deploy these products in a scalable and efficient manner without the need to have “boots on the ground” in those countries. During fiscal 2015 and 2016, we added 15 new catalog content offerings in the international outdoor power equipment market. In September 2016, we hired a general manager in the Netherlands intended to expand our European presence.

Nurture and retain existing customers through world-class customer service and value-added product feature updates.

In order to achieve sustained double-digit organic growth, we not only need to execute the growth strategies described above, we must also retain our existing customers. In a SaaS business, the cost to retain an existing customer is much less than the cost to acquire a new customer. Accordingly, customer churn is an important metric we track and manage. We experienced improvements in our churn rates the past several years as a result of strategic actions taken by the Company, all of which are designed to enhance the “stickiness” of our product within our customers’ operations. In fiscal 2016, we experienced a slight decrease in customer churn from 15.5% in fiscal 2015 to 15.4%. We will continue to leverage our relationships with existing customers and closely monitor and manage the level of customer churn.

Lead the market with open integration to related platforms.

One of our strategic advantages is our focus on integrating our solutions with dealer business management systems (DMS) in order to pass key information, including customer and transactional data, between our solutions and the DMS, saving our customers valuable time and eliminating redundant data entry. We currently have integration capabilities with over 90 DMS (we refer to these

relationships as “Compass Partners”), and we continue to seek other strategic alliances that can be integrated with our product and service offerings.

Successfully execute acquisitions that align with our core strategy.

Since 1995, we have had a formal corporate development program aimed at identifying, evaluating and closing acquisitions that align with our strategy. We focus on vertically-oriented markets with a large base of independent, multi-line dealers that sell and service complex equipment. Our strategy is to acquire companies that allow us to do one or more of the following: (i) expand our market share in existing verticals; (ii) expand into new markets that fit our desired profile; (iii) provide us with complementary products which can be cross-sold to our existing customer base; (iv) provide opportunities to cross-sell our existing products; and (v) can be integrated into our operations, thereby creating cost-saving synergies.

From the program’s inception through the end of fiscal 2016, we have closed 16 acquisitions. A summary of some of our most recent acquisitions is as follows:

| Acquisition | Date | Strategy |
|------------------------------------------------------------------|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|
| Direct Communications Inc. | July 2015 | A leading provider of electronic catalog and content in the AAPS industry |
| TASCO Corporation (and affiliated Signal Extraprise Corporation) | April 2015 | Extend business management software platform in the ATW market |
| Tire Company Solutions, LLC | September 2014 | Consolidate website position and add new business management software in the ATW market |
| DUO Web Solutions | November 2013 | A leading provider of social media and online digital marketing services in the powersports industry |
| 50 Below Sales & Marketing, Inc. (Retail Division) | November 2012 | A market leader in the powersports industry |
| Ready2Ride, Inc. | August 2012 | Entrance into ATW and DME industries New award-winning website platform First of its kind aftermarket fitment data for the powersports industry |

During fiscal 2015, we completed the following three acquisitions aligned with our acquisition strategy:

- Our acquisition of Tire Company Solutions, LLC (“TCS”) not only cemented our position as one of the largest suppliers of eCommerce solutions in the ATW market, but also added a new business management software product to the Company’s product suite for retailers, wholesalers and retreaders in the ATW and AAPS markets.
- Our acquisition of TASCO Corporation (“TASCO”) has extended our position as a business management system leader in the ATW market, including the addition of business management software dedicated to solving the unique

needs of large, multi-location franchised businesses.

- Our acquisition of Direct Communications Inc. (“DCi”) accelerated our entry into the AAPS market. DCi is a leading provider of differentiated product content and electronic parts catalog software serving manufacturers, distributors, jobbers and independent retailers in the AAPS.

Our Competitive Strengths

Market Leader in Core Verticals

We believe that we are one of the leaders in each of our core vertical markets. More than 23,500 equipment dealers, distributors and manufacturers worldwide leverage our web and eCatalog platforms, allowing us to cost effectively leverage our proprietary library of enriched electronic product content into a large and diversified customer base and to launch new product enhancements and technology-enabled solutions into the vertical markets we serve.

Breadth and Depth of Published Content

The breadth and depth of our content library, as well as our ability to enhance and efficiently publish manufacturers’ data as it becomes available, provides ARI with a critical competitive advantage and represents a high barrier to entry for potential new competitors. Our content library enables multi-line dealers to easily access catalog content for multiple manufacturers using a single software platform. This advantage, which saves our customers significant time, provides "stickiness" for our catalog customer base which allows us to efficiently and cost effectively nurture our existing customers while devoting resources to develop new products and services, enabling us to grow our overall dealer subscriber base as well as ARPD.

Recurring Revenue Model

During fiscal 2016, more than 90% of our revenue was subscription-based and RR. The majority of our customers are on contracts of 12 months or longer, and these contracts typically auto-renew for additional 12-month terms. This provides us with advanced visibility into our future revenues and opportunities to sell additional services to our customers. Our RR model also emphasizes the importance of maintaining a low rate of customer churn, one of the key financial drivers of any SaaS business. We closely monitor customer churn via end-of-service surveys, so we can take action on the churn drivers within our control in order to reduce churn rates in the future.

Our RR model, when combined with low rates of customer churn, significantly reduces the cost to maintain and nurture our customer base. This, in turn, frees up resources to enhance our existing products and work toward new revenue-generating product innovations. Additionally, a substantial portion of our eCatalog business is focused on our customers' service and repair operations. This allows our revenues to remain strong even in a down economy, as consumers tend to repair their equipment rather than buy new equipment during challenging economic times.

Suite of Products Covers Entire Sales and Service Cycle

Our suite of dealer products and services enhance our customers' front office operations by covering the entire sales cycle from lead generation and lead management to eCommerce sales of whole goods and PG&A to billing and collections. Additionally, our eCatalog products, website service scheduling features and customer relationship management functionality in our business management systems allow dealers to efficiently service and repair their customer's existing equipment to build their customer's lifetime value.

We believe that our competitive advantages will enable us to compete effectively and sustainably in our vertical markets, although given the current pace of technological change, it is possible that as yet unidentified competitors could emerge; existing competitors could merge and/or obtain additional capital, thereby making them more formidable; or new technologies could come on-stream and potentially threaten our position.

Our Markets and the Challenges We Face

Competition for our products and services varies by product and by vertical market. We believe that no single competitor today offers a product and service portfolio that competes against all of our offerings in any of our vertical markets.

In the eCatalogs product category, we compete primarily with Snap-on Business Solutions which designs and delivers eCatalogs, accessory sales tools and manufacturer network development services primarily to the automotive, powersports and OPE markets. In addition, there are a variety of smaller eCatalog companies, each focused on one to two vertical markets.

In the lead management, dealer websites and eCommerce product category, our primary competitors in powersports and marine are Dealer Spike and PowerSports Network, owned by Dominion Enterprises. We also compete with Net Driven in the ATW market. Competition for our website development services also comes from dealers' in-house information technology groups that may prefer to build their own web-based proprietary systems, rather than utilizing our proven industry solutions.

There are also large, general market eCommerce companies, such as IBM, which offer products and services that could address some of our customers' needs. These general eCommerce companies do not typically compete with us directly, but they could in the future.

We believe we maintain a competitive advantage in our core vertical markets given the breadth and integration of our published catalog content into our eCatalog and website products.

Several of the markets we serve, including powersports, marine and RV, are closely aligned with the state of the economy, given the luxury nature of the products in those verticals. Our customer churn rates have shown improvement in these markets over the past several fiscal years. However, future economic downturns could have a significant adverse impact on our business, as a downturn could lead to an increase in customer churn in these markets due to manufacturer bankruptcies, dealer closures and extreme cost reduction measures by our dealer customers. It is also important to note that the effects of a difficult economic environment may be somewhat softened, relative to other product and service providers to the markets, by the consumers' willingness in a down economy to repair existing equipment rather than purchase new equipment. This serves to amplify the importance of our published OEM replacement parts and PG&A content provided to customers via our eCatalog products and our dealer websites.

Intellectual Property

We rely on various intellectual property laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We also enter into confidentiality and proprietary rights agreements with our employees, consultants and other third parties, and we control access to software, documentation and other proprietary information. We have numerous registered trademarks in the U.S. and Europe.

Employees

As of July 31, 2016, we had 405 full-time equivalent employees (FTEs) and a total of 415 employees. Of these FTEs, 194 are involved in customer operations and support; 115 are in sales and marketing; 66 are engaged in maintaining or developing software and providing software customization services; and 30 are involved in general and administrative functions. None of these employees are represented by a union.

Fiscal Year

ARI's fiscal year ends on July 31st. Any references throughout this document to "2016" or "fiscal 2016" and "2015" or "fiscal 2015" refer to the fiscal years ended July 31, 2016, and July 31, 2015, respectively.

Executive Team

The table below sets forth the names of ARI's executive team as of October 21, 2016. The executives serve at the discretion of the Board of Directors.

| Name | Age | Capacity Served |
|---------------------|-----|-----------------------------------------------------------------------------|
| Roy W. Olivier | 57 | President, Chief Executive Officer and Director |
| William A. Nurthen | 43 | Vice President of Finance, Chief Financial Officer, Secretary and Treasurer |
| Robert A. Ostermann | 37 | Chief Technology Officer |
| Bradley J. Smith | 34 | Vice President, Product Management |
| Robert A. Jones | 45 | Vice President, Sales |

Roy W. Olivier

Olivier was appointed President and Chief Executive Officer of the Company in May 2008, after having served in the capacity of Vice President of Global Sales and Marketing of the Company since September 2006. Prior to joining ARI in 2006, Olivier was a consultant to start-up, small- and medium-sized businesses. Prior to that, he served as Vice President of Sales and Marketing for ProQuest Media Solutions, a business he founded in 1993 and sold to ProQuest in 2000. Olivier previously held various sales and marketing executive and managerial positions with several other companies in the telecommunications and computer industries, including Multicom Publishing Inc., Tandy Corporation, BusinessLand and PacTel.

William A. Nurthen

Nurthen was appointed Vice President of Finance and Chief Financial Officer of ARI in November 2013 when he joined the Company. Nurthen also serves as Treasurer and Corporate Secretary. Prior to joining ARI, Nurthen served as CFO of Cabrera Capital Markets, LLC, an investment banking firm from 2011 to 2013. Prior to that, he served in a variety of high-level financial leadership positions including CFO of bioLytical Laboratories from 2008 to 2011. From 1999 to 2007, Nurthen served in various financial roles at Inforte Corp., a NASDAQ company, including Vice President of Finance and CFO. From 1997 to 1999, Nurthen worked in various financial operations roles at Platinum Technology International, Inc., a software and consulting company. Nurthen earned his B.A. from The University of Notre Dame in 1995 and his MBA from The Kellogg School of Management at Northwestern University in 2002.

Robert A. Ostermann

Ostermann was appointed Chief Technology Officer of ARI in August 2012 after having served as Executive Director of Technology since November 2011. Prior to that, he served as Director of Product Engineering since joining the Company in June 2008. Before joining ARI, Ostermann served in various technology management and development roles at Parcel Pro Inc. in Torrance, California, and The California Breath Clinics in Los Angeles, California from 2003 to 2008. Prior to that, he was lead developer at OC-Net, Inc., a company ARI acquired in January 2008, in Cypress, California. Ostermann earned a B.S. in Business Administration, Computer Information Systems from California State University.

Bradley J. Smith

Smith was appointed Vice President of Product Management in February 2014, leading the Company's innovative product strategy. Smith previously served as Director of Product Management, and prior to that, served in various web development positions since joining the Company in July 2007. Before joining ARI, Smith served in the U.S. Army from 2000 to 2006. Smith earned a double B.A. in Web/Technology Development and Spanish from the University of Wisconsin-Stevens Point in 2007 and an MBA from the University of Wisconsin-Eau Claire in 2012.

Robert A. Jones

Jones was appointed Vice President of Sales in August 2014, after having served as Director of Sales since November 2013 when he joined the Company. Prior to joining ARI, Jones served as Director of Retail Sales at 50 Below Sales and Marketing, Inc., from February 2010 to November 2013. Prior to that, Jones spent 25 years in the hospitality industry.

Available Information

You can obtain copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and other filings with the SEC and all amendments to these filings free of charge on our investor relations website at investor.arinet.com as soon as reasonably practical following our filing of any of these reports with the SEC. You can also obtain copies free of charge by contacting us at our office address listed above.

Item 1A. Risk Factors

The risks and uncertainties described below are not the only ones the Company faces. Other events that we do not currently anticipate or that we do not currently deem to be material also affect our results of operations and financial condition.

Continued uncertain economic conditions or reduced investments in technology spending may negatively impact our business.

Our business depends on the overall demand for technology services spending and on the economic health and general willingness of our current and prospective customers to make capital and expense commitments. If the conditions in the U.S. and global economic environment remain uncertain or continue to be volatile, or if they deteriorate further, our business, operating results, and financial condition may be adversely affected. Our customers sell capital goods, some of which are considered luxury in nature, which are highly dependent on the disposable income of end consumers. Weak or volatile economic conditions or a reduction in consumer spending may weaken our customers' demand for eCatalogs, lead management and eCommerce websites, business management software, digital marketing services and other technology-enabled services or their general information technology spending, which would likely harm our business and operating results in a number of ways, including longer sales cycles, potential lower prices for our services, reduced sales and increased churn.

We may become liable to our customers and lose customers if we have defects or disruptions in our service or if we provide poor service.

Because we deliver some of our technology as a service, errors or defects in the software applications underlying our services or a failure of our hosting infrastructure may make our services, in particular our eCommerce services, unavailable to our customers. Since our customers use our eCommerce services to facilitate their sales, any errors, defects, disruptions in service or other performance problems with our services, whether in connection with the day-to-day operation of our services, upgrades or otherwise, could damage our customers' businesses.

Despite the implementation of security measures, the core of our network infrastructure is vulnerable to unauthorized access, computer viruses, equipment failure and other disruptive problems including the following:

- we and our users may experience interruptions in service as a result of the accidental or intentional actions of Internet users, current and former employees or others;
- unauthorized access may jeopardize the security of confidential information stored in our computer systems and our customers' computer systems, which may result in liability to our customers and also may deter potential customers;
- we may face liability for transmitting viruses to third parties that damage or impair their access to computer networks, programs, data or information;
- we may experience a denial-of-service ("DoS") attack in an attempt to make our network unavailable to our customers, typically accomplished by flooding the targeted network with superfluous requests in an attempt to overload systems and prevent some or all legitimate requests from being fulfilled;
- there may be a systemic failure of Internet communications, leading to claims associated with the general unavailability of some of our products; or

- eliminating computer viruses and alleviating other security or technical problems may require interruptions, delays or cessation of service to our customers.

If we have any errors, defects, disruptions in service or other performance problems with our services, customers could elect not to renew, customers could delay or withhold payment to us, we could lose future sales or customers could make claims against us which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or litigation costs.

We may be exposed to risks and costs associated with protecting the integrity and security of our customers' information.

A significant number of customers make purchases from us using credit cards. In order for our business to function successfully, we and other market participants must be able to handle and transmit confidential information, including credit card information, securely. There can be no assurance that in the future we will be able to operate our facilities and our customer service and sales operations in accordance with PCI or other industry recommended practices.

Further, there is increased litigation over personally identifiable information, and we may be subject to one or more claims or lawsuits related to intentional or unintentional exposure of our customer's personally identifiable information. Even if we are compliant with PCI standards, we still may not be able to prevent security breaches involving customer transaction data. Any breach could cause consumers to lose confidence in the security of our websites and choose not to purchase from us. If a computer hacker or other criminal is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Any security breach could expose us to risks of data loss, fines, litigation and liability, and could seriously disrupt our operations and harm our reputation, any of which could adversely affect our business.

In addition, states and the federal government have enacted additional laws and regulations to protect consumers against identity theft, including laws governing treatment of personally identifiable information. We collect and store personal information from consumers in the course of doing business. These laws have increased the costs of doing business, and if we fail to implement appropriate safeguards, or we fail to detect and provide prompt notice of unauthorized access as required by some of these laws, we could be subject to potential claims for damages and other remedies. If we were required to pay any significant amounts in satisfaction of claims under these laws, or if we were forced to cease our business operations for any length of time as a result of our inability to comply fully with any such law, our business, operating results and financial condition could be adversely affected.

Our core markets and verticals are competitive, and if we do not compete effectively, our operating results may be negatively impacted.

The markets for eCatalogs, lead management and eCommerce websites, business management software, digital marketing services and other technology-enabled services targeted at our vertical markets are competitive, and the eCommerce area specifically, is rapidly changing with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to remain intense. In addition, increased competition generally could result in reduced sales, reduced margin or the failure of our services to achieve or maintain more widespread market acceptance. Competition in our market is based principally upon service breadth and functionality; service performance, security and reliability; the ability to tailor and customize services for a specific company, vertical market or industry; ease of use of the service; speed and ease of deployment, integration and configuration; total cost of ownership, including price, implementation costs and support costs; professional services implementation; strength of customer relationships; and financial resources of the vendor. To compete effectively, we also must be able to more frequently update our services to meet market demand.

Our larger principal competitors include Snap-on Business Solutions and PowerSports Network, owned by Dominion Enterprises. Some of our actual and potential competitors enjoy competitive advantages over us such as greater name recognition within our target vertical markets, larger marketing budgets as well as substantially greater financial,

technical and other resources. If we are not able to compete effectively, our operating results will be harmed.

The impact of negative factors on the business may not be immediately reflected in our financial results.

Because we recognize subscription revenue over the term of the applicable agreement, non-renewal of subscriptions or reductions in new service agreements may not be immediately reflected in our operating results. The majority of our revenue in any given period is attributable to service agreements entered into during previous periods. A decline in new or renewed service agreements in any one period will not be fully reflected in our revenue in that period, but will reduce our revenue in future periods. As a result, the effect of significant downturns in sales and market acceptance of our services in a particular period may not be fully reflected in our operating results until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period because revenue from new customers must be recognized over the applicable subscription term.

Our operating results may fluctuate from quarter to quarter.

We expect that a portion of our revenue in the future will be derived from non-recurring fee income, which consists primarily of revenues from professional services such as software customization and training, software sales and one-time network installation fees. The timing of recording of this revenue is dependent upon several factors that we cannot predict. These factors include:

- the time required to close large license fee and development agreements, which can be delayed due to customer requirements and decision-making processes;
- the seasonality of certain sectors of the markets in which we operate;
- delays in the introduction of new products or services and their acceptance by customers; and
- delays in delivering customized software to our customers.

Our costs are not entirely predictable and may vary from quarter-to-quarter due to acquisitions or non-recurring expenditures. Cash flows may also vary from quarter to quarter, depending on the timing of disbursements and customer payments. These fluctuations may make period-to-period comparisons of our results of operations more complex.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and harm our operating results.

A change in accounting standards or practices could harm our operating results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may harm our operating results or the way we conduct our business and may increase our compliance costs.

Our business could suffer if we are unable to protect our intellectual property rights or become liable for infringing on the intellectual property rights of others.

We regard our trademarks, proprietary technology and similar intellectual property as critical to our success, and we rely upon trademark law, trade secret protection and confidentiality and license agreements with our employees, strategic partners and others to protect our proprietary rights, but these measures can have only limited effectiveness. Prevalent use of the Internet has also increased the ease with which third parties can distribute our intellectual property without our authorization.

We intend to pursue the registration of our material trademarks as necessary. We may not be entitled to the benefits of any such registration until such registration takes effect. In addition, effective protection may not be available in every country in which our products are available. Further, we may be subject to claims in the ordinary course of our business, including claims of alleged infringement of the trademarks, copyrights and other intellectual property rights of third parties by us and our licensees.

Other parties may assert claims of infringement of intellectual property or other proprietary rights against us. These claims, even if without merit, could require us to expend significant financial and managerial resources. Furthermore, if claims like this were successful, we might be required to change our trademarks, alter our content, products or services, or pay financial damages, any of which could substantially increase our operating expenses. We also may be required to obtain licenses from others to refine, develop, market and deliver new services. We may be unable to obtain any needed license on commercially reasonable terms or at all, and rights granted under any licenses may not be valid and enforceable. In the future, we could be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of trademarks and other intellectual property

rights of third parties by us and our licensees. Any such claims could have a material adverse effect on our business, financial condition and operating results.

We are dependent on our management and employees.

We are dependent on the services of our executive officers and other key employees. There can be no assurance, however, that we can obtain executives of comparable expertise and commitment in the event of death, disability or voluntary departure of one of our executive officers or other key employees, or that our business would not suffer material adverse effects as the result of the death, disability or voluntary departure. Further, the loss of the services of any one or more of these employees could have an adverse effect on our business. In addition, we will also need to attract and retain other highly skilled technical and managerial personnel for whom competition is intense. If we are unable to do so, our business, results of operations and financial condition could be materially and adversely affected.

Our common stock has had limited trading.

Trading in our common stock has historically been thin. Because of the thinness of the market for our stock, the price of our common stock may be subject to manipulation. This limited trading may adversely affect the liquidity of our common stock, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us. As a result, there could be a larger spread between the bid and the ask prices of our common stock and investors may not be able to sell shares of our common stock when or at prices they desire.

We may not be able to identify, acquire and successfully integrate acquisitions.

A key component of our growth strategy has been and will continue to be acquisitions and other business development opportunities that solidify or accelerate our market position in our core offerings and vertical markets. The successful implementation of this strategy depends upon our ability to identify suitable acquisition candidates, acquire such businesses on acceptable terms, finance the acquisitions and integrate their operations successfully into ARI. There can be no assurance that such candidates will be available or, if such candidates are available, that the price will be attractive or that we will be able to identify, acquire, finance or integrate such businesses successfully. In addition, in pursuing such acquisition opportunities, we may compete with other entities with similar growth strategies; these competitors may be larger and have greater financial and other resources than ARI. Competition for these acquisition targets could also result in increased prices of acquisition targets and/or a diminished pool of companies available for acquisition.

The successful integration of these acquisitions also may involve a number of additional risks, including: (i) the inability to retain the clients of the acquired business; (ii) the lingering effects of poor client relations or service performance by the acquired business, which also may taint our existing business; (iii) the inability to retain the desirable management, key personnel and other employees of the acquired business; (iv) the inability to fully realize the desired efficiencies and economies of scale; (v) the inability to establish, implement or police ARI's existing standards, controls, procedures and policies in the acquired business; (vi) diversion of management attention; and (vii) exposure to client, employee and other legal claims for activities of the acquired business prior to acquisition. In addition, any acquired business could perform significantly worse than expected.

The inability to identify, acquire, finance and successfully integrate acquisitions could have a material adverse effect on ARI or its estimated or desired business, income, growth or other condition and results.

Future acquisitions, financing arrangements or exercise of outstanding options and warrants may result in dilution to existing shareholders.

The timing, size and success of acquisition efforts and any capital commitments cannot be readily predicted. Future acquisitions or investments may be financed by issuing shares of common stock, cash or a combination thereof. To the extent our common stock is used for all or a portion of the consideration to be paid for future acquisitions or investments, shareholders' ownership will be diluted.

We face risks with our international strategy.

Our business strategy includes increasing our presence in markets outside the U.S. This strategy presents a number of risks, including:

- managing more geographically diverse operations;
- dealing with currency fluctuations;
- increased costs of operation;
- only having a small number of employees in these markets;

- our dependence on value-added resellers and contractors to sell and service our products;
- a much smaller and more concentrated current customer base; and
- assumption that U.S. international policy will remain favorable towards the countries in which we sell our products and services.

Our historical losses have resulted in accumulated deficits on the consolidated balance sheet.

While we have been profitable in recent years, we have experienced net losses in numerous fiscal years since our incorporation in 1981. These net losses have resulted in an accumulated deficit of \$86,050,000 as of July 31, 2016. We may not be able to maintain or increase profitability in the future. As a result of these historical losses, our financial position has been weakened, and our ability to finance our growth may be constrained.

Our unused net operating loss carryforwards could become impaired if we do not maintain profitability.

We have federal net operating loss carryforwards (NOLs) of \$2,023,000 as of July 31, 2016. We may not be able to generate sufficient, timely taxable income to utilize these before they expire. As a result, both net income and income tax liabilities could be negatively impacted.

We will require a significant amount of cash to service our indebtedness. Our ability to generate cash depends on certain factors beyond our control.

Our ability to make principal and interest payments on our indebtedness and to fund planned capital expenditures and product development efforts will depend on our ability to generate cash flow in the future. Our future operating performance and financial results will be subject, in part, to factors beyond our control, including dealer bankruptcies in the vertical markets we serve, and general economic, financial and business conditions. We cannot assure that our business will generate sufficient cash flow from operations or that future financing facilities will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs.

If we are unable to generate sufficient cash flow to service our debt, we may be required to:

- refinance all or a portion of our debt or obtain additional financing, neither of which can be assured and may be at terms that are less favorable than our current financing arrangements;
- sell some of our assets or operations;
- reduce or delay capital expenditures, research and development efforts and acquisitions; or
- revise or delay our strategic plans.

If we are required to take any of these actions, it could have a material adverse effect on our business, financial condition and results of operations. In addition, we cannot assure that we would be able to take any of these actions, that these actions would enable us to continue to satisfy our capital requirements or that these actions would be permitted under the terms of our various debt instruments.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties

The table below summarizes ARI's current facilities. Management believes that the Company's current facilities are suitable and sufficient to support present operations.

| Description of Use | Location | Square Footage | Lease Expiration | Country |
|----------------------------------------------------------------------------------|------------------|----------------|------------------|---------------|
| Corporate headquarters; outdoor power equipment, marine and recreational vehicle | Milwaukee, WI | 16,300 | July 2021 | United States |
| Software development | Cypress, CA | 6,000 | July 2020 | United States |
| Aftermarket publishing | Floyds Knobs, IN | 2,200 | April 2017 | United States |
| Automotive aftermarket sales and support | Des Moines, IA | 8,000 | November 2017 | United States |

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| | | | | |
|----------------------------------------------------------------------------------------|-------------------------|--------|---------------|-----------------|
| Powersports, automotive tire and wheel and durable medical equipment sales and support | Duluth, MN | 25,500 | January 2019 | United States |
| Automotive tire and wheel sales and support | Wexford, PA | 1,100 | May 2017 | United States |
| Automotive tire and wheel sales and support | Cookeville, TN | 14,000 | November 2018 | United States |
| Automotive tire and wheel sales and support | Salt Lake City, UT | 2,000 | April 2016 | United States |
| European sales and support | Leiden, The Netherlands | 2,200 | April 2020 | The Netherlands |
| Software development and website implementation | Gurgaon, India | 7,600 | April 2025 | India |

Item 3. Legal Proceedings

None.

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

ARI’s common stock is currently traded on the NASDAQ Capital Market under the symbol “ARIS”. The following table sets forth the high and low sales price for the periods indicated.

| Quarter Ended: | High | Low |
|----------------|---------|---------|
| 10/31/2014 | \$ 3.56 | \$ 2.41 |
| 1/31/2015 | \$ 4.45 | \$ 3.07 |
| 4/30/2015 | \$ 3.99 | \$ 3.01 |
| 7/31/2015 | \$ 3.30 | \$ 2.74 |
| 10/31/2015 | \$ 4.80 | \$ 2.95 |
| 1/31/2016 | \$ 4.82 | \$ 3.33 |
| 4/30/2016 | \$ 4.69 | \$ 3.50 |
| 7/31/2016 | \$ 5.47 | \$ 3.68 |

As of October 21, 2016, there were approximately 2,477 holders of record of ARI common stock. We have not paid cash dividends to date and have no current intention to pay cash dividends. Our ability to make distributions to our shareholders, including cash dividends, is also restricted under the terms of our credit facilities.

During fiscal 2016, the Company did not repurchase any of its equity securities.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our results of operations and financial condition should be read together with our audited consolidated financial statements for fiscal 2016 and fiscal 2015, including the notes thereto, which appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which as previously identified, are subject to the safe harbors created under the Securities Act and Exchange Act.

Overview

In fiscal 2016, ARI achieved record results in revenue, operating income, net income, Adjusted EBITDA and cash flow from operations.

Total revenue increased 17.9%, or \$7,250,000, during fiscal 2016 over fiscal 2015. Recurring revenue increased 20.4% in fiscal 2016, compared to fiscal 2015, and constituted over 90% of our total revenue in both fiscal 2016 and 2015 as the Company continued to see growth in recurring revenue outpacing overall revenue growth. The growth in revenue is primarily attributable to revenue from the DCi, TASC0, and TCS acquisitions during fiscal 2015, and

organic revenue growth.

Our operating income increased 53.2%, or \$1,230,000, from \$2,314,000 during fiscal 2015 to \$3,544,000 during fiscal 2016. Operating expenses increased 14.6%, or \$4,516,000, during fiscal 2016 compared to fiscal 2015, primarily due to the additional costs of our newly-acquired operations and additional expenses due to revenue growth. We continue to see the benefits of scale in our business as operating expenses as a percentage of sales decreased from 76.2% in fiscal 2015 to 74.1% in fiscal 2016.

The Company generated net income of \$1,743,000 or \$0.10 per share during fiscal 2016, compared to \$1,071,000 or \$0.07 per share during fiscal 2015. The increase in both operating and net income is primarily due to (i) operational efficiency improvements; (ii) organic revenue growth; and (iii) the growth in the overall business as a result of the acquisitions, while recognizing cost synergies from the combined businesses.

Cash flow from operations was \$7,725,000 during fiscal 2016, compared to \$6,313,000 during fiscal 2015.

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Revenue

The following table summarizes our revenue by product and by RR and non-recurring revenue:

| | Twelve months ended July 31 | | | | | |
|----------------------------------------|-----------------------------|------------|--|-----------|------------|----------|
| | 2016 | % of Total | | 2015 | % of Total | % Change |
| Lead Generation and eCommerce Websites | \$ 24,028 | 50.4 % | | \$ 22,258 | 55.0 % | 8.0 % |
| eCatalog Services | 17,879 | 37.5 % | | 13,917 | 34.4 % | 28.5 % |
| Business Management Software | 3,051 | 6.4 % | | 1,955 | 4.8 % | 56.1 % |
| Digital Marketing Solutions | 1,934 | 4.1 % | | 1,228 | 3.0 % | 57.5 % |
| Other Revenue | 801 | 1.7 % | | 1,085 | 2.7 % | (26.2)% |
| Total revenue | \$ 47,693 | 100.0 % | | \$ 40,443 | 100.0 % | 17.9 % |
| Recurring revenue | 43,911 | 92.1 % | | 36,483 | 90.2 % | 20.4 % |
| Non-recurring revenue | 3,782 | 7.9 % | | 3,960 | 9.8 % | (4.5) % |
| Total revenue | \$ 47,693 | 100.0 % | | \$ 40,443 | 100.0 % | 17.9 % |

Total revenue increased 17.9% or \$7,250,000 during fiscal 2016, compared to fiscal 2015. Recurring revenue increased 20.4% or \$7,428,000 during fiscal 2016, compared to fiscal 2015, and represented 92.1% of total revenues during fiscal 2016 versus 90.2% during fiscal 2015. The increase in RR as a percentage of total revenue during fiscal 2016 was related to the decrease in revenue related to non-recurring professional services in the period as well as a continued focus of the Company to sell products that generate recurring revenue.

Lead Generation and eCommerce Website Revenue

Our Lead Generation and eCommerce Website solutions generate revenue from one-time set-up and customization fees to develop new dealer websites, which is recognized ratably over the term of the contract, monthly recurring subscription fees and variable transaction fees. Our Lead Generation and eCommerce Website solutions are typically sold as one year, renewable contracts with monthly payment terms. We currently host and maintain more than 7,500 websites for dealers in all of our vertical markets. Lead Generation and eCommerce Website solutions have become ARI's largest source of revenue and accounted for 50.4% of total revenue during fiscal 2016. Lead Generation and eCommerce Website revenue increased 8.0% to \$24,028,000 in fiscal 2016, compared to \$22,258,000 during fiscal 2015. This increase was a result of both organic revenue growth from our historic Lead Generation and eCommerce solutions and revenue from the TCS eCommerce website solution that was acquired in September 2014. We anticipate that our Lead Generation and eCommerce Website platforms will continue to be the Company's largest source of growth from a total revenue perspective, much of this growth coming in the ATW, AAPS and HME markets.

eCatalog Revenue

Our eCatalog solutions generate revenue from renewable subscription fees for our software, data content, software maintenance and support fees and software customization fees. eCatalog is our second largest source of RR, representing 37.5% of total revenue during fiscal 2016. eCatalog revenue increased 28.5% or \$3,962,000 during fiscal 2016, compared to fiscal 2015 primarily as a result of our acquisition of DCi in July 2015. The catalog content provided in our eCatalog solutions helps to drive sales growth in our Lead Generation and eCommerce Website solutions as well, so while eCatalog organic revenue growth is expected to be lower than our other products, it continues to drive growth in other areas of the business. Management expects eCatalog revenue to increase at a low organic growth rate as the Company already has strong market share with this product.

Business Management Software Revenue

Business management software revenue is generated from perpetual one-time license and installation fees for our new business management software, along with recurring maintenance and support fees, as well as hosting fees for our SaaS version. Business management software revenue represented 6.4% of total revenue during fiscal 2016. Business management software revenue increased 56.1% or \$1,096,000 during fiscal 2016 as a result of both organic growth and revenue from TCS and TASC0, which were acquired in September 2014 and April 2015, respectively. Management expects business management software revenue to increase in fiscal 2017 due to organic growth, however, some of this growth depends upon non-recurring perpetual license sales which can be harder to project from a timing perspective.

Digital Marketing Solutions Revenue

Revenues from our Digital Marketing Solutions are generated from set-up fees and subscription fees for our lead generation tools through search engine optimization, social media marketing and website enhancements. We derived 4.1% of our revenues from Digital Marketing Services during fiscal 2016. Digital marketing revenue increased 57.5%, from \$1,228,000 during fiscal 2015 to \$1,934,000 during fiscal 2016, primarily due to organic growth from our existing offerings. Management expects digital marketing revenue to increase as this service offering is a relatively new offering and is complementary to our other products, allowing us to expand within our current markets and current customers.

Other Revenue

We also offer a suite of complementary solutions, which include software, professional services and hosting services. Other revenue, which is primarily non-recurring in nature, represented approximately 1.7% of total revenue, and decreased 38.7%, from \$1,085,000 during fiscal 2015, to \$801,000 during fiscal 2016. The decrease in other revenue is primarily due to a decrease in our professional services revenue. Revenues from non-recurring professional services will fluctuate from period to period based on the timing of custom projects and the Company has intentionally de-emphasized these projects as it focuses more on RR.

Recurring Revenue

RR is one of the most important growth drivers of our business. Increasing the percentage of our revenues that are recurring, while at the same time reducing the rate of customer churn, enhances our ability to generate profitable growth. Our subscription-based SaaS and DaaS products generate higher margins than our non-recurring products and services, and the incremental cost of selling these products to new dealers (we refer to these as new “logos”) is relatively low. Reducing the rate of our customer churn, which is the percentage of RR that does not renew, helps drive organic growth as it allows for a greater percentage of our new logos to be incremental to the top line (versus making up for lost logos) and also increases the base upon which we can apply price increases and sell additional products and features.

We generate RR from each of our primary product categories from monthly license, subscription, maintenance and support fees. RR increased 20.4% from \$36,483,000 during fiscal 2015, to \$43,911,000 during fiscal 2016, primarily attributable to both the addition of RR from our acquisitions in fiscal 2016 and organic growth. We expect Lead Generation and eCommerce Website RR to continue to be our largest contributor to RR growth in fiscal 2017.

Non-recurring Revenue

Non-recurring revenue is generated from one-time perpetual license fees from our business management offerings, certain offerings within the Company's digital marketing services, professional services related to software customization and data conversion, usage fees charged on our RR products, set-up fees and other complementary products and services. Total non-recurring revenue decreased 4.5% from \$3,960,000 during fiscal 2015, to \$3,782,000 during fiscal 2016, primarily due to decreased professional services revenue partially offset by increased perpetual license revenue from software management solutions. Our goal is to maintain non-recurring revenue of less than 10% of total revenue, as the margins on this revenue tends to be lower than our RR products. Furthermore, non-recurring revenue must be resold each year.

Cost of Revenue and Gross Margin

| | Twelve months ended July 31 | | | | | | |
|--------------------------------------------|-----------------------------|--------------|---|-----------|--------------|---|----------|
| | 2016 | % of Revenue | | 2015 | % of Revenue | | % Change |
| Net revenues | \$ 47,693 | | | \$ 40,443 | | | 17.9 % |
| Cost of revenues: | | | | | | | |
| Amortization of capitalized software costs | 2,108 | 4.4 | % | 2,023 | 5.0 | % | 4.2 % |
| Direct labor | 2,840 | 6.0 | % | 2,150 | 5.3 | % | 32.1 % |
| Other direct costs | 3,858 | 8.1 | % | 3,129 | 7.7 | % | 23.3 % |
| Total cost of revenues | 8,806 | 18.5 | % | 7,302 | 18.1 | % | 20.6 % |
| Gross profit | \$ 38,887 | 81.5 | % | \$ 33,141 | 81.9 | % | 17.3 % |

Gross profit was \$38,887,000 or 81.5% of revenue in fiscal 2016, compared to \$33,141,000 or 81.9% of revenue for fiscal 2015. The decrease in gross profit margin was due to investments made to migrate website customers from older platforms that we are no longer actively selling to newer platforms, and an increase in royalty costs as we continue to expand our product offerings.

Amortization of capitalized software costs as a percentage of revenue decreased during fiscal 2016, compared to last year, primarily due to revenue increasing at a faster rate than software capitalization costs in recent years. Direct labor costs as a percentage of revenue increased during fiscal 2016, compared to last year, primarily due to: (i) an increase in our digital marketing revenue, which has higher direct costs than our other products; (ii) an increase in website implementations; and (iii) the migration of customer websites in an effort to consolidate our customers to the product most suited to their industry and consolidate our website platforms. Other direct costs increased as a percentage of revenue during fiscal 2016, compared to fiscal 2015, due to increased third party costs associated with our digital marketing and website add-on offerings and fees paid to outside contractors for assistance with the website migrations and custom professional service projects. The Company expects fluctuations in gross margin from quarter to quarter and year over year based on sales bookings, the mix of products sold, and the nature of any ongoing website platform migrations.

Operating Expenses

We categorize net operating expenses as follows:

- Sales and marketing expenses consist primarily of personnel and related costs, including commissions for our sales and marketing employees and the cost of marketing programs and trade show attendance.
- Customer operations and support expenses are composed of our computer hosting operations, software maintenance agreements for our core network and personnel and related costs for operations and support employees.
 - Software development and technical support expenses are composed primarily of personnel and related costs; we capitalize certain of these costs in accordance with GAAP, which is discussed below, while the remaining costs are primarily related to technical support and research and development.
- General and administrative expenses primarily consist of personnel and related costs for executive, finance, human resources and administrative personnel, legal and other professional fees and other corporate expenses and overhead.
- Depreciation and amortization expenses consist of depreciation on fixed assets, which are composed of leasehold improvements and information technology assets, and the amortization of acquisition-related intangible assets. Costs associated with the amortization of software products are a component of cost of revenue.
- We allocate certain shared costs among the various net operating expense classifications. Allocated costs include facilities, insurance, internal software and telecommunications. These costs are generally allocated based on headcount, unless circumstances dictate otherwise. All public company costs, including legal and accounting fees, investor relations costs, board fees and directors and officers liability insurance, remain in general and administrative.

The following table summarizes our operating expenses by expense category (in thousands):

| | Twelve months ended July 31 | | | | | |
|--------------------------------------------|-----------------------------|--------------|-----------|--------------|----------|--|
| | 2016 | % of Revenue | 2015 | % of Revenue | % Change | |
| Sales and marketing | \$ 10,847 | 22.7 % | \$ 10,427 | 25.8 % | 4.0 % | |
| Customer operations and support | 9,940 | 20.8 % | 7,811 | 19.3 % | 27.3 % | |
| Software development and technical support | 5,093 | 10.7 % | 4,199 | 10.4 % | 21.3 % | |
| General and administrative | 7,056 | 14.8 % | 6,634 | 16.4 % | 6.4 % | |
| Depreciation and amortization (1) | 2,407 | 5.0 % | 1,756 | 4.3 % | 37.1 % | |
| Net operating expenses | \$ 35,343 | 74.1 % | \$ 30,827 | 76.2 % | 14.6 % | |

(1) Exclusive of amortization of software product costs of \$2,108 and \$2,023 for the twelve months ended July 31, 2016 and 2015, respectively, which are included in cost of revenue

Net operating expenses increased 14.6% or \$4,516,000 during fiscal 2016, compared to fiscal 2015. The Company acquired the net assets of TCS in September 2014, the net assets of TASC0 in April 2015 and the net assets of DCi in July 2015. The increase in net operating expenses was primarily due to the costs necessary to operate the acquired businesses for a full 12 months in fiscal 2016, as compared to the TCS office for only 10 months, the TASC0 office for 3 months and the DCi office for part of July in fiscal 2015. Net operating expenses as a percentage of sales decreased from 76.2% in fiscal 2015 to 74.1% in fiscal 2016. This is primarily a result of operational efficiencies and revenue growth. To the extent the Company can leverage growth in its core RR products, management expects net operating expenses to decline as a percentage of total revenues, as incremental costs related to these products decrease for every dollar of new revenue.

Sales and Marketing

Sales and marketing expense increased 4.0% or \$420,000 during fiscal 2016, compared to fiscal 2015. The increase was primarily a result of the cost of the sales staff associated with the DCi operation. Sales and marketing expense as a percentage of revenue decreased from 25.8% of revenue in fiscal 2015 to 22.7% for the same period in fiscal 2016. This decrease is due to the growth in our RR base, which requires much less resources to renew. Management expects sales and marketing expense as a percentage of revenue to be flat or down as RR continues to grow.

Customer Operations and Support

Customer operations and support expense increased 27.3% or \$2,129,000 during fiscal 2016, compared to fiscal 2015, and as a percentage of revenue increased from 19.3% of revenue during fiscal 2015 to 20.8% during fiscal 2016. The customer operations and support functions of an acquired business typically take longer to fully integrate due to merging software platforms, help desks and customer hosting systems in order to operate more efficiently. Management expects customer operations and support expenses to decline as a percentage of revenue over time, to the extent we continue to integrate these areas into our operations and we supplement labor capacity in our India office, while RR continues to grow.

Software Development and Technical Support

Our software development and technical support staff have three essential responsibilities for which the accounting treatment varies depending upon the work performed: (i) costs associated with internal software development efforts (after technological feasibility is established) are capitalized as software product costs and amortized over the estimated useful lives of the product; (ii) costs for professional services performed for customers related to software customization projects are classified as cost of revenue; and (iii) all other activities, including research and development, are considered operating expenses and included within the software development and technical support operating expense category.

Software development and technical support costs increased 21.3% or \$894,000 during fiscal 2016 versus fiscal 2015, primarily due to the additional development staff associated with the TCS products and additional capacity related to the Company's continued focus to reduce churn. During fiscal 2016, we capitalized \$1,302,000 of software development labor, overhead and interest expense, versus \$1,091,000 during fiscal 2015. In addition to internal capitalized software costs, we had outsourced development costs of \$478,000 during fiscal 2016 and \$320,000 during fiscal 2015. We devoted much of these resources to a major upgrade of our website products during fiscal 2016.

We expect fluctuations in the percentage of software development and technical support costs classified as operating expenses from period-to-period, based on the mix of research and prototype work versus capitalized software development and professional services activities.

General and Administrative

General and administrative expense increased 6.4% or \$422,000 during fiscal 2016, compared to fiscal 2015. The increase was primarily a result of additional headcount from the TCS and DCi acquisitions. General and administrative expense as a percentage of revenue decreased from 16.4% of revenue for fiscal 2015 to 14.8% for the same period in fiscal 2016. Management expects general and administrative expense as a percentage of revenue to decrease over time as we continue to scale the business, although additional acquisitions or other transactions could result in elevated general and administrative expense in future periods.

Other Income and Expense

The table below summarizes the components of other income and expenses for fiscal 2016 and fiscal 2015 (in thousands):

| | Twelve months ended July 31 | | |
|------------------------------|-----------------------------|----------|----------|
| | | | % |
| | 2016 | 2015 | Change |
| Interest expense | \$ (460) | \$ (465) | (1.1) % |
| Other, net | 10 | 33 | (69.7) % |
| Total other income (expense) | \$ (450) | \$ (432) | 4.2 % |

Interest expense is composed of both interest paid on the Company's debt financing arrangements and amortization of non-cash interest charges related to deferred finance costs and imputed interest on contingent liabilities. Interest expense remained relatively unchanged in fiscal 2016 as compared to 2015. This is a result of the Company continuing to pay down outstanding debt balances partially offset by an increase in the Prime Rate of interest. The Company expects interest expense to decrease in fiscal 2017, compared to fiscal 2016, due to the continued pay down of outstanding debt.

Adjusted EBITDA

EBITDA is calculated as net income adjusted to exclude interest expense, amortization, depreciation and income tax expense. Adjusted EBITDA further eliminates non-cash, stock-based compensation expense. Management believes Adjusted EBITDA is helpful in understanding period-over-period operating results separate and apart from non-operating expenses and expenses pertaining to prior period investing activities, particularly given the Company's significant investments in capitalized software and its continuing efforts in completing acquisitions, which typically result in significant non-cash depreciation and amortization expense in subsequent periods. However, Adjusted EBITDA has significant limitations as an analytical tool and should only be used cautiously in addition to, and never as a substitute for, operating income, cash flows or other measures of financial performance prepared in accordance with generally accepted accounting principles and may not necessarily be comparable to similarly titled measures of other companies.

The table below presents the reconciliation of net income to EBITDA and Adjusted EBITDA for fiscal 2016 and fiscal 2015 (in thousands):

| | Twelve months ended July | |
|----------------------------------------|--------------------------|-----------|
| | 31 | |
| | 2016 | 2015 |
| Net income | \$ 1,743 | \$ 1,071 |
| Interest expense | 460 | 465 |
| Amortization included in cost of sales | 2,108 | 2,023 |
| Depreciation and amortization | 2,407 | 1,756 |
| Income tax expense | 1,351 | 811 |
| EBITDA | \$ 8,069 | \$ 6,126 |
| Stock-based compensation expense | 427 | 446 |
| Adjusted EBITDA | \$ 8,496 | \$ 6,572 |
| Revenue | \$ 47,693 | \$ 40,443 |
| Adjusted EBITDA as a % of revenue | 17.8 % | 16.3 % |

Adjusted EBITDA increased 29.3%, from \$6,572,000 during fiscal 2015 to \$8,496,000 during fiscal 2016. Adjusted EBITDA as a percentage of revenue increased from 16.3% during fiscal 2015 to 17.8% during fiscal 2016. The increase was primarily due to the improvement in operating income and an increase in depreciation and amortization expense. Management expects Adjusted EBITDA to increase in fiscal 2016, to the extent earnings continue to increase as a result of RR growth.

Acquisitions

On July 13, 2015, the Company acquired substantially all of the assets of DCi, a leading provider of differentiated product content and electronic catalog software serving manufacturers, distributors, jobbers and independent retailers

in the AAPS. Consideration for the acquisition included: (i) a cash payment equal to \$3,750,000; (ii) 159,795 shares of the Company's common stock; and (iii) the issuance of a promissory note in principal amount of \$2,000,000 to DCi. The principal amount of the DCi note was reduced by approximately \$64,000 as a result of post-closing adjustments to the estimated valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement.

On April 27, 2015, the Company acquired substantially all of the assets of TASCOCORPORATION and its affiliated company Signal Extraprise Corporation (collectively "TASCOCORPORATION"), a leading provider of business management software designed exclusively for the automotive tire and wheel aftermarket industry. Consideration for the acquisition included: (i) a cash payment at the closing of the transaction equal to \$1,750,000, which was funded through a borrowing on the Company's revolving credit facility; (ii) 242,424 shares of the Company's common stock; and (iii) a \$200,000 holdback payable on April 27, 2016. In October 2015, the holdback amount was reduced by approximately \$62,000 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement.

On September 30, 2014, the Company acquired substantially all of the assets of TCS, a leading provider of software, websites and digital marketing solutions designed exclusively for dealers, wholesalers, retreaders and manufacturers within the automotive tire and wheel industries. Consideration for the acquisition included (i) a cash payment equal to \$4,200,000; (ii) 618,744 shares of the Company's common stock; (iii) the issuance of two promissory notes in aggregate principal amount of \$2,933,000 (as adjusted) to the former owners of TCS; and (iv) a contingent earn-out purchase price contingent upon the attainment of specific revenue goals over the first three years following the acquisition. The earn-out, with an original fair value of \$711,000, was amended in March 2016 to four quarterly payments of \$120,905, which commenced in December 2015, followed by four quarterly payments of \$70,000 to commence in December 2016.

The Company's strategy is to integrate the sales teams from acquisitions as quickly as possible in order to realize cross selling synergies. As a result, we do not track revenues and costs specific to the individual acquired businesses.

Income Taxes

The Company has net deferred tax assets of \$4,294,000 as of July 31, 2016, primarily consisting of net operating loss carryforwards ("NOLs") and book-to-tax temporary differences. Income tax expense is provided for at the applicable statutory tax rate applied to current U.S. income before taxes, plus or minus any adjustments to the deferred tax assets and to the estimated valuation allowance against deferred tax assets. Income tax expense does not represent a significant current cash obligation, as we continue to have NOLs to offset substantially all of the taxable income.

We had income tax expense of \$1,351,000 during fiscal 2016, compared to \$811,000 during fiscal 2015. We paid income taxes of \$46,000 and \$64,000 during fiscal 2016 and 2015, respectively, primarily related to state income taxes and federal statutory alternative minimum taxes. Income tax expense may vary from period to period as we continue to evaluate the valuation allowance against net deferred tax assets.

We also have NOLs related to tax losses incurred by both our Netherlands and India operations. We have determined that, consistent with prior periods, it is not likely that the net operating losses will be utilized and therefore, a full valuation allowance is recorded, resulting in \$0 net deferred tax assets related to the Netherlands and India operations at July 31, 2016 and 2015.

Liquidity and Capital Resources

The following table sets forth, for the periods indicated, certain cash flow information derived from our consolidated financial statements (in thousands):

| | Twelve months ended July 31 | | |
|----------------------------------------------------------|-----------------------------|----------|----------|
| | 2016 | 2015 | Change |
| Net cash provided by operating activities | \$ 7,725 | \$ 6,313 | \$ 1,412 |
| Net cash used in investing activities | (3,496) | (11,942) | 8,446 |
| Net cash provided by (used in) financing activities | (1,381) | 6,127 | (7,508) |
| Effect of foreign currency exchange rate changes on cash | (14) | (22) | 8 |
| Net change in cash | \$ 2,834 | \$ 476 | \$ 2,358 |
| Cash at end of period | \$ 5,118 | \$ 2,284 | \$ 2,834 |

We generated \$2,834,000 of net cash during fiscal 2016, compared to the \$476,000 during fiscal 2015. We generated net cash from operating activities of \$7,725,000 during fiscal 2016 compared to \$6,313,000 during fiscal 2015. This increase in cash generated from operations was primarily due to increased pre-tax profitability, and higher non-cash depreciation and amortization expense as a result of our acquisitions in fiscal 2015.

Cash used in investing activities decreased \$8,446,000 during fiscal 2016, compared to fiscal 2015. During fiscal 2015, we paid cash of \$4,200,000 as consideration for the TCS acquisition, \$1,750,000 as consideration for the TASCOS acquisition and \$3,750,000 as consideration for the DCi acquisition, while we had no acquisitions in fiscal 2016. These decreases were partially offset by increased investment in equipment and software development costs as we upgraded the equipment in our data centers, built out our India office, invested in an enterprise CRM system and invested more heavily in product improvements. We will continue to invest cash in the business to further our growth strategies previously discussed.

Net cash used in financing activities was \$1,381,000 during fiscal 2016, as the Company made payments on its outstanding debt. Net cash provided by financing activities was \$6,127,000 in fiscal 2015 as the Company increased its senior debt, as described below, to partially fund the TCS acquisition in September 2014, and generated \$4,756,000 from the sale of the Company's common stock pursuant to an underwritten offering.

On May 12, 2015, the Company completed an underwritten offering pursuant to which it sold 1,760,000 shares of its common stock at a price to the public of \$3.00 per share. The Company received net proceeds of approximately \$4,686,300 from the sale, after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company. The Company used a portion of the net proceeds to fund the DCi acquisition and a portion to repay its outstanding line of credit balance of \$1,750,000 incurred in connection with its April 2015 acquisition of TASC0 (thus making the line of credit fully available for future transactions).

The Company borrowed an additional \$2.1 million on the Silicon Valley Bank ("SVB") term note and \$1.5 million on the SVB revolving credit line (each as described below) to partially fund its acquisition of TCS on September 30, 2014. The balance on the revolving credit line was subsequently repaid by the Company. The Company also issued two promissory notes in the aggregate principal amount of \$3,000,000 in connection with the TCS acquisition and one promissory note in the principal amount of \$2,000,000 in connection with the DCi acquisition.

Management believes that current cash balances and its ability to generate cash from operations are sufficient to fund our needs over the next twelve months, although additional financing may be necessary if the Company were to complete a material acquisition or to make a large investment in its business.

Debt

The Company has a Loan and Security Agreement (the “Agreement”) with SVB, pursuant to which SVB extended to the Company credit facilities consisting of a \$3,000,000 revolving credit facility with a maturity date of November 30, 2016 and a \$6,050,000 term loan with a maturity date of September 30, 2019. In addition to this, the Company has issued several promissory notes in connection with its acquisitions. See Note 4 to the consolidated financial statements for further details.

The following table summarizes the Company’s outstanding debt obligations as of July 31, 2016 (in thousands):

| Fiscal year ending July 31: | SVB | | DCi Notes | Total Notes Payable |
|-----------------------------|-----------|-----------|-----------|---------------------|
| | Term Note | TCS Notes | | |
| 2017 | \$ 832 | \$ 965 | \$ 621 | \$ 2,418 |
| 2018 | 1,134 | 1,014 | 645 | 2,793 |
| 2019 | 1,211 | 261 | 670 | 2,142 |
| 2020 | 1,815 | — | — | 1,815 |
| | \$ 4,992 | \$ 2,240 | \$ 1,936 | \$ 9,168 |

Leases

We lease office space and certain office equipment under capital and operating lease arrangements expiring through 2021. See Note 8 to the consolidated financial statements for further details. The following table shows our remaining obligations under these arrangements as of July 31, 2016 (in thousands):

| Fiscal Year Ending July 31: | Capital Leases | Operating Leases |
|----------------------------------|----------------|------------------|
| 2017 | \$ 58 | \$ 1,101 |
| 2018 | 50 | 1,004 |
| 2019 | 17 | 726 |
| 2020 | — | 473 |
| 2021 | — | 364 |
| Thereafter | — | — |
| Total minimum lease payments | 125 | 3,668 |
| Less amounts related to interest | (12) | — |
| Net minimum lease payments | \$ 113 | \$ 3,668 |

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformance with GAAP requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and results of operations, and which require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified as the most critical accounting policies and judgments those addressed below. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions that are significant to understanding our results. For additional information, refer to Note 1 of the consolidated financial statements, which appear elsewhere within this report on Form 10-K. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information currently available. Actual results may differ significantly from these estimates under different assumptions, judgments or conditions.

Revenue Recognition

Revenues from subscription fees for use of our software, access to our catalog content and software maintenance and support fees are all recognized ratably over the contractual term of the arrangement. The Company accounts for delivered elements in accordance with the selling price when arrangements include multiple product components or other elements and vendor-specific objective evidence exists for the value of all undelivered elements. Revenue on undelivered elements is recognized when the elements are delivered. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

For software license arrangements that do not require significant modification or customization of the underlying software, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is probable.

Revenues for professional services to customize complex features and functionality in a product's base software code or develop complex interfaces within a customer's environment are recognized as the services are performed if they are determined to have stand-alone value to the customer or if all of following conditions are met (i) the customer has a contractual right to take possession of the software; (ii) the customer will not incur significant penalty if it exercises this right; and (iii) it is feasible for the customer to either run the software on its own hardware or contract with another unrelated party to host the software. When the current estimates of total contract revenue for professional services and the total related costs indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined. Professional service revenues for set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of the arrangement, are recognized over the term of the contract.

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within thirty (30) days from the invoice date. Payments of trade receivables are allocated to the specific invoices identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of trade receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews receivable balances based on an assessment of current creditworthiness and estimates the portion of the balance that will not be collected. The allowance for potential doubtful accounts is reflected as an offset to trade receivables in the accompanying balance sheets.

Deferred Income Taxes

The tax effect of the temporary differences between the book and tax basis of assets and liabilities and the estimated tax benefit from tax net operating losses is reported as deferred tax assets and liabilities in the consolidated balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed periodically. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as a valuation allowance is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance

during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the statement of income. Future events that could have a material impact on the valuation allowance include, but are not limited to, acquisitions, triggering a limitation of use under Section 382 of the Internal Revenue Code and changes in tax legislation.

Stock-Based Compensation

We use the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. As stock-based compensation expense recognized in our results of operations is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures, which were estimated based on our historical experience. Management reviews the critical assumptions used in the Black-Scholes model each quarter and adjusts those assumptions when necessary.

Goodwill and Other Intangible Assets

As fully described in Note 1 to the consolidated financial statements, we annually review the carrying value of goodwill to determine whether an impairment may exist. We determined that there is a single reporting unit for the purpose of goodwill impairment testing. We estimate the fair value of the reporting unit using various valuation techniques, with our primary techniques being a discounted cash flow valuation and control premium adjusted market capitalization. There are many estimates and assumptions involved in preparing a discounted cash flow analysis, including estimating future operating results, selecting a weighted average cost of capital to discount estimated future cash flows, anticipated long-term growth rates and future profit margins.

Estimating the fair value of a reporting unit is an inherently subjective process. Changes in assumptions, estimates, and other inputs could result in the indication of potential impairment of a portion of the recorded goodwill. Management believes the assumptions, estimates and other inputs used reflect our best efforts and are appropriate for valuing the reporting unit. Our goodwill impairment test indicated that goodwill was not impaired in fiscal 2016 or fiscal 2015.

Impairment tests are also performed for those intangible assets with estimable useful lives if circumstances indicate that an impairment event may have occurred.

Quarterly Financial Data

The following table sets forth the unaudited results of operations for each of the eight quarterly periods ended July 31, 2016, prepared on a basis consistent with the audited financial statements, reflecting all normal recurring adjustments that are considered necessary. The quarterly information is as follows (in thousands, except per share data):

| | 1st Quarter | | 2nd Quarter | | 3rd Quarter | | 4th Quarter | |
|------------------------------------------------|-------------|----------|-------------|-----------|-------------|-----------|-------------|-----------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Net revenues | \$ 11,737 | \$ 9,112 | \$ 11,752 | \$ 10,139 | \$ 11,984 | \$ 10,280 | \$ 12,220 | \$ 10,912 |
| Gross margin | \$ 9,668 | \$ 7,363 | \$ 9,688 | \$ 8,277 | \$ 9,650 | \$ 8,500 | \$ 9,881 | \$ 9,001 |
| Net income (loss) | \$ 389 | \$ 104 | \$ 448 | \$ 260 | \$ 448 | \$ 339 | \$ 458 | \$ 368 |
| Basic and diluted net income per common share: | | | | | | | | |
| Basic | \$ 0.02 | \$ 0.01 | \$ 0.03 | \$ 0.02 | \$ 0.03 | \$ 0.02 | \$ 0.03 | \$ 0.02 |
| Diluted | \$ 0.02 | \$ 0.01 | \$ 0.03 | \$ 0.02 | \$ 0.03 | \$ 0.02 | \$ 0.03 | \$ 0.02 |

Off-Balance Sheet Arrangements

ARI has no significant off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on its financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 (the "Exchange Act"), and are not required to provide the information under this item.

Item 8. Financial Statements and Supplementary Data

Reference is made to the consolidated financial statements, the reports thereon and the notes thereto commencing after the signature page of this Report, which are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, as amended, is recorded, processed, summarized and reported within the required time periods and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

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As required by Rule 13a-15 under the Exchange Act, we have completed an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness and the design and operation of our disclosure controls and procedures as of July 31, 2016. Based upon this evaluation, our management, including the Chief Executive Officer and the Chief Financial Officer, has concluded that our disclosure controls and procedures were effective as of July 31, 2016.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and the Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control over Financial Reporting – Guidance for Smaller Public Companies issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under this framework, our management concluded that our internal control over financial reporting was effective as of July 31, 2016.

This Annual Report on Form 10-K does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Internal control over financial reporting was not subject to attestation by our independent registered public accounting firm based on our status as a non-accelerated filer. We are required to provide only management's report in this Annual Report on Form 10-K.

Changes in Internal Controls

There were no changes to the Company's internal control over financial reporting during the year ended July 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include, but are not limited to, the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers, and Corporate Governance

Information required by Item 10 of Part III will be included in our Proxy Statement relating to our Fiscal 2016 Annual Meeting of Shareholders and is incorporated herein by reference, with the exception of information relating to the Company's executive officers, which is set forth in Part I of this report.

Item 11. Executive Compensation

Information required by Item 11 of Part III will be included in our Proxy Statement relating to our Fiscal 2016 Annual Meeting of Shareholders, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by Item 12 of Part III will be included in our Proxy Statement relating to our Fiscal 2016 Annual Meeting of Shareholders, and is incorporated herein by reference.

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Item 13. Certain Relationships, Related Transactions, and Director Independence

Information required by Item 13 of Part III will be included in our Proxy Statement relating to our Fiscal 2016 Annual Meeting of Shareholders, and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information required by Item 14 of Part III will be included in our Proxy Statement relating to our Fiscal 2016 Annual Meeting of Shareholders, and is incorporated herein by reference.

PART IV

Item 15. Exhibits

- 2.1 Asset Purchase Agreement, dated September 30, 2014, by and among ARI Network Services, Inc., Tire Company Solutions, LLC, Barry Reese and Kenny Pratt, incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 2, 2014.
- 2.2 First Amendment to the Asset Purchase Agreement dated as of March 7, 2016, by and among ARI Network Services, Inc., BK Holdings, LLC (f/k/a Tire Company Solutions, LLC), Barry Reese and Kenny Pratt, incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended January 31, 2016.
- 2.3 Asset Purchase Agreement dated August 17, 2012 by and among ARI Network Services, Inc., Ready2Ride, Incorporated, Jamie Amy-Longacre and Ronald L. Longacre, Jr., incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on August 23, 2012.
- 2.4 First Amendment to Asset Purchase Agreement by and among ARI Network Services, Inc., RJ Longacre, Inc., Jamie Amy-Longacre and Ronald R. Longacre, Jr., dated as of October 22, 2013, incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2013.
- 2.5 Asset Purchase Agreement, dated July 13, 2015, by and among ARI Network Services, Inc., Direct Communications, Incorporated, et al., incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on July 14, 2015.
- 3.1 Articles of Incorporation of the Company, as amended, incorporated herein by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 1999.
- 3.2 Articles of Amendment of the Company, incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on August 18, 2003.
- 3.3 By-laws of the Company incorporated herein by reference to Exhibit 3.1 of the Company's Registration Statement on Form S-1 (Reg. No. 33-43148).
- 4.1 Form of Subordinated Promissory Note, dated September 30, 2014, incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on October 2, 2014.
- 4.2 Form of Common Stock Purchase Warrant dated March 15, 2013, incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on March 18, 2013.
- 4.3 Form of First Amendment to Common Stock Purchase Warrant, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 31, 2013.
- 4.4 Unsecured Non-Negotiable Subordinated Promissory Note, dated July 13, 2015, made by ARI Network Services, Inc. in favor of Direct Communications, Incorporated, incorporated by reference to Exhibit 5.1 to the

- Company's Current Report on Form 8-K filed on July 14, 2015.
- 10.1 Form of Securities Purchase Agreement dated March 12, 2013, between ARI Network Services, Inc. and the Purchasers identified therein, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 18, 2013.
- 10.2* Summary of Executive Bonus Arrangements (Fiscal 2016).
- 10.3* Amended and Restated Employment Agreement, executed as of October 31, 2011, between Roy W. Olivier and ARI Network Services, Inc., incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 4, 2011.
- 10.4* First Amendment to Amended and Restated Employment Agreement, dated February 5, 2015, between Roy W. Olivier and ARI Network Services, Inc., incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 9, 2015.
- 10.5* Second Amendment to Amended and Restated Employment Agreement, dated October 9, 2015, between Roy W. Olivier and ARI Network Services, Inc., incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 15, 2015.
- 10.6* Second Amendment to Change of Control Agreement, dated October 31, 2011, between Roy W. Olivier and ARI Network Services, Inc., incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 4, 2011.
- 10.7 Loan and Security Agreement dated as of April 26, 2013 among Silicon Valley Bank, ARI Network Services, Inc. and Project Viking II Acquisition, Inc., incorporated by reference to Exhibit 10.1 to the Company Form 8-K filed on April 29, 2013.
- 10.8 First Loan Modification Agreement, dated September 30, 2014, by and among Silicon Valley Bank, ARI Network Services, Inc. and Project Viking II Acquisition, Inc., incorporated by reference to the Company's Current Report on Form 8-K filed on October 2, 2014.
- 10.9* Employment Agreement by and between William A. Nurthen and ARI Network Services, Inc., incorporated by reference to the Company's Current Report on Form 8-K filed on November 22, 2013.
- 10.10* Change of Control Agreement between ARI Network Services, Inc. and William A. Nurthen, incorporated by reference to the Company's Current Report on Form 8-K filed on November 22, 2013.
- 10.11* ARI Network Services, Inc. 2000 Employee Stock Purchase Plan, as amended, incorporated by reference to the Company's Current Report on Form 8-K filed on January 8, 2014.

- 10.12* ARI Network Services, Inc. 2000 Stock Option Plan, amended April 15 2014, incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report for the quarter ended April 30, 2014.
- 10.13* ARI Network Services, Inc. 2010 Equity Incentive Plan, amended April 15, 2014, incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report for the quarter ended April 30, 2014.
- 10.14* Form of 2010 Equity Incentive Plan Restricted Stock Award Agreement, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 9, 2015.
- 21.1 Subsidiaries of the Company.
- 23.1 Consent of Wipfli LLP.
- 24.1 Powers of Attorney appear on the signature page hereof.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

* Indicates Management Contract or Compensatory Plan or Agreement.

SIGNATURES

Pursuant to the requirements of Section 15 or 15(d) of the Securities Exchange Act of 1934, this report has been signed on its behalf by the undersigned, thereunto duly authorized, on this 28th day of October, 2016.

ARI NETWORK SERVICES, INC.

By: /s/ Roy W. Olivier

Roy W. Olivier

President and Chief Executive Officer

(Principal Executive Officer)

By: /s/ William A. Nurthen

William A. Nurthen

Vice President of Finance and Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Roy W. Olivier and William A. Nurthen, his true and lawful attorney-in-fact and agent with full power of substitution and resubstitution, for him and his name, place and stead, in any and all capacities, to sign any and all amendments to this report and to file the same with all exhibits thereto, and other documents in connection therewith, with the Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each act and thing requisite and necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Roy W. Olivier October 28, 2016
Roy W. Olivier
Director

/s/ William H. Luden, III October 28, 2016
William H. Luden, III
Chairman of the Board

/s/ William C. Mortimore October 28, 2016
William C. Mortimore
Director

/s/ P. Lee Poseidon October 28, 2016
P. Lee Poseidon
Director

/s/ Robert Y, Newell, IV October 28, 2016
Robert Y, Newell, IV
Director

/s/ Chad J. Cooper October 28, 2016
Chad J. Cooper
Director

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

ARI Network Services, Inc.

We have audited the accompanying consolidated balance sheets of ARI Network Services, Inc. and its Subsidiaries (“the Company”) as of July 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income (loss), shareholders’ equity and cash flows for each of the years in the two-year period ended July 31, 2016. The Company’s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the two-year period ended July 31, 2016, in conformity with accounting principles generally accepted in the United States.

/s/ Wipfli LLP

Minneapolis, MN

October 28, 2016

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ARI Network Services, Inc.
 Consolidated Balance Sheets
 (Dollars in Thousands, Except per Share Data)

| | July 31 2016 | July 31 2015 |
|--------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 5,118 | \$ 2,284 |
| Trade receivables, less allowance for doubtful accounts of \$211 and \$372 at July 31, 2016 and 2015, respectively | 1,942 | 2,046 |
| Work in process | 132 | 165 |
| Prepaid expenses and other | 781 | 820 |
| Deferred income taxes | 3,182 | 3,092 |
| Total current assets | 11,155 | 8,407 |
| Equipment and leasehold improvements: | | |
| Computer equipment and software for internal use | 3,575 | 2,800 |
| Leasehold improvements | 639 | 629 |
| Furniture and equipment | 2,544 | 2,981 |
| Total equipment and leasehold improvements | 6,758 | 6,410 |
| Less accumulated depreciation and amortization | (4,237) | (3,989) |
| Net equipment and leasehold improvements | 2,521 | 2,421 |
| Capitalized software product costs: | | |
| Amounts capitalized for software product costs | 24,774 | 25,463 |
| Less accumulated amortization | (19,743) | (20,337) |
| Net capitalized software product costs | 5,031 | 5,126 |
| Deferred income taxes | 1,112 | 2,398 |
| Other intangible assets | 7,890 | 10,116 |
| Goodwill | 21,634 | 21,168 |
| Total non-current assets | 38,188 | 41,229 |
| Total assets | \$ 49,343 | \$ 49,636 |
| LIABILITIES | | |
| Current portion of long-term debt | \$ 2,417 | \$ 1,338 |
| Current portion of contingent liabilities | 331 | 754 |
| Accounts payable | 718 | 708 |
| Deferred revenue | 6,763 | 7,327 |
| Accrued payroll and related liabilities | 1,817 | 1,752 |
| Accrued sales, use and income taxes | 297 | 140 |
| Other accrued liabilities | 677 | 748 |
| Current portion of capital lease obligations | 50 | 174 |
| Total current liabilities | 13,070 | 12,941 |
| Long-term debt | 6,658 | 9,079 |
| Long-term portion of contingent liabilities | 60 | 362 |
| Capital lease obligations | 63 | 106 |
| Other long-term liabilities | 166 | 199 |
| Total non-current liabilities | 6,947 | 9,746 |

| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| Total liabilities | 20,017 | 22,687 |
| SHAREHOLDERS' EQUITY | | |
| Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at July 31, 2016 and 2015, respectively | — | — |
| Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at July 31, 2016 and 2015, respectively | — | — |
| Common stock, par value \$.001 per share, 25,000,000 shares authorized; 17,310,763 and 17,097,426 shares issued and outstanding at July 31, 2016 and 2015, respectively | 17 | 17 |
| Additional paid-in capital | 115,364 | 114,700 |
| Accumulated deficit | (86,050) | (87,793) |
| Other accumulated comprehensive income | (5) | 25 |
| Total shareholders' equity | 29,326 | 26,949 |
| Total liabilities and shareholders' equity | \$ 49,343 | \$ 49,636 |

See accompanying notes

ARI Network Services, Inc.
Consolidated Statements of Operations
(Dollars in Thousands, Except per Share Data)

| | Twelve months ended July 31 | |
|-----------------------------------------------------------------------------------------------------------------|--------------------------------|-----------|
| | 2016 | 2015 |
| Net revenue | \$ 47,693 | \$ 40,443 |
| Cost of revenue | 8,806 | 7,302 |
| Gross profit | 38,887 | 33,141 |
| Operating expenses: | | |
| Sales and marketing | 10,847 | 10,427 |
| Customer operations and support | 9,940 | 7,811 |
| Software development and technical support (net of capitalized software product costs) | 5,093 | 4,199 |
| General and administrative | 7,056 | 6,634 |
| Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue) | 2,407 | 1,756 |
| Net operating expenses | 35,343 | 30,827 |
| Operating income | 3,544 | 2,314 |
| Other income (expense): | | |
| Interest expense | (460) | (465) |
| Other, net | 10 | 33 |
| Total other income (expense) | (450) | (432) |
| Income before provision for income tax | 3,094 | 1,882 |
| Income tax expense | (1,351) | (811) |
| Net income | \$ 1,743 | \$ 1,071 |
| Weighted average common shares outstanding: | | |
| Basic | 17,218 | 14,849 |
| Diluted | 17,710 | 15,279 |
| Net income per common share: | | |
| Basic | \$ 0.10 | \$ 0.07 |
| Diluted | \$ 0.10 | \$ 0.07 |

See accompanying notes

Consolidated Statements of Comprehensive Income
(Dollars in Thousands)

Twelve months
ended July 31
2016 2015

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| | | |
|------------------------------------------------|----------|----------|
| Net income | \$ 1,743 | \$ 1,071 |
| Other comprehensive income (loss), net of tax: | | |
| Foreign currency translation adjustments | (30) | 46 |
| Total other comprehensive income (loss) | (30) | 46 |
| Comprehensive income | \$ 1,713 | \$ 1,117 |

See accompanying notes

ARI Network Services, Inc.

Consolidated Statements of Shareholders' Equity

(Dollars in Thousands)

| | Common Stock Shares Issued and Outstanding | Par Value | Paid-in Capital | Accumulated Deficit | Other Accumulated Comprehensive Income (Loss) | Total Shareholders' Equity |
|-----------------------------------------------------------------------------|-----------------------------------------------------|--------------|--------------------|------------------------|-----------------------------------------------------------|----------------------------------|
| Balance July 31, 2014 | 13,506,316 | \$ 14 | \$ 106,077 | \$ (88,864) | \$ (21) | \$ 17,206 |
| Stock-based compensation | - | - | 152 | - | - | 152 |
| Issuance of common stock related to director compensation | 41,652 | - | 65 | - | - | 65 |
| Issuance of common stock under employee bonus plan | 605,895 | - | 100 | - | - | 100 |
| Issuance of common stock under employee stock purchase plan | 39,019 | - | 109 | - | - | 109 |
| Issuance of common stock from exercise of stock options | 108,581 | - | 71 | - | - | 71 |
| Issuance of common stock related to acquisitions | 1,020,963 | 1 | 3,280 | - | - | 3,281 |
| Issuance of common stock related to payment of contingent liabilities | 15,000 | - | 42 | - | - | 42 |
| Income tax benefit related to exercise of non-qualified stock options | - | - | 48 | - | - | 48 |
| Issuance of common stock in public offering, net of issuance costs | 1,760,000 | 2 | 4,756 | - | - | 4,758 |
| Net income | - | - | - | 1,071 | - | 1,071 |
| Foreign currency translation adjustments | - | - | - | - | 46 | 46 |
| Balance July 31, 2015 | 17,097,426 | \$ 17 | \$ 114,700 | \$ (87,793) | \$ 25 | \$ 26,949 |
| Stock-based compensation | - | - | 78 | - | - | 78 |
| Issuance of common stock related to director compensation | 34,859 | - | 130 | - | - | 130 |
| Issuance of common stock under employee bonus plan | 456 | - | 160 | - | - | 160 |

| | | | | | | |
|-----------------------------------------------------------------------|------------|-------|------------|-------------|--------|-----------|
| Issuance of common stock under employee stock purchase plan | 36,306 | - | 153 | - | - | 153 |
| Issuance of common stock from exercise of stock options | 113,680 | - | 83 | - | - | 83 |
| Issuance of common stock related to payment of contingent liabilities | 15,000 | - | 60 | - | - | 60 |
| Issuance of common stock from net exercise of warrants | 13,036 | - | - | - | - | - |
| Net income | - | - | - | 1,743 | - | 1,743 |
| Foreign currency translation adjustments | - | - | - | - | (30) | (30) |
| Balance July 31, 2016 | 17,310,763 | \$ 17 | \$ 115,364 | \$ (86,050) | \$ (5) | \$ 29,326 |

See accompanying notes

ARI Network Services, Inc.

Consolidated Statements of Cash Flows

(Dollars in Thousands)

| | Twelve months ended | |
|-----------------------------------------------------------------------------------|---------------------|-------------|
| | July 31 | |
| | 2016 | 2015 |
| Operating activities: | | |
| Net income | \$ 1,743 | \$ 1,071 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of software products | 2,108 | 2,023 |
| Amortization of deferred loan fees and imputed interest expense | 42 | 77 |
| Depreciation and other amortization | 2,407 | 1,756 |
| Gain on change in fair value of earn-out receivable and payable | (5) | (28) |
| Provision for bad debt allowance | 55 | 168 |
| Deferred income taxes | 1,196 | 720 |
| Stock based compensation | 427 | 446 |
| Net change in assets and liabilities: | | |
| Trade receivables | 74 | 114 |
| Work in process, prepaid expenses and other | 68 | 153 |
| Other long-term assets | - | (50) |
| Accounts payable | (1) | (75) |
| Deferred revenue | (618) | (584) |
| Accrued payroll and related liabilities | 167 | 266 |
| Accrued taxes and other accrued liabilities | 62 | 256 |
| Net cash provided by operating activities | \$ 7,725 | \$ 6,313 |
| Investing activities: | | |
| Purchase of equipment, software and leasehold improvements | (1,090) | (692) |
| Cash received on earn-out from disposition of a component of the business | - | 111 |
| Cash paid for contingent liabilities related to acquisitions | (626) | (250) |
| Cash paid for net assets related to acquisitions | - | (9,700) |
| Software development costs capitalized | (1,780) | (1,411) |
| Net cash used in investing activities | \$ (3,496) | \$ (11,942) |
| Financing activities: | | |
| Payments on long-term debt | (1,298) | (622) |
| Borrowings under long-term debt | - | 2,168 |
| Payments of capital lease obligations | (176) | (253) |
| Net proceeds from public equity offering | - | 4,756 |
| Proceeds from exercise of common stock options and warrants | 93 | 78 |
| Net cash provided by (used in) financing activities | \$ (1,381) | \$ 6,127 |
| Effect of foreign currency exchange rate changes on cash | (14) | (22) |
| Net change in cash and cash equivalents | 2,834 | 476 |
| Cash and cash equivalents at beginning of period | 2,284 | 1,808 |
| Cash and cash equivalents at end of period | \$ 5,118 | \$ 2,284 |

| | | |
|----------------------------|--------|--------|
| Cash paid for interest | \$ 442 | \$ 350 |
| Cash paid for income taxes | \$ 46 | \$ 64 |

See accompanying notes

ARI Network Services, Inc.

Notes to Consolidated Financial Statements

1. Description of the Business and Significant Accounting Policies

Description of the Business

ARI Network Services, Inc. (“ARI” or “the Company”) creates software-as-a-service (“SaaS”), data-as-a-service (“DaaS”) and other solutions that help equipment manufacturers, distributors and dealers in selected vertical markets to Sell More Stuff!™ – online and in-store. We remove the complexity of selling and servicing new and used whole goods inventory and PG&A for customers in the automotive tire and wheel aftermarket (“ATW”), automotive aftermarket parts and service (“AAPS”), powersports, outdoor power equipment (“OPE”), marine, home medical equipment (“HME”), recreational vehicles (“RV”) and appliance industries. Our innovative products are powered by a proprietary library of enriched original equipment and aftermarket content from over 1,800 manufacturers. More than 23,500 equipment dealers, distributors and manufacturers worldwide leverage our web and eCatalog platforms to Sell More Stuff!™

We were incorporated in Wisconsin in 1981. Our principal executive office and headquarters is located in Milwaukee, Wisconsin. The office address is 10850 West Park Place, Suite 1200, Milwaukee, WI 53224, and our telephone number at that location is (414) 973-4300. Our principal website address is www.arinet.com. ARI also maintains operations in Cypress, California; Floyds Knobs, Indiana; Des Moines, Iowa; Duluth, Minnesota; Wexford, Pennsylvania; Cookeville, Tennessee; Salt Lake City, Utah; Leiden, The Netherlands; and Gurgaon, India.

Basis of Presentation

These consolidated financial statements include the consolidated financial statements of ARI and its wholly-owned subsidiaries, ARI Europe B.V. and ARI Network Services Pvt. Ltd. and have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). We eliminated all significant intercompany balances and transactions in consolidation. All adjustments that, in the opinion of management, are necessary for a fair presentation of the periods presented have been reflected as required by Regulation S-X, Rule 10-01.

Fiscal Year

Our fiscal year ends on July 31. References to fiscal 2016, for example, refer to the fiscal year ended July 31, 2016, and references to fiscal 2015 refer to the fiscal year ended July 31, 2015.

Foreign Currency Translation

The functional currency of the Company’s subsidiary in the Netherlands is the Euro and in India it is the Rupee. Accordingly, monetary assets and liabilities are translated into U.S. dollars at the rate of exchange existing at the end of the period, and non-monetary assets and liabilities are translated into U.S. dollars at historical exchange rates. Translation gains and losses are translated at the weighted-average exchange rates during the period and expensed to other income (expense). Adjustments resulting from the re-measurement of the consolidated financial statements into the reporting currency are charged or credited to comprehensive income (loss).

Use of Estimates

The preparation of the Company’s consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and

accompanying notes. Actual results could differ from those estimates. The Company considers capitalization and amortization of software product costs, valuation and useful life of intangible assets, goodwill, allowance for bad debt, contingent liabilities for anticipated future earn-out payments, valuation of stock-based compensation and the deferred tax valuation allowance to be significant estimates subject to change in the near term.

Revenue Recognition

Revenues from subscription fees for use of our software, access to our catalog content, and software maintenance and support fees are all recognized ratably over the contractual term of the arrangement. The Company has customer contracts with multiple services or elements, which may be delivered at different times. The Company accounts for delivered elements in accordance with the selling price when arrangements include multiple product components or other elements and vendor-specific objective evidence exists for the value of all undelivered elements. Revenue on undelivered elements is recognized when the elements are delivered. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

For software license arrangements that do not require significant modification or customization of the underlying software, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is probable.

Revenues for professional services to customize complex features and functionality in a product's base software code or develop complex interfaces within a customer's environment are recognized as the services are performed if they are determined to have standalone value to the customer or if all of the following conditions are met (i) the customer has a contractual right to take possession of the software; (ii) the customer will not incur significant penalty if it exercises this right; and (iii) it is feasible for the customer to either run the software on its own hardware or contract with another unrelated party to host the software. When the current estimates of total contract revenue for professional services and the total related costs indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined. Professional service revenues for set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of the arrangement, are amortized over the term of the contract.

Revenue for variable transaction fees, primarily for use of the shopping cart feature of our websites, is recognized as it is earned.

Amounts received for shipping and handling fees are reflected in revenue. Costs incurred for shipping and handling are reported in cost of revenue.

Amounts invoiced to customers prior to recognition as revenue, as discussed above, are reflected in the accompanying balance sheets as deferred revenue.

No single customer accounted for 10% or more of ARI's revenue during fiscal 2016 or 2015.

Cash and Cash Equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within thirty (30) days from the invoice date. Payments of trade receivables are allocated to the specific invoices

identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of trade receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews receivable balances that exceed ninety (90) days from the invoice date and, based on an assessment of current creditworthiness, estimates the portion of the balance that will not be collected. The allowance for potential doubtful accounts is reflected as an offset to trade receivables in the accompanying consolidated balance sheets.

Work in Process

Work in process consists of services provided by the Company, for which revenue was recognized and billing is done in arrears and has not been invoiced as of the end of the reporting period.

Equipment and Leasehold Improvements

Equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed under the straight-line method for financial reporting and income tax purposes. Leasehold improvements are amortized over the useful lives of the assets or the term of the related lease agreement, whichever is shorter. Depreciation and amortization is expensed over the estimated useful lives of the assets as follows:

| | |
|--------------------------------------------------|-------------|
| Computer equipment and software for internal use | 3 – 7 years |
| Leasehold improvements | 2 – 7 years |
| Furniture and equipment | 3 – 5 years |

Capitalized and Purchased Software Product Costs

Certain software development and acquisition costs are capitalized when incurred. Capitalization of these costs begins upon the establishment of technological feasibility. The establishment of technological feasibility and the on-going assessment of recoverability of software costs require considerable judgment by management with respect to certain external factors, including, but not limited to, the determination of technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technologies. The Company capitalizes software enhancements on an on-going basis and all other software development and support expenditures are charged to expense in the period incurred.

The annual amortization of software products is computed using the straight-line method over the estimated economic life of the product, which currently ranges from 2 to 14 years. Amortization starts when the product is available for general release to customers.

Deferred Loan Fees and Debt Discounts

Fees associated with securing debt are capitalized and shown as contra-debt, reducing the carrying amount of long-term debt on the consolidated balance sheet. Deferred loan fees and debt discounts are amortized to interest expense over the life of the debt using the effective interest method.

Impairment of Long-Lived Assets

In accordance with GAAP, long-lived assets, including capitalized software product costs, property and equipment and amortized intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve judgment.

Goodwill

GAAP requires that we assess goodwill for impairment annually, or more frequently if circumstances indicate that an impairment event may have occurred. Certain triggering events that may warrant a more frequent impairment test include a significant change in the business climate, legal factors, a decline in operating performance, competition, sale or disposition of a significant portion of the business, or other factors. Our annual assessment date is July 31.

We test goodwill for impairment using a two-step process, as prescribed by GAAP. The first step of the test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the

carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. We determined there is a single reporting unit for the purpose of goodwill impairment tests. We estimate the fair value of the reporting unit using various valuation techniques, with the primary techniques being a market capitalization test and a discounted cash flow analysis. There are many estimates and assumptions involved in preparing a discounted cash flow analysis, including most significantly the weighted average cost of capital ("WACC") used to discount future cash flows, anticipated long-term growth rates and future profit margins. Management uses its best efforts to reasonably estimate all of these and other inputs in the cash flow models utilized. We estimated future cash flows using multiple forecast scenarios and management used its judgment to assign a weighting to each scenario.

Step 1 of the goodwill impairment test indicated that goodwill was not impaired in fiscal 2016 or fiscal 2015. As a result, step 2 of the test was not performed.

Deferred Income Taxes

The tax effect of the temporary differences between the book and tax bases of assets and liabilities and the estimated tax benefit from tax net operating losses is reported as deferred tax assets and liabilities in the consolidated balance sheets. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed at each reporting date or when events or changes in circumstances indicate that there may be a change in the valuation allowance. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as a valuation allowance is considered to be a significant estimate that is subject to change. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in income tax expense in the consolidated statements of operations.

Stock-Based Compensation

ARI uses the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. As stock-based compensation expense recognized in our results of operations is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures, which were estimated based on our historical experience. ARI values restricted stock issued under its Equity Plans at fair market value on the date of grant. Occasionally the restrictions of the stock are based on future variables such as market price, and require the more sophisticated Monte Carlo Simulation Model to value the award.

Common Stock Warrants

ARI may issue common stock warrants in connection with debt and equity financing arrangements. In such instances, the terms of the agreements are assessed to determine whether the instrument qualifies as an equity arrangement or a liability arrangement. Arrangements determined to be derivatives are recorded at fair value as liabilities on the consolidated balance sheet, with periodic gains and losses related to the change in fair value recorded to earnings on the consolidated statement of operations. The Company had outstanding warrants to purchase 178,800 shares of common stock at a strike price of \$2.00 per share at July 31, 2016, with an expiration date of March 15, 2018.

Advertising Costs

Advertising costs, which are included in sales and marketing expense on the consolidated statements of operations, are expensed as incurred. Total advertising costs were approximately \$40,000 and \$115,000 in fiscal 2016 and fiscal 2015, respectively.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting method that includes disclosure of financial information that has not been recognized in the calculation of net income. We reported comprehensive income, which includes net income and foreign currency translation adjustments, in the consolidated statements of comprehensive income and shareholders' equity for fiscal 2016 and fiscal 2015.

Legal Provisions

ARI is periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable and reasonably estimable, in accordance with GAAP. We had no legal provisions in fiscal 2016 or fiscal 2015 and management believes that the results of any outstanding litigation will not have a material impact on the Company's financial condition or results of operations.

Recently Adopted Accounting Standards

On August 1, 2015, the Company retrospectively adopted Accounting Standards Update (“ASU”) 2015-03 related to the presentation of debt issuance costs. Debt issuance costs of \$29,000, previously recorded to prepaid expenses and other, and \$84,000, previously recorded to other long-term assets as of July 31, 2015, are now presented as a direct deduction from the carrying amount of long-term debt on the consolidated balance sheet, net of amortization.

New Accounting Pronouncements

The FASB has issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606, which affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other guidance. The core principle of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. An entity should apply the amendments in this ASU using one of the following two methods: (i) retrospectively to each prior reporting period; or (ii) retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. We are evaluating the potential impact of adopting this standard on the consolidated financial statements for fiscal 2019 and beyond.

The FASB recently issued ASU No. 2015-17, Balance sheet classification of deferred taxes: this amendment requires that deferred tax assets and liabilities be classified as noncurrent in the balance sheet. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016. The adoption of this guidance will have no impact on our financial position, results of operations or cash flows.

Management has reviewed recently issued accounting pronouncements and believes that there are no other pronouncements that will have a material impact on the Company’s consolidated financial statements in fiscal 2017.

Supplemental Cash Flow Information

The following table shows cash flow information related to non-cash investing and financing activities as of July 31 (in thousands):

| | Twelve months ended July 31 | |
|-------------------------------------------------------------------------------|--------------------------------|-------|
| | 2016 | 2015 |
| Non-cash investing and financing activities: | | |
| Issuance of common stock related to payment of contingent liabilities | \$ 60 | \$ 42 |
| Tax benefit of stock options exercised | - | 48 |
| Cashless exercise of common stock warrants | 46 | - |
| Acquisition related: | | |
| Issuance of common stock in connection with acquisitions | - | 3,280 |
| Debt issued in connection with acquisition | 64 | 4,933 |
| Capital leases acquired in connection with acquisitions | - | 105 |
| Current assets acquired in connection with acquisitions | 41 | 1,177 |
| Accrued liabilities assumed in connection with acquisitions | (58) | 989 |
| Equipment and leasehold improvements acquired in connection with acquisitions | (125) | 629 |

| | | |
|-----------------------------------------------------------------------------|-------|-------|
| Capitalized software product costs acquired in connection with acquisitions | 234 | 1,718 |
| Goodwill and intangible assets acquired in connection with acquisitions | (217) | 6,694 |
| Contingent liabilities incurred in connection with acquisition | 62 | 911 |

2. Basic and Diluted Net Income per Common Share

Basic net income per common share is computed by dividing net income by the basic weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and reflects the potential dilution that could occur if all of ARI's outstanding stock options and warrants that are in the money were exercised (calculated using the treasury stock method).

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The following table is a reconciliation of basic and diluted net income per common share for fiscal 2016 and fiscal 2015 (in thousands, except per share data):

| | Twelve months ended July 31 | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|----------|
| | 2016 | 2015 |
| Net income | \$ 1,743 | \$ 1,071 |
| Weighted-average common shares outstanding | 17,218 | 14,849 |
| Effect of dilutive stock options and warrants | 492 | 430 |
| Diluted weighted-average common shares outstanding | 17,710 | 15,279 |
| Net income per share | | |
| Basic | \$ 0.10 | \$ 0.07 |
| Diluted | \$ 0.10 | \$ 0.07 |
| Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive | - | 10 |

3. Capitalized and Purchased Software Product Costs

The balance of capitalized and purchased software product costs consisted of the following (in thousands):

| | Software Product Costs | Accumulated Amortization | Net Value |
|----------------------|------------------------------|-----------------------------|--------------|
| Balance 7/31/14 | \$ 22,676 | \$ (18,656) | \$ 4,020 |
| Capitalized costs | 1,411 | - | 1,411 |
| Acquired software | 1,718 | - | 1,718 |
| Disposals | (342) | 342 | - |
| Amortization expense | - | (2,023) | (2,023) |
| Balance 7/31/15 | \$ 25,463 | \$ (20,337) | \$ 5,126 |
| Capitalized costs | 1,779 | - | 1,779 |
| Acquired software | 234 | - | 234 |

| | | | |
|----------------------|-----------|-------------|----------|
| Disposals | (2,702) | 2,702 | - |
| Amortization expense | - | (2,108) | (2,108) |
| Balance 7/31/16 | \$ 24,774 | \$ (19,743) | \$ 5,031 |

The estimated aggregate amortization expense for each of the five succeeding fiscal years related to capitalized and purchased software product costs consist of the following at July 31, 2016 (in thousands):

| | |
|------------|----------|
| 2017 | \$ 1,995 |
| 2018 | 1,381 |
| 2019 | 835 |
| 2020 | 337 |
| 2021 | 187 |
| Thereafter | 296 |
| | \$ 5,031 |

4. Debt

Silicon Valley Bank

On April 26, 2013, the Company entered into a Loan and Security Agreement (the “Agreement”) with Silicon Valley Bank (“SVB”), pursuant to which SVB extended to the Company credit facilities consisting of a \$3,000,000 revolving credit facility with a maturity date of April 26, 2015 and a \$4,500,000 term loan with a maturity date of April 26, 2018.

On September 30, 2014, in connection with the Company’s acquisition of Tire Company Solutions, LLC (“TCS”), the Company entered into the First Loan Modification Agreement (the “Modification Agreement”) with SVB, which contained substantial amendments to the terms of the Agreement.

The Modification Agreement includes credit facilities consisting of a \$3,000,000 revolving credit facility with a maturity date of November 30, 2016 and a \$6,050,000 term loan with a maturity date of September 30, 2019. This term loan is an amendment to the existing \$4,500,000 term loan with an original maturity date of April 26, 2018.

The term loan and any loans made under the SVB revolving credit facility accrue interest at a per annum rate equal to the Prime Rate plus the Applicable Margin for Prime Rate Loans set forth in the chart below based on the Total Leverage Ratio, as defined in the Modification Agreement. The Company had \$0 outstanding on the revolving credit facility and the effective interest rate was 4.00% at July 31, 2016, based upon a prime rate of 3.50%.

| Total Leverage Ratio | Applicable Margin for Prime Rate Loans |
|-----------------------------------|----------------------------------------------------|
| >= 2.50 to 1.0: | 1.50 % |
| > 1.75 to 1.00 but <2.50 to 1.00: | 1.00 % |
| <= 1.75 to 1.00: | 0.50 % |

Principal with respect to any loans made under the revolving facility is required to be paid in its entirety on or before November 30, 2016. Principal with respect to the term loan is required to be paid in quarterly installments on the first day of each fiscal quarter of the Company as follows: \$151,250 commenced on November 1, 2014 through August 1, 2016; \$226,875 commencing on November 1, 2016 through August 1, 2017; and \$302,500 commencing on November 1, 2017 through August 1, 2019. All remaining principal with respect to the term loan is due and payable on September 30, 2019. The Company is permitted to prepay all of, but not less than all of, the outstanding principal amount of the term loan upon notice to SVB and, in certain circumstances, the payment of a prepayment penalty of up to \$61,000. Following July 31, 2015, the Modification Agreement requires the Company to make additional payments in the amount of 25% of excess cash flow, as defined in the agreement, until the Company's Total Leverage Ratio is less than 2.00 to 1.00.

The Modification Agreement contains covenants that restrict, among other things and subject to certain conditions, the ability of the Company to permit a change of control, incur debt, create liens on its assets, make certain investments, enter into merger or acquisition transactions and make distributions to its shareholders. Financial covenants include the maintenance of a minimum Total Leverage Ratio equal to or less than 3.00 to 1.00 and the maintenance of a Fixed Charge Coverage Ratio (as defined in the Modification Agreement) equal to or greater than 1.25 to 1.00. The Total Leverage Ratio was 1.13 and the Fixed Charge Ratio was 2.22 for the twelve months ended July 31, 2016. The Modification Agreement also contains customary events of default that, if triggered, could result in an acceleration of the Company's obligations under the Modification Agreement. The loans are secured by a first priority security interest in substantially all assets of the Company.

TCS Promissory Notes

In connection with the acquisition of TCS, on September 30, 2014, the Company issued two promissory notes (the "TCS Notes") in the aggregate principal amount of \$3,000,000 to the former owners of TCS. In February 2015, the principal amount of the TCS Notes was reduced by approximately \$67,000 as a result of post-closing adjustments to the valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The TCS Notes initially accrue interest on the outstanding unpaid principal balance at a rate per annum equal to 5.0%; however, if any amount payable under a TCS Note is not paid when due, such overdue amount will bear interest at the default rate of 7.5% from the date of such non-payment until such amount is paid in full. Accrued interest on the TCS Notes is due and

payable quarterly commencing on December 29, 2014 and continuing on each 90th calendar day thereafter, until September 30, 2018, at which time all accrued interest and outstanding principal balance will be due and payable in full. The first four payments due and payable under the TCS Notes were interest-only payments, and payments of principal and interest commenced on December 29, 2015. The payments are subject to acceleration upon certain Events of Default, as defined in the TCS Notes.

DCi Promissory Note

In connection with the acquisition of Direct Communications Inc. (“DCi”), on July 13, 2015, the Company issued a promissory note (the “DCi Note”) in the aggregate principal amount of \$2,000,000 to the former owners of DCi. The principal amount of the DCi Note was reduced by approximately \$64,000 as a result of post-closing adjustments to the estimated valuation of the net assets acquired, pursuant to the terms of the asset purchase agreement. The DCi Note initially accrues interest on the outstanding unpaid principal balance at a rate per annum equal to 4.0%. Accrued interest on the DCi Note is due and payable quarterly commencing on October 13, 2015 and continuing on each 90th calendar day thereafter, until July 13, 2019, at which time all accrued interest and outstanding principal balance will be due and payable in full. The first four payments due and payable under the DCi Note were interest only payments, and payments of principal and interest commenced with the payment due on October 13, 2016. The payments are subject to acceleration upon certain Events of Default, as defined in the DCi Note.

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The following table sets forth certain information related to the Company's long-term debt as of July 31, 2016 and 2015 (in thousands):

| | July 31 2016 | July 31 2015 |
|-----------------------------|-----------------|-----------------|
| Notes payable principal | \$ 9,168 | \$ 10,529 |
| Less debt issuance costs | (93) | (112) |
| Less current maturities | (2,417) | (1,338) |
| Notes payable - non-current | \$ 6,658 | \$ 9,079 |

Minimum principal payments due on the Company's notes payable are as follows for the fiscal years ending July 31 (in thousands):

| Fiscal year ending July 31: | SVB | | DCi Notes | Total Notes Payable |
|-----------------------------|--------------|--------------|-----------|---------------------|
| | Term Note | TCS Notes | | |
| 2017 | \$ 832 | \$ 965 | \$ 621 | \$ 2,418 |
| 2018 | 1,134 | 1,014 | 645 | 2,793 |
| 2019 | 1,211 | 261 | 670 | 2,142 |
| 2020 | 1,815 | — | — | 1,815 |
| | \$ 4,992 | \$ 2,240 | \$ 1,936 | \$ 9,168 |

5. Business Combinations

DCi Acquisition

On July 13, 2015, the Company acquired substantially all of the assets of DCi, a leading provider of differentiated product content and electronic catalog software serving manufacturers, distributors, jobbers and independent retailers in the AAPS. Consideration for the acquisition included: (i) a cash payment equal to \$3,750,000; (ii) 159,795 shares of the Company's common stock; and (iii) the issuance of a promissory note in principal amount of \$1,936,000 (as adjusted) to the former owners of DCi.

The DCi acquisition was intended to accelerate the Company's growth in the AAPS and provide a platform to further expand the reach of ARI's data-driven eCommerce websites and automotive point-of-sale software. The combined customer benefits and operational efficiencies are expected to result in a stronger organization that can create more value for our customers, shareholders and employees.

The following tables show the allocation of the DCi final purchase price (in thousands):

| | Purchase Price |
|--------------------------|-------------------|
| Cash | \$ 3,750 |
| Financed by note payable | 1,936 |
| Issuance of common stock | 500 |
| Purchase price | \$ 6,186 |

| | Purchase Allocation |
|---------------------------|------------------------|
| Trade receivables | \$ 427 |
| Prepaid expense and other | 38 |
| Assumed liabilities | (260) |
| Furniture and equipment | 387 |
| Software product costs | 698 |
| Intangible assets | 1,830 |
| Goodwill | 3,066 |
| Purchase price allocation | \$ 6,186 |

Intangible assets include the fair value of tradenames, customer relationships, and non-competition agreements. Goodwill represents the additional benefits provided to the Company by the acquisition of DCi operational synergies. The Company acquired approximately \$3,250,000 of tax deductible goodwill related to the DCi acquisition.

TASCO Acquisition

On April 27, 2015, the Company acquired substantially all of the assets of TASCO Corporation and its affiliated company Signal Extraprise Corporation (collectively "TASCO"), a leading provider of business management software designed exclusively for the ATW industry. Consideration for the acquisition included: (i) a cash payment at the closing of the transaction equal to \$1,750,000, which was funded through borrowing on the Company's revolving credit facility; (ii) 242,424 shares of the Company's common stock; and (iii) a \$138,000 (as adjusted) holdback payable on April 27, 2016. The Company determined that the TASCO assets acquired did not constitute a business that is "significant" as defined in the applicable SEC regulations.

The following tables show the allocation of the final purchase price (in thousands):

| | Purchase Price |
|--|-------------------|
|--|-------------------|

| | |
|---------------------------|------------|
| Cash | \$ 1,750 |
| Issuance of common stock | 800 |
| Contingent holdback | 138 |
| Purchase price | \$ 2,688 |
| | Purchase |
| | Allocation |
| Trade receivables | \$ 120 |
| Assumed liabilities | (227) |
| Software product costs | 434 |
| Intangible assets | 1,000 |
| Goodwill | 1,361 |
| Purchase price allocation | \$ 2,688 |

TCS Acquisition

On September 30, 2014, the Company acquired substantially all of the assets of TCS, a leading provider of software, websites and digital marketing services designed exclusively for dealers, wholesalers, retreaders and manufacturers within the ATW industries. Consideration for the acquisition included (i) a cash payment equal to \$4,200,000; (ii) 618,744 shares of the Company's common stock; (iii) the issuance of two promissory notes in aggregate principal amount of \$2,933,000 (as adjusted) to the former owners of TCS; and (iv) a contingent earn-out purchase price contingent upon the attainment of specific revenue goals over the first three years following the acquisition.

The TCS acquisition increased the Company's portfolio of ATW dealer websites by more than 30%. The acquisition is expected to continue to accelerate ARI's opportunity to drive organic growth through the cross selling of new products. It also provides solutions for the entire ATW supply chain, including wholesalers, retreaders and manufacturers. The TCS business offers a business management solution for ATW dealers as well as for auto repair shops. The combined customer benefits and operational efficiencies are expected to result in a stronger organization that can create more value for our customers, shareholders and employees.

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The acquisition was funded from cash on hand, an increase in our SVB Term Loan, funds available on our revolving credit facility, seller financing and the Company's common stock. The following table shows the allocation of the final purchase price (in thousands):

| | Purchase Price |
|--------------------------|----------------|
| Cash | \$ 4,200 |
| Financed by note payable | 2,933 |
| Issuance of common stock | 1,980 |
| Contingent earn-out | 711 |
| Purchase price | \$ 9,824 |

| | Purchase Allocation |
|---------------------------|---------------------|
| Trade receivables | \$ 606 |
| Prepaid expense and other | 33 |
| Assumed liabilities | (668) |
| Furniture and equipment | 117 |
| Software product costs | 820 |
| Intangible assets | 4,080 |
| Goodwill | 4,836 |
| Purchase price allocation | \$ 9,824 |

Intangible assets include the fair value of tradenames, customer relationships, and non-competition agreements. Goodwill represents the additional benefits provided to the Company by the acquisition of TCS operational synergies. The Company acquired approximately \$5,200,000 of tax deductible goodwill related to the TCS acquisition.

Pro Forma Information

The following unaudited pro forma combined financial information presents the Company's results as if the Company had acquired TCS and DCi on August 1, 2014. The unaudited pro forma information has been prepared with the following considerations:

- i. The unaudited pro forma condensed consolidated financial information has been prepared using the acquisition method of accounting under existing GAAP. The Company is the acquirer for accounting purposes.
- ii. The pro forma combined financial information does not reflect any operating cost synergy savings that the combined company may achieve as a result of the acquisition, the costs necessary to achieve these operating synergy savings or additional charges necessary as a result of the acquisition.

The unaudited pro forma financial information presented is for information purposes only and does not purport to represent what the Company's and TCS's or DCi's financial position or results of operations would have been had the acquisitions in fact occurred on such date or at the beginning of the period indicated, nor does it project the Company's and TCS's or DCi's financial position or results of operation for any future date or period.

| | Twelve months ended July 31 | |
|------------------------------|--------------------------------|-----------|
| | 2016 | 2015 |
| Revenue | \$ 47,693 | \$ 45,106 |
| Net income | \$ 1,743 | \$ 1,270 |
| Net income per common share: | | |
| Basic | \$ 0.10 | \$ 0.08 |
| Diluted | \$ 0.10 | \$ 0.07 |

Pro forma adjustments to net income include amortization costs related to the acquired intangible assets, acquisition-related professional fees, interest expense on the debt incurred to acquire the assets of TCS and DCi, and the tax effect of the historical TCS and DCi results of operations and the pro forma adjustments at an estimated tax rate of 40% as follows:

| | Twelve months ended July 31 | |
|---------------------------------------|--------------------------------------|-------|
| | 2016 | 2015 |
| Amortization of intangible assets | - | 343 |
| Acquisition-related professional fees | - | (442) |
| Interest expense | - | 125 |
| Income tax benefit (expense) | - | 132 |
| Total adjustments | - | 158 |

The Company recorded additional goodwill of approximately \$8,800,000 in fiscal 2015, related to the TCS, TASCO and DCi acquisitions, and \$466,000 in fiscal 2016, as a result of adjustments to the final purchase price allocations of TCS, TASCO and DCi. The Company cannot determine revenue and expenses specifically related to its acquisitions since the date of acquisition, as we begin integrating these operations into our business upon closing of the acquisitions.

6. Other Intangible Assets

Amortizable intangible assets include customer relationships and trade names. Amortizable intangible assets are composed of the following at July 31, 2016 and 2015 (in thousands):

| | Twelve months ended July 31, 2015 | | | Wtd. avg. |
|------------------------|-----------------------------------|--------------|----------|-----------|
| | Cost | Accumulated | Net | remaining |
| | Basis | Amortization | Value | life |
| Customer relationships | | | | |
| Beginning balance | \$ 7,174 | \$ (3,584) | \$ 3,590 | |
| Activity | 4,773 | (834) | 3,939 | |

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Ending balance \$ 11,947 \$ (4,418) \$ 7,529 12.02

Other intangibles

Beginning balance \$ 383 \$ (361) \$ 22
 Activity 2,820 (255) 2,565
 Ending balance \$ 3,203 \$ (616) \$ 2,587 3.18

Total intangibles

Beginning balance \$ 7,557 \$ (3,945) \$ 3,612
 Activity 7,593 (1,089) 6,504
 Ending balance \$ 15,150 \$ (5,034) \$ 10,116 11.31

Twelve months ended July 31, 2016 Wtd. avg.

| | Cost Basis | Accumulated Amortization | Net Value | Wtd. avg. remaining life |
|------------------------|------------|--------------------------|-----------|--------------------------|
| Customer relationships | | | | |
| Beginning balance | \$ 11,947 | \$ (4,418) | \$ 7,529 | |
| Activity | (220) | (1,140) | (1,360) | |
| Ending balance | \$ 11,727 | \$ (5,558) | \$ 6,169 | 11.83 |

Other intangibles

Beginning balance \$ 3,203 \$ (616) \$ 2,587
 Activity (464) (402) (866)
 Ending balance \$ 2,739 \$ (1,018) \$ 1,721 8.53

Total intangibles

Beginning balance \$ 15,150 \$ (5,034) \$ 10,116
 Activity (684) (1,542) (2,226)
 Ending balance \$ 14,466 \$ (6,576) \$ 7,890 11.11

The estimated amortization expense related to intangible assets for the years subsequent to July 31, 2016 is as follows (in thousands):

| | |
|------------|----------|
| 2017 | \$ 1,417 |
| 2018 | 1,099 |
| 2019 | 956 |
| 2020 | 737 |
| 2021 | 606 |
| Thereafter | 3,075 |
| | \$ 7,890 |

7. Contingent Liabilities

Consideration for the April 2015 TASC0 acquisition included a \$138,000 (as adjusted) holdback which was paid in April 2016.

Consideration for the September 2014 TCS acquisition includes a contingent earn-out purchase price, originally contingent upon the attainment of specific revenue goals. The fair value of the earn-out was originally estimated at \$711,000. On March 7, 2016, the TCS Asset Purchase Agreement was amended in relation to the contingent earn-out, whereas four quarterly payments of \$120,905 commenced on December 31, 2015, followed by four quarterly payments of \$70,000, commencing December 31, 2016. The Company recorded a gain of \$13,000 as a result of the Amendment during fiscal 2016.

Consideration for the 2012 Ready2Ride acquisition included a contingent hold-back purchase price of up to \$250,000 and contingent earn-out payments as follows: (i) the first earn-out payment, composed of \$125,000 was paid in October 2013 and 10,000 shares of common stock issued in November 2013; (ii) the second earn-out payment, composed of \$125,000 and 15,000 shares of common stock was paid in September 2014; and (iii) the final earn-out payment, composed of \$125,000 and 15,000 shares of common stock was paid in September 2015. The Company recorded a loss of \$8,000 as a result of a change in estimate related to an increase in the market price of the Company's common stock during fiscal 2016.

The following table shows changes in the holdback and earn-out payable related to the Ready2Ride, TCS and TASC0 acquisitions (in thousands):

| | |
|---------------|------|
| Twelve months | |
| ended July 31 | |
| 2016 | 2015 |

| | | |
|------------------------------------------|----------|----------|
| Beginning balance | \$ 1,116 | \$ 448 |
| Additions | - | 911 |
| Adjustments | (62) | - |
| Payments | (686) | (292) |
| Imputed interest recognized | 28 | 49 |
| Gain on change in fair value of earn-out | (5) | - |
| Ending balance | \$ 391 | \$ 1,116 |
| Less current portion | \$ (331) | \$ (754) |
| Ending balance, long-term | \$ 60 | \$ 362 |

The following table shows the remaining estimated payments of contingent liabilities related to the TCS and TASCO at July 31, 2016, (in thousands):

| | |
|-----------------------------------------|--------|
| 2017 | \$ 331 |
| 2018 | 70 |
| Total estimated payments | 401 |
| Less imputed interest | (10) |
| Present value of contingent liabilities | \$ 391 |

8. Capital and Operating Leases

The Company leases certain furniture, leasehold improvements and equipment under capital lease arrangements with monthly payment terms ranging from 3 to 7 years and a weighted average interest rate of 8.8%. The Company recognized \$143,000 and \$146,000 of depreciation expense related to fixed assets under capital lease agreements during fiscal 2016 and 2015, respectively.

The Company leases office space and certain office equipment under operating lease arrangements expiring through 2021. Annual rent increases under these operating leases range from 0% to 5%. The Company is generally liable for its share of the landlord's direct operating expenses and real estate taxes related to these leases. Total rental and related operating expense for the operating leases was \$1,055,000 in fiscal 2016 and \$883,000 in fiscal 2015. Leasehold improvements are depreciated over the shorter of their useful life or the term of the lease.

Rent expense for leased offices is recognized on a straight-line basis over the lease terms, which differs from the pattern of payments required by certain leases. Other accrued liabilities included \$35,000 and \$20,000 of deferred rent and other long term liabilities included \$166,000 and \$200,000 of deferred rent at July 31, 2016 and 2015, respectively, related to these leases.

The following table shows equipment and leasehold improvements financed with capital lease obligations (in thousands):

| | 2016 | 2015 |
|-------------------------------------------------------------------------------------|--------|--------|
| Equipment and leasehold improvements with outstanding capital lease obligations | \$ 663 | \$ 663 |
| Less: accumulated depreciation (1) | (358) | (215) |
| Net equipment and leasehold improvements with outstanding capital lease obligations | \$ 305 | \$ 448 |

(1) Depreciation of leased equipment and leasehold improvements is included in depreciation and other amortization expense

Minimum lease payments under remaining capital and operating leases, including current contractual operating costs, are as follows (in thousands):

| Fiscal Year Ending July 31: | Capital Leases | Operating Leases |
|----------------------------------|----------------|------------------|
| 2017 | \$ 58 | \$ 1,101 |
| 2018 | 50 | 1,004 |
| 2019 | 17 | 726 |
| 2020 | — | 473 |
| 2021 | — | 364 |
| Thereafter | — | — |
| Total minimum lease payments | 125 | 3,668 |
| Less amounts related to interest | (12) | — |
| Net minimum lease payments | \$ 113 | \$ 3,668 |

9. Stock-based Compensation Plans

The Company uses the Black-Scholes model to value stock options granted. Volatility is calculated as managements' estimate of future volatility over the expected term of the option based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the United States Treasury yields in effect at the time of grant.

Stock options granted to employees under the Company's stock option plan typically vest 25% on the first anniversary of the grant and 25% on the one-year anniversary of each of the three following years. Stock options granted to non-employee directors under the Company's stock option plan typically vest 50% on the first anniversary of the grant and 50% on the next one-year anniversary. The Company recognizes stock option expense over the vesting period for each vesting tranche. There were no options issued in fiscal 2016.

As recognizing stock-based compensation expense is based on awards ultimately expected to vest, the amount of recognized expense has been reduced for estimated forfeitures of 10.1%, based on the Company's historical experience. Total stock compensation expense recognized by the Company related to stock options was approximately \$79,000 and \$152,000 during fiscal 2016 and fiscal 2015, respectively. There was approximately \$38,000 and \$142,000 of total unrecognized compensation costs related to non-vested options granted under the Company's stock option plans as of July 31, 2016 and 2015, respectively. Total unrecognized compensation cost will be adjusted for the difference between estimated and actual forfeitures. There were no capitalized stock-based compensation costs during the years ended July 31, 2016 or 2015. The Company received approximately \$94,000 from the exercise of stock options during fiscal 2016.

2000 Stock Option Plan

The Company's 2000 Stock Option Plan (the "2000 Plan") had 1,950,000 shares of common stock authorized for issuance. Each incentive stock option that was granted under the 2000 Plan is exercisable for a period of not more than 10 years from the date of grant (five years in the case of a participant who is a 10% shareholder of the Company, unless the stock options are nonqualified), or such shorter period as determined by the Compensation Committee, and shall lapse upon the expiration of said period, or earlier upon termination of the participant's employment with the Company. The 2000 Plan expired on December 13, 2010, at which time it was terminated except for outstanding options. While options previously granted under the 2000 Plan will remain outstanding through the remainder of their terms, or until exercised, no new options may be granted under the 2000 Plan. Changes in option shares under the 2000 Plan during fiscal 2016 were as follows:

| | Number of Options | Wtd. Avg. Exercise Price | Wtd. Avg. Remaining Contractual Period (Years) | Aggregate Intrinsic Value |
|--------------------------|----------------------|-----------------------------------|------------------------------------------------------------|---------------------------------|
| Outstanding at 7/31/2015 | 472,250 | \$ 1.52 | 2.52 | \$ 783,174 |
| Granted | - | n/a | n/a | n/a |
| Exercised | (86,500) | 1.79 | n/a | n/a |
| Forfeited | (1,000) | 2.15 | n/a | n/a |
| Outstanding at 7/31/2016 | 384,750 | \$ 1.46 | 1.89 | \$ 1,408,027 |
| Exercisable at 7/31/2016 | 384,750 | \$ 1.46 | 1.89 | \$ 1,408,027 |

The range of exercise prices for options outstanding under the 2000 Plan was \$0.49 to \$1.96 at July 31, 2016.

2010 Equity Incentive Plan

The Board of Directors adopted the ARI Network Services, Inc. 2010 Equity Incentive Plan (as amended, the "2010 Plan") on November 9, 2010. The plan was approved by the Company's shareholders in December 2010, and amendments to the 2010 Plan were approved by the Company's shareholders in January 2014. The 2010 Plan is the successor to the Company's 2000 Plan. There are 1,850,000 shares of Company common stock authorized for issuance under the 2010 Plan. Potential awards under the 2010 Plan include incentive stock options and non-statutory stock options, shares of restricted stock or restricted stock units, stock appreciation rights ("SARs"), and shares of common stock. Up to 1,525,000 of the shares authorized for issuance under the 2010 Plan may be used for common stock, restricted stock or restricted stock unit awards.

The exercise price for options and SARs under the 2010 Plan cannot be less than 100% of the fair market value of the Company's common stock on the date of grant, and the exercise prices for options and SARs cannot be repriced without shareholder approval, except to reflect changes to the capital structure of the Company as described in the 2010 Plan. The maximum term of options and SARs under the 2010 Plan is 10 years. The 2010 Plan does not have liberal share counting provisions, such as provisions that would permit shares withheld for payment of taxes or the exercise price of stock options to be re-granted under the plan.

Changes in option shares under the 2010 Plan during fiscal 2016 were as follows:

| | Number of Options | Wtd. Avg. Exercise Price | Wtd. Avg. Remaining Contractual Period (Years) | Aggregate Intrinsic Value |
|--------------------------|----------------------|-----------------------------------|------------------------------------------------------------|---------------------------------|
| Outstanding at 7/31/2015 | 434,751 | \$ 2.34 | 7.47 | \$ 387,964 |
| Granted | - | n/a | n/a | n/a |
| Exercised | (57,500) | 1.40 | n/a | n/a |
| Forfeited | (19,625) | 1.86 | n/a | n/a |
| Outstanding at 7/31/2016 | 357,626 | \$ 2.52 | 6.95 | \$ 930,816 |
| Exercisable at 7/31/2016 | 287,626 | \$ 2.33 | 6.75 | \$ 802,666 |

The range of exercise prices for options outstanding under the 2010 Plan was \$0.59 to \$3.61 at July 31, 2016.

Changes in the 2010 Plan's non-vested option shares included in the outstanding shares above during fiscal 2016 were as follows:

| | Number of Options | Wtd. Avg. Exercise Price |
|-------------------------|----------------------|-----------------------------------|
| Non-vested at 7/31/2015 | 166,498 | \$ 2.99 |
| Granted | - | n/a |
| Vested | (85,623) | 2.81 |
| Forfeited | (10,875) | 2.54 |
| Non-vested at 7/31/2016 | 70,000 | \$ 3.29 |

The weighted average remaining vesting period was 1.47 years at July 31, 2016.

Employee Stock Purchase Plan

The Company's 2000 Employee Stock Purchase Plan, as amended, ("ESPP") has 575,000 shares of common stock reserved for issuance, of which 300,280 and 263,974 of the shares have been issued as of July 31, 2016 and 2015, respectively. All employees with at least six months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year. The Company expensed \$39,000 and \$31,000 related to the ESPP discount during fiscal 2016 and 2015, respectively.

Restricted Stock

Pursuant to the 2010 Plan, there are 1,525,000 shares authorized for issuance in the form of shares of common stock, restricted stock or restricted stock units. The Company grants restricted stock to its directors as an annual retainer, its officers under the Long Term Equity Bonus Plan ("LTEB") and from time to time to directors, officers or employees as incentive compensation or, in some cases, as discretionary compensation in place of cash. The Company recognized compensation expense of \$310,000 and \$263,000 during fiscal 2016 and fiscal 2015, respectively, related to restricted stock expensed over the vesting period. The remaining balance of unrecognized compensation expense related to restricted stock was \$383,000 at July 31, 2016.

Changes in unvested restricted shares of common stock under the 2010 Plan were as follows:

| | Twelve months ended July 31 | |
|---------------------------------------------|--------------------------------|----------|
| | 2016 | 2015 |
| Beginning balance unvested restricted stock | 671,211 | 93,704 |
| Granted | 42,359 | 653,321 |
| Vested | (49,887) | (70,040) |
| Forfeited | (5,771) | (5,774) |
| Ending balance unvested restricted stock | 657,912 | 671,211 |

The Compensation Committee adopted the LTEB for eligible executive officers of the Company effective beginning in fiscal 2013. In March 2015, the Compensation Committee issued 550,000 shares of restricted stock under the 2010 plan, as payment under the LTEB, which will vest according to the following schedule:

- 30% when the volume-weighted average price of the Company's common stock for the previous 30 trading day period (the "30-day VWAP") equals or exceeds trades at or above \$6.00
- 20% when the 30-day VWAP equals or exceeds \$7.00
- 20% when the 30-day VWAP equals or exceeds \$8.00
- 30% when the 30-day VWAP equals or exceeds \$9.00

Under the plan described above, a target price must be reached within a four-year period starting on the date of grant for any restricted stock to vest. All unvested restricted stock will be forfeited when the four-year period expires. The initial value of the common stock granted under the LTEB was approximately \$350,000, valued using a Monte Carlo Simulation with a 46% volatility rate and a 1.34% risk-free interest rate, and is expensed over the vesting period. The remaining balance of unrecognized compensation expense related to the fiscal 2016 LTEB is \$206,000.

10. Income Taxes

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

| | Twelve months ended July 31 | |
|-------------------------------|--------------------------------|----------|
| | 2016 | 2015 |
| Current: | | |
| Federal | \$ (52) | \$ (36) |
| State | (106) | (54) |
| Change in valuation allowance | 222 | (212) |
| Deferred, net | (1,415) | (509) |
| Income tax expense | \$ (1,351) | \$ (811) |

The provision for income taxes is based on taxes payable under currently enacted tax laws and an analysis of temporary differences between the book and tax bases of the Company's assets and liabilities, including various accruals, allowances, depreciation and amortization, and does not represent current taxes due. The tax effect of these temporary differences and the estimated benefit from tax net operating losses are reported as deferred tax assets and liabilities in the consolidated balance sheets. We have unused net operating loss carry forwards ("NOLs") for federal income tax purposes, and as a result, we generally only incur alternative minimum taxes at the federal level that are currently payable.

A reconciliation between income tax expense and income taxes computed by applying the statutory federal income tax rate of 34% and the state rate of approximately 3% to U.S. based income (loss) before income taxes for the year ended July 31 is as follows (in thousands):

| | Twelve months ended July 31 | |
|------------------------------------------------|--------------------------------|----------|
| | 2016 | 2015 |
| Computed federal and state income taxes at 37% | \$ (1,272) | \$ (805) |
| Permanent items | (53) | (64) |
| Change in estimate of valuation allowance | - | (420) |
| Change in tax law | - | 466 |
| Prior year true ups | (5) | - |
| Other | (21) | 12 |
| Income tax expense | \$ (1,351) | \$ (811) |

In March 2015, the Wisconsin legislature enacted a change for tax years beginning on or after January 1, 2014 to extend the carryforward period for corporate NOLs from 15 to 20 years. As a result of this change, the Company recorded additional deferred tax assets of approximately \$466,000 with an off-setting valuation allowance of approximately \$420,000.

An assessment is performed periodically of the likelihood that the Company's net deferred tax assets will be realized from future taxable income. To the extent management believes it is more likely than not that some portion, or all, of the deferred tax asset will not be realized, a valuation allowance is established. This assessment is based on all available evidence, both positive and negative, in evaluating the likelihood of realizability. Issues considered in the

assessment include future reversals of existing taxable temporary differences, estimates of future taxable income (exclusive of reversing temporary differences and carryforwards) and prudent tax planning strategies available in future periods. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as a valuation allowance is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the consolidated statements of operations.

The Company recorded expense related to a net change in estimate on our valuation allowance related to US deferred tax assets of approximately \$420,000, or \$0.03 per basic and diluted share related to estimated expiration of the deferred tax assets resulting from the extension of NOL carryforward expirations during fiscal 2015 as a result of our evaluation of the likelihood that our net deferred tax assets will be realized from future taxable income. There was no change in the remaining estimated valuation allowance during fiscal 2016.

The Company has NOLs related to tax losses incurred by its Netherlands operation. Under tax laws in the Netherlands, NOLs are able to be carried forward for a period of nine years. The Company has determined that, consistent with prior periods, it is not likely that the net operating losses will be utilized by the Company. This conclusion was primarily based on the negative evidence of a history of losses and expired NOLs related to this entity. In the opinion of the Company, there is not enough positive evidence to overcome this negative evidence. Therefore, a full valuation allowance of \$430,000 and \$508,000 are recorded, resulting in \$0 net deferred tax assets related to the Netherlands operation at July 31, 2016 and 2015, respectively.

The Company also has an NOL related to a current year tax loss incurred by its India operation. Under tax laws in India, NOLs are able to be carried forward for a period of eight years. The Company has determined that it is not likely that the net operating loss will be utilized by the Company primarily based on the start-up nature of this operation. Therefore, a full valuation allowance of

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\$55,000 was recorded, resulting in \$0 net deferred tax assets related to the India operation at July 31, 2016.

As of July 31, 2016, the Company had accumulated NOLs for federal, state and international tax purposes of approximately \$2,023,000, \$8,326,000 and \$1,870,000, respectively, which expire as follows (in thousands):

| Twelve months ended July 31, | Federal | State | International |
|------------------------------|----------|----------|---------------|
| 2017 | \$ — | \$ 2,665 | \$ 276 |
| 2018 | — | 1,841 | 145 |
| 2019 | — | 482 | — |
| 2020 | 1,073 | 3,258 | 78 |
| 2021 | — | — | 103 |
| 2022 | — | — | 228 |
| 2023 | — | — | 225 |
| 2024 | 4 | 4 | 544 |
| 2025 | — | — | 271 |
| 2030+ | 946 | 75 | — |
| | \$ 2,023 | \$ 8,326 | \$ 1,870 |

* Years not shown have no amounts that expire.

Significant components of our deferred tax liabilities and assets as of July 31 were as follows (in thousands):

| | 2016 | 2015 |
|----------------------------------------------|----------|----------|
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 1,617 | \$ 2,677 |
| Alternative minimum tax credit carryforwards | 298 | 246 |
| Deferred revenue | 2,306 | 2,525 |
| Software product costs | 633 | 566 |
| Intangible assets | 923 | 689 |
| Other | 630 | 620 |
| Total deferred tax assets | \$ 6,407 | \$ 7,323 |
| Valuation allowance for deferred tax assets | (898) | (1,113) |
| Net deferred tax assets | \$ 5,509 | \$ 6,210 |
| Deferred tax liabilities: | | |
| Goodwill | (1,215) | (720) |
| Net deferred taxes | \$ 4,294 | \$ 5,490 |

We perform an evaluation of uncertain tax positions as a component of income tax expense on an annual basis. We determined that the Company did not have any significant risk related to income tax expense and therefore no amounts were reserved for uncertain tax positions as of July 31, 2016 and 2015. We will accrue and recognize interest and penalties related to uncertain tax positions as a component of income tax expense if it becomes necessary. Fiscal years subsequent to 2012 remain open and subject to examination by state tax jurisdictions and the United States federal tax authorities.

11. Employee Benefit Plan

ARI has a qualified retirement savings plan (the “401(k) Plan”) covering its employees. Each employee may elect to reduce his or her current compensation by up to 50%, up to a maximum of \$18,000 (\$24,000 over age 50) in calendar years 2016 and 2015 (subject to adjustment in future years) and have the amount of the reduction contributed to the 401(k) Plan. Company contributions to the 401(k) Plan are at the discretion of the Board of Directors. The Company contributes \$0.50 per \$1.00 contributed by the employees with a maximum of 4% of an employee’s salary. The Company contributed \$352,000 and \$258,000 to the 401(k) Plan related to matching of employee contributions during fiscal 2016 and 2015, respectively.

12. Shareholders’ Equity

On May 12, 2015, the Company completed an underwritten public offering pursuant to which it sold 1,760,000 shares of its common stock at a price to the public of \$3.00 per share. The Company received net proceeds of approximately \$4,700,000 from the sale, after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company.

13. Litigation

The Company had no material litigation-related contingent liabilities as of July 31, 2016 or 2015.