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**Report of Wipfli LLP,  
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 Subsidiaries (the Company) as of July 31, 2009 and 2008 and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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 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 audit 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Wipfli LLP  
Milwaukee, Wisconsin  
October 29, 2009



## **Consolidated Financial Statements**

ARI Network Services, Inc.  
Years ended July 31, 2009 and 2008



**ARI Network Services, Inc.**  
**Consolidated Balance Sheet**  
**(Dollars in Thousands)**

<b>ASSETS</b>	<b>July 31</b>	
	<b>2009</b>	<b>2008</b>
Current assets:		
Cash	\$ 650	\$ 1,086
Trade receivables, less allowance for doubtful accounts of \$410 and \$178 at July 31, 2009 and 2008	1,352	1,304
Work in process	156	264
Prepaid expenses and other	321	392
Deferred income taxes	513	330
Total Current Assets	<u>2,992</u>	<u>3,376</u>
Equipment and leasehold improvements:		
Computer equipment	1,827	5,647
Leasehold improvements	463	198
Furniture and equipment	2,479	2,842
	<u>4,769</u>	<u>8,687</u>
Less accumulated depreciation and amortization	2,827	7,523
Net equipment and leasehold improvements	1,942	1,164
Capitalized software product costs:		
Amounts capitalized for software product costs	14,886	13,209
Less accumulated amortization	12,489	11,613
Net capitalized software product costs	2,397	1,596
Deferred income taxes	2,141	2,412
Other long term assets	59	53
Other intangible assets	3,637	1,396
Goodwill	5,439	2,196
<b>Total Assets</b>	<u><u>\$ 18,607</u></u>	<u><u>\$ 12,193</u></u>

See accompanying notes



**ARI Network Services, Inc.**  
**Consolidated Balance Sheet**  
**(Dollars in Thousands)**

<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>July 31</b>	
	<b>2009</b>	<b>2008</b>
Current liabilities:		
Current borrowings on line of credit	\$ 500	\$ 700
Current portion of notes payable	117	676
Accounts payable	788	408
Deferred revenue	5,523	5,071
Accrued payroll and related liabilities	1,421	922
Accrued sales, use and income taxes	82	80
Other accrued liabilities	729	899
Current portion of capital lease obligations	109	95
Total current liabilities	<u>9,269</u>	<u>8,851</u>
Non-current liabilities:		
Notes payable (net of discount)	5,000	116
Long-term portion of accrued compensation	36	97
Capital lease obligations	115	233
Total non-current liabilities	<u>5,151</u>	<u>446</u>
Total liabilities	<u>14,420</u>	<u>9,297</u>
Shareholders' equity:		
Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at July 31, 2009 and 2008	-	-
Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at July 31, 2009 and 2008	-	-
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 7,693,510 and 6,971,927 shares issues and outstanding at July 31, 2009 and 2008	8	7
Common stock warrants and options	816	501
Additional paid-in-capital	95,681	95,148
Accumulated deficit	(92,284)	(92,708)
Other accumulated comprehensive income (loss)	(34)	(52)
Total Shareholders' Equity	<u>4,187</u>	<u>2,896</u>
<b>Total Liabilities and Shareholders' Equity</b>	<u><u>\$ 18,607</u></u>	<u><u>\$ 12,193</u></u>

See accompanying notes



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

	<b>Year ended July 31</b>	
	<b>2009</b>	<b>2008</b>
Net revenue	\$ 17,637	\$ 16,917
Cost of revenue	3,412	2,871
Gross margin	14,225	14,046
Operating expenses:		
Sales and marketing	4,072	3,448
Customer operations and support	2,785	2,728
Software development and technical support (net of capitalized product costs)	1,288	1,656
General and administrative	4,212	4,137
Restructuring	-	529
Depreciation and amortization (exclusive of amortization of software products included in cost of products and services sold)	1,101	727
Net operating expenses	13,458	13,225
Operating income	767	821
Other income (expense):		
Interest expense	(214)	(99)
Other, net	(6)	71
Total other income (expense)	(220)	(28)
Income before provision for income taxes	547	793
Income tax benefit (expense)	(123)	590
<b>Net income</b>	<b>\$ 424</b>	<b>\$ 1,383</b>
Basic and diluted net income per common share:		
Basic	\$0.06	\$0.21
Diluted	\$0.06	\$0.20

See accompanying notes



**ARI Network Services, Inc.**  
**Consolidated Statements of Shareholders' Equity**  
**(Dollars in Thousands, Except per Share Data)**

	Common Stock			Paid in Capital	Accumulated Deficit	Other	Total Shareholders' Equity
	Shares Issued and Outstanding	Par Value	Warrants & Options			Accumulated Comprehensive Loss	
<b>Balance July 31, 2007</b>	<b>6,623,605</b>	<b>\$ 7</b>	<b>\$ 195</b>	<b>\$ 94,627</b>	<b>\$ (94,091)</b>	<b>\$ (20)</b>	<b>\$ 718</b>
Issuance of common stock under stock purchase plan	5,541	-	-	7	-	-	7
Issuance of common stock as contribution to 401(k) plan	30,090	-	-	48	-	-	48
Return of common stock from 401(k) plan	(6,031)	-	-	(10)	-	-	(10)
Issuance of common stock under executive bonus plan	6,222	-	-	7	-	-	7
Issuance of common stock related to acquisitions	312,500	-	-	469	-	-	469
Stock based compensation	-	-	306	-	-	-	306
Net income	-	-	-	-	1,383	-	1,383
adjustments	-	-	-	-	-	(32)	(32)
Comprehensive income	-	-	-	-	1,383	(32)	1,351
<b>Balance July 31, 2008</b>	<b>6,971,927</b>	<b>7</b>	<b>501</b>	<b>95,148</b>	<b>(92,708)</b>	<b>(52)</b>	<b>2,896</b>
Issuance of common stock under stock purchase plan	4,359	-	-	4	-	-	4
Issuance of common stock under executive bonus plan	8,642	-	-	8	-	-	8
Issuance of common stock as contribution to 401(k) plan	32,955	-	-	45	-	-	45
Issuance of common stock from exercise of stock options	60,242	-	-	16	-	-	16
Issuance of common stock related to acquisitions	615,385	1	-	460	-	-	461
Stock based compensation	-	-	315	-	-	-	315
Net income	-	-	-	-	424	-	424
Foreign currency translation adjustments	-	-	-	-	-	18	18
Comprehensive income	-	-	-	-	424	18	442
<b>Balance July 31, 2009</b>	<b>7,693,510</b>	<b>\$ 8</b>	<b>\$ 816</b>	<b>\$ 95,681</b>	<b>\$ (92,284)</b>	<b>\$ (34)</b>	<b>\$ 4,187</b>

Shareholders' Equity Includes cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at July 31, 2007, July 31, 2008 and July 31, 2009.

Shareholders' Equity includes junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at July 31, 2007, July 31, 2008 and July 31, 2009.

See accompanying notes



**ARI Network Services, Inc.**  
**Consolidated Statements of Shareholders' Equity**  
(Dollars in Thousands, Except per Share Data)

	<b>Year ended July 31</b>	
	<b>2009</b>	<b>2008</b>
<b>Operating activities</b>		
Net income	\$ 424	\$ 1,383
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of software products	876	764
Amortization of deferred financing costs, debt discount and excess carrying value over face amount of notes payable	8	25
Depreciation and other amortization	1,101	727
Allowance for investment in Bank Note	127	-
Deferred income taxes	88	(648)
Stock based compensation related to stock options	315	306
Stock issued as contribution to 401(k) plan	45	38
Net change in assets and liabilities:		
Trade receivables, net	235	9
Work in process	108	(41)
Prepaid expenses and other	89	(91)
Other long term assets	(5)	(53)
Accounts payable	137	(364)
Deferred revenue	(859)	(571)
Accrued payroll related liabilities	352	9
Accrued sales, use and income taxes	2	52
Other accrued liabilities	(298)	482
Net cash provided by operating activities	<u>2,745</u>	<u>2,027</u>
<b>Investing activities</b>		
Purchase of equipment, software and leasehold improvements	(692)	(119)
Cash paid for goodwill and intangible assets related to acquisitions	(645)	(769)
Cash paid for other net assets related to acquisitions	(123)	(239)
Software product costs capitalized	(759)	(524)
Net cash used in investing activities	<u>(2,219)</u>	<u>(1,651)</u>
<b>Financing activities</b>		
Borrowings (repayments) under line of credit	(200)	700
Payments under notes payable	(684)	(1,035)
Payments of capital lease obligations	(104)	(25)
Proceeds from issuance of common stock	20	7
Net cash used in financing activities	<u>(968)</u>	<u>(353)</u>
Effect of foreign currency exchange rate changes on cash	<u>6</u>	<u>13</u>
Net change in cash	(436)	36
Cash at beginning of period	1,086	1,050
Cash at end of period	<u>\$ 650</u>	<u>\$ 1,086</u>
Cash paid for interest	<u>\$ 211</u>	<u>\$ 109</u>
Cash paid for income taxes	<u>\$ 28</u>	<u>\$ 5</u>
<b>Noncash investing and financing activities</b>		
Capital lease obligations incurred for computer equipment	\$ -	\$ 334
Capital lease obligations acquired in connection with acquisitions	-	6
Accrued liabilities related to purchase of computer equipment	86	-
Accrued liabilities assumed in connection with acquisitions	1,691	113
Debt issued in connection with acquisition	5,000	300
Issuance of common stock related to payment of executive bonus	8	7
Issuance of common stock in connection with acquisitions	461	469

See accompanying notes



## ARI Network Services, Inc. Notes to Consolidated Financial Statements

### 1. Description of Business and Significant Accounting Policies

#### Description of Business

ARI Network Services, Inc. (the “Company” or “ARI”) is a leading provider of technology enabled services that help dealers, distributors and manufacturers reduce costs and increase sales in selected vertical markets. Specifically, ARI provides electronics parts catalogs, dealer e-commerce solutions, professional services and outsourced finance and insurance (“F&I”) services in about a dozen vertical markets worldwide, including outdoor power, power sports, motorcycles, marine, recreational vehicles (“RV”), appliances, agricultural equipment, floor maintenance and construction. ARI currently serves over 20,000 dealers, 10 manufacturers and 150 distributors in more than 100 countries worldwide.

Manufacturers and distributors drive revenue, efficiency and customer satisfaction by leveraging ARI’s technology enabled services and dealer relationships, and look to ARI as a partner to reach their dealers. Dealers rely on ARI’s technology enabled services and extensive network of manufacturer and distributor relationships to attain content and technology solutions, which results in improved revenue, efficiency and customer satisfaction.

ARI operates primarily in two geographical segments: the U.S. and Netherlands-based European operations. Each provides technology-enabled business solutions that connect manufacturers in selected industries with their service and distribution networks. Segmented operating information is provided to the Company’s chief operating decision makers.

No single customer accounted for 10% or more of ARI’s revenue in fiscal 2009 or 2008.

#### Reclassifications

Beginning in fiscal 2009, the Company reports revenue in total on the income statement rather than by service type and has reclassified the components of operating expenses. Beginning in the fourth quarter of fiscal 2008, the Company reports net changes in assets and liabilities in detail on the Statement of Cash Flows rather than in the condensed format, as has been done historically. The fiscal 2008 financial statements have been reclassified to conform to the fiscal 2009 presentation.

#### Principles of Consolidation

The financial statements include the accounts of ARI Network Services, Inc. (the “Company”) and its wholly owned subsidiaries, ARI Europe B. V. and ARI F&I Services, LLC (“AFIS”), formerly known as ARI Outsourced F&I Center, LLC (“OFIC”). Operations of OFIC were suspended in December 2007, and re-initiated on April 18, 2009, when the Company acquired a small outsourced finance and insurance (“F&I”) business in Schenectady, NY. All inter-company transactions and balances have been eliminated.

The functional currency of the Company’s subsidiary in the Netherlands is the Euro; 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. Income and expense amounts, except for those related to assets translated at historical rates, are translated at the weighted-average exchange rates during the period. Adjustments resulting from the re-measurement of the financial statements into the functional currency are charged or credited to comprehensive income (loss).

#### Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

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

#### Concentrations

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash deposits in bank accounts. Deposits in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) of approximately \$250,000 on interest-bearing accounts as of July 31, 2009 and \$100,000 as of July 31, 2008 are exposed to loss in the event of nonperformance by the institution. The Company had cash



deposits in excess of the FDIC insurance coverage of \$400,000 and \$986,000 as of July 31, 2009 and 2008, respectively.

### Trade Receivables and Credit Policy

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within 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 all receivable balances that exceed 60 days from the invoice date and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. The allowance for potential credit losses is reflected as an offset to trade receivables in the accompanying balance sheets. The Company recorded bad debt expense in the Consolidated Statements of Income of \$110,000 and \$52,000 for the fiscal years ended July 31, 2009 and 2008, respectively.

### Work in Process

Work in process consists of billable professional services performed by the Company, for which revenue was recognized pursuant to contract accounting primarily using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred, which have not been invoiced as of the end of the reporting period.

### Revenue Recognition

Revenue for use of the network and for information services is recognized on a straight-line basis over the period of the contract.

Revenue from annual or periodic maintenance fees is recognized ratably over the period the maintenance is provided. Revenue from catalog subscriptions is recognized on a straight-line basis over the subscription term.

Revenue from software licenses in multiple element arrangements is recognized ratably over the contractual term of the arrangement. The Company 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 Company's standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential include customizing complex features and functionality in a product's base software code or developing complex interfaces within a customer's environment. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When professional services are considered essential, revenue under the arrangement is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined.

Revenue on arrangements with customers who are not the ultimate users (resellers) is deferred if there is any uncertainty regarding the ability and intent of the reseller to sell such software independent of their payment to the Company.

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

### Use of Estimates

The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The Company considers capitalization and amortization of software product costs, realizability and valuation of intangible assets, accruals for anticipated losses on projects and litigation, sales tax liabilities, various contract arrangements, and the deferred tax valuation allowance to be significant estimates that are subject to change in the near term.

### 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 purposes and accelerated methods for income tax purposes. Depreciation and amortization have been provided over the estimated useful lives of the assets as follows:

	<u>Years</u>
Computer equipment	3-7
Leashold improvements	2-7
Furniture and equipment	3-5

Leasehold improvements are amortized over the useful lives of the assets or the term of the related lease agreement, whichever is shorter.



### 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 revenues, estimated economic life and changes in software and hardware technologies.

The annual amortization of software products is the greater of the amount computed using: (a) the ratio that current gross revenues for the network or a software product bear to the total of current and anticipated future gross revenues for the network or a software product, or (b) the straight-line method over the estimated economic life of the product which currently runs from three to five years. Amortization starts when the product is available for general release to customers. All other software development and support expenditures are charged to expense in the period incurred.

### Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", equipment and leasehold improvements and capitalized software product costs are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve judgment. The Company evaluated the ongoing value of its long-lived assets as of July 31, 2009 and 2008. During fiscal 2009, the Company disposed of fully depreciated long-lived assets with a cost basis of \$5,309,000. The Company did not incur any impairment charges in fiscal 2009 and 2008.

### Capitalized Interest Costs

In 2009 and 2008, interest costs of \$9,000 and \$3,000, respectively, were capitalized and included in the capitalized software product costs.

### Insurance Premiums Receivable

The Company is the beneficiary of the total premiums it paid on a split-dollar life insurance policy at the death of the policy holder. Insurance premiums receivable are recorded at present value based on the average life expectancy of the policy holder and are included in other long term assets. Insurance premiums receivable consisted of \$59,000 and \$53,000 at July 31, 2009 and 2008, respectively, which is the present value of future life insurance premiums receivable of approximately \$237,000 discounted at an average rate of 9% and averaged over 17 and 18 years. There was no life insurance premiums receivable recorded prior to July 31, 2008.

### Fair Value Measurements

Effective July 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements". SFAS No. 157 clarifies how companies are required to use a fair value measure for recognition and disclosure by establishing a common definition of fair value, creating a framework for measuring fair value, and expanding disclosures about fair value measurements. SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions. The adoption of SFAS No. 157 did not have a material impact on the Company's result of operations or financial position.

The Company measures many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are recognized in earnings.

Using Level 3 inputs, the Company evaluated the fair market value of a note receivable with a book value of approximately \$127,000 and, based on managements' expectation of collection, booked an allowance to the note resulting in a fair market value of \$0 at July 31, 2009.

### Shipping and Handling

Revenue received from shipping and handling fees is reflected in net revenue. Costs incurred for shipping and handling are reported in cost of products and services sold.



## Income Taxes

Income taxes are accounted for using an asset and liability approach, which requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the financial statements or tax returns. The measurement of current and deferred tax assets and liabilities is based on provisions of enacted tax laws; the effects of potential future changes in tax laws or rates are not anticipated. If it is more likely than not that full realization of deferred income tax benefits is not expected, a deferred tax valuation allowance is recorded.

## Foreign Currency Translation

The Company's Netherland subsidiary uses the euro as its functional currency. Accordingly, assets and liabilities are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at weighted-average exchange rates. The resulting translation adjustment is recorded as a separate component of shareholders' equity and will be included in the determination of net income (loss) only upon sale or liquidation of the subsidiary.

## Stock-Based Compensation

The Company 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. SFAS 123(R), "Share-Based Payments" requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on our historical experience. There were no capitalized stock-based compensation costs at July 31, 2009 and 2008.

## Comprehensive Income (Loss)

Comprehensive income is a more inclusive financial reporting method that includes disclosure of financial information that historically has not been recognized in the calculation of net income. The Company has reported Comprehensive Income which includes net income and foreign currency translation adjustments in the Consolidated Statements of Shareholders' Equity for the years ended July 31, 2009 and 2008.

## 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 the Company's outstanding stock options and warrants that are in the money were exercised (calculated using the treasury stock method).

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

	<u>2009</u>	<u>2008</u>
Net income	\$ 424	\$ 1,383
Weighted-average common shares outstanding	7,203	6,678
warrants outstanding	25	225
	<u>7,228</u>	<u>6,903</u>
Net income per share:		
Basic	\$ 0.06	\$ 0.21
Diluted	<u>\$ 0.06</u>	<u>\$ 0.20</u>
Options 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	<u>1,394</u>	<u>941</u>

## Goodwill and Other Intangible Assets

Under (SFAS) No. 142, "Goodwill and Other Intangible Assets", goodwill and intangible assets deemed to have indefinite lives are not amortized, but are subject to annual impairment tests. Intangible assets with definitive lives at July 31, 2009 and 2008 consist primarily of costs of customer relationships, which are amortized over their estimated useful lives of 2-8 years. These assets were acquired in the Eye Communication Systems, Inc. ("ECSI") acquisition on July 1, 2008, the OC-Net, Incorporated, ("OC-Net") acquisition on January 26, 2007 and the Channel Blade Technologies ("Channel Blade") acquisition on April 27, 2009, where the fair values were determined using the discounted cash flow approach.

The Company performs impairment tests annually or more frequently if facts and circumstances warrant a review. The Company determined that there was a single reporting unit for the purpose of goodwill impairment tests under SFAS 142. For purposes of assessing the impairment of goodwill, the Company estimates the value of the reporting unit using the best evidence available, which in fiscal 2009 and 2008 was a discounted cash flow model, consideration of recent transaction values and market capitalization. This fair value is then compared with the carrying value of the reporting unit. During fiscal 2009 and 2008 there were no impairments to goodwill.



Intangible assets with indefinite lives consisted of \$5,439,000 and \$2,196,000 of goodwill at July 31, 2009 and 2008, respectively.

Amortizable intangible asset costs, including customer relationships, trade names and employee non-compete agreements, consisted of the following (in thousands):

	Customer Relationships	Trade Names	Non-Compete Agreements	Finance Costs	Total
Net value 7/31/07	\$ 862	\$ -	\$ -	\$ 1	\$ 863
Additions	730	-	-	-	730
Amortization	(196)	-	-	(1)	(197)
Net value 7/31/08	1,396	-	-	-	1,396
Additions	2,274	252	186	-	2,712
Amortization	(435)	(13)	(23)	-	(471)
Net value 7/31/09	\$ 3,235	\$ 239	\$ 163	\$ -	\$ 3,637

The estimated amortization expense related to intangible assets for the years subsequent to July 31, 2009 is as follows (in thousands):

	Year Ending July 31:
2010	\$ 810
2011	787
2012	602
2013	335
2014	322
2015	284
2016	284
2017	213
	<u>\$ 3,637</u>

During fiscal 2008 the Company reclassified \$190,000 from amortizable intangible assets to goodwill. The reclassification was related to the value assigned to workforce intangible assets acquired in the OC-Net acquisition during fiscal 2007. It was determined during fiscal 2008 that the nature of the workforce intangible assets capitalized required the assets to be presented with goodwill as required by SFAS No. 141, "Business Combinations". The impact that this reclassification had on amortization expense was immaterial. The fiscal 2008 financial statements have been restated to conform to the fiscal 2009 presentation.

## Accounting Pronouncements

In April 2008, the FASB issued FASB Staff Position ("FSP") FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets" FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP FAS 142-3 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 requires companies with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. SFAS 161 is effective for the Company's fiscal year beginning August 1, 2009. The adoption of SFAS 161 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. It requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. SFAS 160 establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation. SFAS 160 is effective for the Company's fiscal year beginning August 1, 2009. The adoption of SFAS 160 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.



In December 2007, the FASB issued SFAS No. 141 (Revised 2007), “Business Combinations” (“SFAS 141(R)"). SFAS 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. SFAS 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any non-controlling interest at their fair values as of the acquisition date. In addition, SFAS 141(R) requires expensing of acquisition-related and restructure-related costs, re-measurement of earn out provisions at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and non-expensing of in-process research and development related intangibles. SFAS 141(R) is effective for the Company’s business combinations for which the acquisition date is on or after August 1, 2009. The impact on the Company of the adoption of SFAS 141(R) cannot be determined at this time but management expects that it may have a material impact on the Company in the event of an acquisition or business combination.

The FASB has issued FASB Statement No. 168, The “FASB Accounting Standards Codification” and the Hierarchy of Generally Accepted Accounting Principles. Statement 168 establishes the FASB Accounting Standards Codification (Codification) as the single source of authoritative U.S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. Statement 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. When effective, the Codification will supersede all existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. Following Statement 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, the FASB will issue Accounting Standards Updates, which will serve only to: (a) update the Codification; (b) provide background information about the guidance; and (c) provide the bases for conclusions on the change(s) in the Codification. The adoption of Statement No. 168 is not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

The FASB has issued the following two standards which change the way entities account for securitizations and special-purpose entities:

- FASB Statement No. 166, Accounting for Transfers of Financial Assets; and
- FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)

FASB Statement No. 166 is a revision to FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a “qualifying special-purpose entity,” changes the requirements for derecognizing financial assets, and requires additional disclosures.

Statement 167 is a revision to FASB Interpretation No. 46 (Revised December 2003), Consolidation of Variable Interest Entities, and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity’s purpose and design and the reporting entity’s ability to direct the activities of the other entity that most significantly impact the other entity’s economic performance. Statement 167 will require a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity’s financial statements. Statement 166 enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and an entity’s continuing involvement in transferred financial assets. Statements 166 and 167 will be effective at the start of a reporting entity’s first fiscal year beginning after November 15, 2009, or January 1, 2010, for a calendar year-end entity. Early application is not permitted. FASB Statement Nos. 166 and 167 are not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

FASB Accounting Standards Update 2009-14 changes the accounting model for revenue arrangements that include both tangible products and software elements. Under this guidance, tangible products containing software components and non-software components that function together to deliver the tangible product’s essential functionality are excluded from the software revenue guidance in Subtopic 985-605, Software-Revenue Recognition. In addition, hardware components of a tangible product containing software components are always excluded from the software revenue guidance. FASB Accounting Standards Updates 2009-14 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company does not expect this guidance to have a material impact on its consolidated financial position, results of operations or cash flows.



FASB Accounting Standards Update 2009-13 addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Specifically, this guidance amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, for separating consideration in multiple-deliverable arrangements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. FASB Accounting Standards Update 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The impact on the Company's consolidated financial position, results of operations or cash flows cannot be determined at this time.

## 2. 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 7/31/08	\$ 13,209	\$ (11,613)	\$ 1,596
Capitalized costs	759		759
Acquisitions	918		918
Amortization expense		(876)	(876)
<b>Balance 7/31/09</b>	<b>\$ 14,886</b>	<b>\$ (12,489)</b>	<b>\$ 2,397</b>

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, 2009 (in thousands):

	Year Ending July 31:
2010	\$ 970
2011	689
2012	459
2013	257
2014	22
	<b>\$ 2,397</b>

## 3. Notes Payable

Notes payable consist of the following at July 31 (in thousands):

	2009	2008
Notes payable	\$ 5,117	\$ 800
Less imputed interest	-	(8)
Notes payable, net of imputed interest	5,117	792
Less current maturities	117	676
<b>Notes payable - non-current</b>	<b>\$ 5,000</b>	<b>\$ 116</b>

The Company issued a \$5,000,000 secured promissory note in connection with the April 27, 2009 purchase of Channel Blade. The Note is subordinated and junior in right of payment to all indebtedness, obligations and liabilities of the Company, existing as of April 27, 2009 or thereafter incurred, to current or future Senior Lenders (as defined in the Note) of the Company. The Company's obligations under the Note are secured by a Subordinated Security Agreement dated as of April 27, pursuant to which the Company granted to Channel Blade a continuing junior security interest in substantially all of the assets of the Company. The payments are subject to acceleration upon certain events of default. The annual interest rate on the note is 10% for the first year and 14% thereafter, unless the conditions of the covenant described below are met. Accrued interest only is due quarterly commencing July 31, 2009 through April 30, 2011. Twenty equal quarterly payments of principal plus accrued interest shall then be due, commencing July 31, 2011. The note contains a covenant that if the Company pre-pays a minimum principal amount of \$3,000,000 on or before April 27, 2010, the interest rate will remain 10% for the remainder of the note's term.

The Company issued \$700,000 of notes and \$400,000 of future, non-interest bearing contingent payments in connection with the OC-Net acquisition in 2007. The interest rate on the notes is prime plus 2%, adjusted quarterly (effective rate of 7.00% as of July 31, 2009). The notes are payable in quarterly principal installments of \$58,333, commencing March 31, 2007 through December 31, 2009. The notes do not contain any financial covenants. The Company paid \$250,000 of the contingent payments in February, 2008, and the remaining \$150,000, which included \$8,000 of imputed interest, was paid in January, 2009.

In 2008, the Company issued \$300,000 of notes payable in connection with the acquisition of ECSI, of which \$100,000 was paid on October 1, 2008 and \$200,000 was paid on July 1, 2009.



Principal payments due on notes payable are as follows (in thousands):

	Year Ending July 31:
2010	\$ 117
2011	177
2012	771
2013	885
2014	1,016
Thereafter	<u>2,151</u>
	<u>\$ 5,117</u>

#### 4. Acquisitions

On July 1, 2008, the Company acquired all of the assets related to electronic parts catalog, electronic commerce and certification testing for service technicians of Info Access, the micropublishing division of Eye Communication Systems, Inc., of Hartland, Wis. Consideration for the acquisition included approximately \$1.0 million in cash, 312,500 shares of the Company's common stock and notes payable of \$300,000.

The purchase price of this acquisition has been allocated to the following specific assets and liabilities acquired based on the fair value of those identified tangible and intangible assets and liabilities (in thousands):

Prepaid expenses	\$ 9
Software	230
Goodwill	927
Other intangible assets	<u>730</u>
Total assets	1,896
Deferred revenue	23
Capital leases	<u>6</u>
Total liabilities	<u>29</u>
<b>Net assets acquired</b>	<b><u>\$ 1,867</u></b>

Capitalized software is amortized over 2 years and intangibles related to customer relationships are amortized over 4 years.

On April 16, 2009, AFIS, a wholly owned subsidiary of the Company, acquired a \$149,000 bank note from Key Bank National Association for \$125,000, which was secured by substantially all of the assets of Powersports Outsourcing Group, LLC ("PSOG"). The Company advanced an additional \$36,000 to PSOG. On April 17, 2009, AFIS acquired the assets of PSOG, valued at approximately \$85,000, in partial satisfaction of its debt to the Company of approximately \$185,000.

The Company allocated the acquisition of the PSOG assets as follows:

Cash	\$ 37
Accounts receivable	37
Other assets	2
Notes receivable	<u>127</u>
Total assets	203
Accounts payable	39
Payroll related accruals	<u>3</u>
Total liabilities	<u>42</u>
<b>Net assets acquired</b>	<b><u>\$ 161</u></b>

Subsequent to April 16, 2009, the Company deemed the fair value of the PSOG note receivable to be \$0 and recorded a valuation adjustment of approximately \$127,000 in the 2009 results from operations.

PSOG, located in Schenectady, NY, had been offering outsourced F&I services to power sports, marine and RV customers in the Northeast U.S. since 1998. In connection with the acquisition, AFIS entered into a three year employment agreement with Mark L. Taylor to serve as Director of F&I Business Development. The Company included the results of operations of AFIS as of April 17, 2009 in its consolidated financial statements for the year ended July 31, 2009.

On April 27, 2009, the Company acquired substantially all of the assets of Channel Blade Technologies, Corp., located in Virginia Beach, VA. The acquisition makes the Company an industry leader with enhanced opportunities for growth. Consideration for the acquisition included approximately \$500,000 in cash, 615,385 shares of the Company's common stock at a market price of \$0.75 per share, \$765,000 of assumed net liabilities and a \$5,000,000 note payable. The Company incurred approximately \$146,000 in capitalized closing costs in connection with the Channel Blade acquisition.



The purchase price of this acquisition has been allocated to the following specific assets and liabilities acquired based on the fair value of those identified tangible and intangible assets and liabilities as determined by an independent valuation (in thousands):

Accounts receivable	\$	253
Prepaid taxes		17
Equipment		613
Software		918
Goodwill		3,243
Other intangible assets		<u>2,712</u>
Total assets		7,756
Accounts payable		242
Deferred revenue		1,311
Accrued payroll and related liabilities		<u>95</u>
Total liabilities		<u>1,648</u>
<b>Net assets acquired</b>	<b>\$</b>	<b><u>6,108</u></b>

Intangibles and other assets include trade names, customer relationships and employee non-compete agreements which are amortized over 5, 8 and 2 years, respectively. Capitalized software product costs are amortized over 4.1 years.

In connection with the acquisition, the Company entered into one year non-compete employment agreements with Jon M. Lintvet and Charles Lewis to serve as Director of New Business Development and Director of Strategic Accounts- Marine and RV, respectively.

The following table shows the unaudited pro forma results of operations for the fiscal years ended July 31, 2009 and 2008, which assumes the Channel Blade acquisition occurred at the beginning of those periods (in thousands, except per share data):

	2009	2008
Revenues	\$ 21,075	\$ 21,443
Cost of revenues	<u>4,096</u>	<u>4,008</u>
Gross profit	16,979	17,435
Net operating expenses	<u>17,245</u>	<u>19,129</u>
Operating loss	(266)	(1,694)
Interest expense	739	599
Other expense (income), net	<u>6</u>	<u>(70)</u>
Loss before provision for income taxes	(1,011)	(2,223)
Income tax provision (benefit)	<u>123</u>	<u>(590)</u>
<b>Net loss</b>	<b><u>\$ (1,134)</u></b>	<b><u>\$ (1,633)</u></b>
Average common shares outstanding:		
Basic	7,780	7,293
Diluted	7,780	7,293
Basic and diluted net loss per share:		
Basic	<u>\$ (0.15)</u>	<u>\$ (0.22)</u>
Diluted	<u>\$ (0.15)</u>	<u>\$ (0.22)</u>

This pro forma information does not purport to be indicative of the results that actually would have been obtained if the combined operations had been conducted during the periods presented and is not intended to be a projection of future results.

## 5. Capital and Operating Leases

The Company leases office space and certain office equipment under operating lease arrangements expiring through 2021. The Company is generally liable for its share of increases in the landlord's direct operating expenses and real estate taxes related to the office space leases. Total rental expense for the operating leases was \$554,000 in 2009 and \$659,000 in 2008. An additional 131,000 of rent costs were incurred in fiscal 2009 but were accrued in fiscal 2008 related to the restructure.

Where applicable, rent expense for leased offices is recognized on a straight-line basis over the lease terms, which differ from the pattern of payments required by the leases. Other accrued liabilities included \$0 and \$48,000 of deferred rent at July 31, 2009 and 2008, respectively. As more fully discussed in Note 12, the Company has a recorded liability totaling \$93,000 for estimated net future lease costs associated with closed offices as of July 31, 2009.

The Company leases approximately 16,300 square feet of office space located at 10850 West Park Place, Milwaukee, Wisconsin 53224. Commencement occurred on July 17, 2009 and runs twelve years until July 17, 2021. Over the twelve year lease agreement, annual base rent of \$149,000 increases approximately 2.9% per year. Rent abatement was negotiated for the first fifteen months, and will save the Company approximately \$187,000. Annual projected operating costs and taxes, which are subject to change, are currently \$8.90 per square foot.

The Company has certain capital lease agreements in place related to computer and office equipment. Minimum lease payments under remaining capital and operating leases are as follows (in thousands):

Fiscal Year Ending July 31	Capital Leases	Operating Leases
2010	\$ 127	\$ 412
2011	94	468
2012	18	322
2013	14	310
2014	-	312
Thereafter	<u>-</u>	<u>2,336</u>
Total minimum lease payments	253	4,160
Less amounts related to interest	<u>29</u>	<u>-</u>
<b>Net minimum lease payments</b>	<b><u>\$ 224</u></b>	<b><u>\$ 4,160</u></b>



## 6. Line of Credit

On July 9, 2004, the Company entered into a line of credit agreement with JPMorgan Chase, N.A. which, as amended, permits the Company to borrow an amount equal to 80% of the book value of all eligible accounts receivable plus 45% of the value of all eligible open renewal orders (provided the renewal rate is at least 85%) minus \$75,000, up to \$1,500,000. Eligible accounts include certain non-foreign accounts receivable which are outstanding for fewer than 90 days from the invoice date. The note bears interest at 1% per annum above the prime rate (plus an additional 3%, at the lender's option, upon the occurrence of any default under the note) plus a non-usage fee of 0.25% per annum on any unused portion of the line of credit. The interest rate on the outstanding principal at July 31, 2009 is 4.25%. The line of credit terminates June 30, 2011 and is secured by substantially all of the Company's assets. The line of credit limits repurchases of common stock, the payment of dividends, liens on assets and new indebtedness. It also contains a financial covenant requiring the Company to maintain a minimum debt service coverage ratio of 1.2 to 1.0, with which the Company was in compliance at July 31, 2009. The Company had \$500,000 and \$700,000 principal outstanding on the line of credit at July 31, 2009, and July 31, 2008, respectively.

## 7. Shareholders' Equity

### Shareholder Rights Plan

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

## 8. Stock-based Compensation Plans

Total stock compensation expense recognized by the Company for the years ended July 31, 2009 and 2008 was approximately \$315,000 and \$306,000, respectively. As of July 31, 2009 and 2008, there was approximately \$224,000 and \$481,000, respectively, of total unrecognized compensation cost related to non-vested options granted under the plans.

The Company used the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding based on the terms of the grant. 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. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on our historical experience.

The weighted average assumptions in the following table were used to estimate the fair value of options granted:

	Year ended July 31	
	2009	2008
Expected life (years)	10 years	10 years
Risk-free interest rate	3.8%	4.5%
Expected volatility	84.4%	78.0%
Expected forfeiture rate	16.3%	20.9%
Expected dividend yield	0.0%	0.0%

### Employee Stock Purchase Plans

The Company's 2000 Employee Stock Purchase Plan has 175,000 shares of common stock reserved for issuance, and 158,681 of the shares have been issued as of July 31, 2009. All employees of the Company, other than executive officers, with nine months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.



## 1991 Stock Option Plan

The Company's 1991 Stock Option Plan was terminated on August 14, 2001, except as to outstanding options. Options granted under the 1991 Plan may be either: (a) options intended to qualify as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended (the Code), or (b) nonqualified stock options. Any incentive stock option that was granted under the 1991 Plan could not be granted at a price less than the fair market value of the stock on the date of grant (or less than 110% of the fair market value in the case of holders of 10% or more of the voting stock of the Company). Nonqualified stock options were allowed to be granted at the exercise price established by the Compensation Committee, which could be less than, equal to or greater than the fair market value of the stock on the date of grant.

Each option granted under the 1991 Plan is exercisable for a period of ten years from the date of grant (five years in the case of a holder of more than 10% of the voting stock of the Company) or such shorter period as determined by the Compensation Committee and shall lapse upon the expiration of said period, or earlier upon termination of the participant's employment with the Company.

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

Changes in option shares under the 1991 Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding 7/31/07	125,686	\$ 2.31	1.89	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(32,500)	\$ 2.28	n/a	n/a
Outstanding and exercisable at 7/31/08	93,186	\$ 2.27	1.23	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(57,686)	\$ 2.18	n/a	n/a
<b>Outstanding and exercisable at 7/31/09</b>	<b>35,500</b>	<b>\$ 2.43</b>	<b>1.09</b>	<b>\$ -</b>

The range of exercise prices for options outstanding at July 31, 2009 and 2008 was \$2.06 to \$9.06.

## 1993 Director Stock Option Plan

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

Changes in option shares under the Director Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding 7/31/07	1,313	\$ 2.65	2.97	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	-	n/a	n/a	n/a
Outstanding and exercisable at 7/31/08	1,313	\$ 2.65	1.97	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	-	n/a	n/a	n/a
<b>Outstanding and exercisable at 7/31/09</b>	<b>1,313</b>	<b>\$ 2.65</b>	<b>0.97</b>	<b>\$ -</b>

The range of exercise prices for options outstanding at July 31, 2009 and 2008 was \$2.00 to \$3.56.

## 2000 Stock Option Plan

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

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

Each incentive stock option granted under the 2000 Plan is exercisable for a period of not more than ten years from the date of grant (five years in the case of a participant who is 10% shareholder of the Company). Nonqualified stock options do not have this restriction.



Eligible participants include current and prospective employees, non-employee directors, consultants or other persons who provide services to the Company and whose performance, in the judgment of the Compensation Committee or management of the Company, can have a significant effect on the success of the Company. Changes in option shares under the 2000 Plan are as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding 7/31/07	1,013,100	\$ 1.45	6.61	\$ 320,062
Granted	548,625	1.51	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(181,187)	1.18	n/a	n/a
Outstanding at 7/31/08	1,380,538	1.51	7.36	150,967
<b>Exercisable at 7/31/08</b>	<b>937,203</b>	<b>1.48</b>	<b>6.28</b>	<b>150,967</b>
Granted	150,250	1.06	n/a	n/a
Exercised	(60,242)	0.26	n/a	n/a
Forfeited	(257,144)	1.52	n/a	n/a
<b>Outstanding at 7/31/09</b>	<b>1,213,402</b>	<b>1.51</b>	<b>7.08</b>	<b>21,337</b>
<b>Exercisable at 7/31/09</b>	<b>871,626</b>	<b>\$ 1.55</b>	<b>6.35</b>	<b>\$ 21,328</b>

The range of exercise prices for options outstanding at July 31, 2009 and 2008 was \$0.15 to \$2.74.

Changes in non-vested option shares under the 2000 Plan are as follows:

	Number of Options	Wtd. Avg. Grant Date Fair Value
Non-vested at 7/31/07	137,675	\$ 1.79
Granted	548,625	1.51
Vested	(226,249)	1.54
Forfeited	(16,716)	2.06
Non-vested at 7/31/08	443,335	1.76
Granted	150,250	1.06
Vested	(195,622)	1.47
Forfeited	(56,187)	1.54
<b>Non-vested at 7/31/09</b>	<b>341,776</b>	<b>\$ 1.40</b>

## 9. Income Taxes

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

	Year ended July 31	
	2009	2008
Current:		
Federal	\$ 475	\$ 362
State	56	121
Utilization of net operating loss carryforwards	(502)	(425)
AMT and other	7	-
Deferred, net	87	(648)
<b>Income tax (benefit) provision</b>	<b>\$ 123</b>	<b>\$ (590)</b>

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 our assets and liabilities, including various accruals, allowances, depreciation and amortization. The tax effect of these temporary differences and the estimated tax benefit from tax net operating losses are reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed. To the extent that management believes it is more likely than not that some portion, or all, of the deferred tax asset will not be realized, a valuation allowance is established. 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 ultimately the realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as valuation allowances is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the statement of operations.

The Company had a change in its estimated valuation allowance primarily due to a change in its projections of taxable income for the next twelve quarters. The Company continues to evaluate the realizability of deferred tax assets on a quarterly basis.



Significant components of the Company's deferred tax liabilities and assets as of July 31 are as follows (in thousands):

	Year ended July 31	
	2009	2008
Deferred tax assets:		
Net operating loss carryforwards	\$ 8,235	\$ 10,615
Alternative minimum tax credit carryforwards	96	78
Deferred revenue	2,032	1,832
Software product costs	378	-
Intangible assets	81	-
Goodwill	-	430
Other	837	1,273
Total deferred tax assets	11,659	14,228
Valuation allowance for deferred tax assets	(8,747)	(10,618)
Net deferred tax assets	2,912	3,610
Deferred tax liabilities:		
Software product costs and other	(208)	(580)
Intangible assets	-	(288)
Goodwill	(50)	-
<b>Net deferred taxes</b>	<b>\$ 2,654</b>	<b>\$ 2,742</b>

As of July 31, 2009, the Company has unused net operating loss carryforwards for federal income tax purposes of \$21,355,000 expiring in 2010 through 2020.

A portion of these unused net operating loss carryforwards for federal income tax purposes totaling \$2,038,000 expire between 2012 and 2014 and are limited to \$116,000 annually that can be utilized to offset taxable income. Use of these net operating loss carryforwards is restricted under Section 382 of the Code because of changes in ownership in 1997.

In addition, the Company has net operating loss carryforwards for state income tax purposes totaling approximately \$16,230,000 expiring in 2010 through 2015.

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 6% to U.S. based income before income taxes is as follows (in thousands):

	Year ended July 31	
	2009	2008
Computed income taxes at 40%	\$ 219	\$ 296
Permanent items	93	4
Deferred tax valuation and effective rate adjustments	(189)	(890)
<b>Income tax expense (benefit)</b>	<b>\$ 123</b>	<b>\$ (590)</b>

During 2009 and 2008, \$6,047,000 and \$6,422,000 respectively, of federal net operating loss carryforwards expired. These expired net operating loss carryforwards have been included in the calculation of the change in valuation allowance.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" (FIN 48), on August 1, 2007. The implementation of FIN 48 did not have a significant impact on our results of operations or financial position and therefore no amounts were reserved for uncertain tax positions as of July 31, 2009 and 2008. If necessary, in the future, the Company will accrue and recognize interest and penalties related to uncertain tax positions as a component of income tax expense.

## 10. Employee Benefit Plan

The Company 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 \$16,500 (\$22,000 over age 50) in calendar 2009 (subject to adjustment in future years to reflect cost of living increases) 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. During 2009 and 2008, the Company issued 32,955 and 24,059 shares of common stock, respectively, as a discretionary contribution to the 401(k) Plan. The amounts charged to expense for the 401(k) contributions, net of forfeitures, were \$45,000 during 2009 and \$38,000 during 2008.

## 11. Changes in Accounting Estimates

During fiscal 2009 and 2008, the Company had a change in its estimated valuation allowance related to deferred tax assets due to continual revisions and evaluations of the estimates of the expected results of operations for the next thirty six months. The difference between the amounts previously recorded as a valuation allowance and the amount currently recorded was charged to income tax expense. The amount of this change in accounting estimate was expense of \$88,000 or \$0.01 per basic and diluted common share in fiscal 2009 and income of approximately \$648,000 or \$0.09 per basic and diluted common share in fiscal 2008.

## 12. Restructuring

In July 2008 the Company announced a restructuring that consolidated its data conversion operations in Virginia into its Wisconsin location and consolidated the software development operations in Colorado into its California location. Adjustments to the restructuring reserve were charged to operating expense during fiscal 2009. The following represents changes to the restructuring reserve (in thousands):

	Balance 7/31/08	Payments	Adjustments	Balance 7/31/09
Severance and related benefits	\$ 292	\$ (292)	\$ -	\$ -
Net future lease costs	204	(111)	-	93
Equipment disposition and other	33	-	(33)	-
<b>Total restructuring costs</b>	<b>\$ 529</b>	<b>\$ (403)</b>	<b>\$ (33)</b>	<b>\$ 93</b>



### 13. Business Segments

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", we have segregated the Netherlands operation and the U.S. operations into separate reportable segments. (Refer to Note 1, "Significant Accounting Policies", for a description of segment operations.) Segment revenue for the Netherlands operation includes only revenue generated out of the Netherlands subsidiary and does not include rest of world revenue sold by the U.S. operation. We evaluate the performance of and allocate resources to each of the segments based on their operating results excluding interest and taxes. The accounting policies for each of the segments are described in Note 1. Information concerning our operating business segments for fiscal 2009 and 2008 is as follows (in thousands):

	Year Ended July 31	
	2009	2008
Revenue :		
Netherlands	\$ 652	\$ 763
United States	16,985	16,154
Consolidated	<u>\$ 17,637</u>	<u>\$ 16,917</u>
Net income (loss)		
Netherlands	\$ (100)	\$ (262)
United States	524	1,645
Consolidated	<u>\$ 424</u>	<u>\$ 1,383</u>
Total Assets		
Netherlands	\$ 227	\$ 272
United States	18,380	10,887
Consolidated	<u>\$ 18,607</u>	<u>\$ 12,193</u>

### 14. Concentration and Related Party

Briggs & Stratton Corporation ("Briggs") is one of the Company's customers and owns approximately 11% of the Company's stock. Briggs has entered into customer contracts with the Company and has provided vendor services to the Company in the ordinary course of business. Generally, the customer contracts are for one or two years and renew annually thereafter unless either party elects otherwise. The Company invoiced Briggs approximately \$416,000 and \$418,000 for products and services provided during fiscal 2009 and fiscal 2008, respectively. Briggs had unpaid net trade receivables of \$201,000 or 15% and \$212,000 or 17% of total trade receivables outstanding as of July 31, 2009 and 2008, respectively, \$0 of which was over 90 days at July 31, 2009 and 2008.

The vendor services provided by Briggs are for printing of materials which are generally resold to customers and included in cost of sales. Briggs invoiced the Company approximately \$105,000 and \$156,000 for printing services during fiscal 2009 and fiscal 2008, respectively, \$2,000 and \$8,000 of which were unpaid as of July 31, 2009 and 2008.

Gordon J. Bridge serves on the Company's board of directors. He was assigned by the board lead Director for F&I Services, LLC, a subsidiary of the Company, for which the Company has accrued but unpaid expenses of \$17,050 at July 31, 2009.

### 15. Litigation

On June 23, 2008, Powersports Complete, LLC ("Powersports") filed a complaint in the U.S. District Court for the Eastern District of Wisconsin against the Company and its wholly-owned subsidiary, AFIS. The complaint claimed, among other things, that the Company and AFIS owe \$56,960 to Powersports in connection with their business arrangements during 2007. The complaint also claimed that Powersports, among other remedies, is entitled to compensatory damages in the amount of \$1,250,000 and punitive damages in the amount of \$2,500,000. The Company and AFIS filed their answer to the complaint on September 16, 2008. The answer denied that Powersports is entitled to the payments described above, and asserted numerous counterclaims against Powersports. On February 4, 2009, the parties agreed to settle all outstanding claims between them. The settlement had no material effect on the Company's financial statements.

### 16. Subsequent Events

The Company evaluated events or transactions that may have occurred after the balance sheet date for potential recognition or disclosure in the financial statements according to the guidance of FASB Statement No. 165, "Subsequent Events", and determined that there were no events that occurred after July 31, 2009, but prior to October 29, 2009 that would affect the financial statements for the period ending July 31, 2009.