ARI NETWORK SERVICES INC /WI
Form 10-K/A
June 01, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

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

for the fiscal year ended July 31, 2000
or

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

From the transition period from .... to ....

Commission File No. 0-19608

ARI NETWORK SERVICES, INC.
(Exact name of registrant as specified in its charter)

Wisconsin	39-1388360
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
330 East Kilbourn Ave. Milwaukee, Wisconsin (Address of principal executive offices)	53202-3149 (zip code)

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

Securities registered pursuant to Section 12(b) of the Act:
NONE
Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, $.001 PAR VALUE
(TITLE OF CLASS)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO
___ ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405

of Regulation S-K 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. [   ]

As of May 25, 2001, aggregate market value of the Common Stock held by non-affiliates (based on the closing price on the NASDAQ National Market System) was approximately $4.1 million.

As of May 25, 2001, there were 6,184,281 shares of Common Stock of the registrant outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement, to be filed with the Securities and Exchange Commission no later than 120 days after July 31, 2000, for the 2000 Annual Meeting of Shareholders are incorporated by reference in Part III hereof.

NOTE REGARDING AMENDED FORM 10-K

The Company is making this filing to show, among other things, the effect of the restatement of our financial statements noted below. For current information on ARI Network Services, Inc., please refer to other recent filings with the Securities and Exchange Commission.

The Company sells licenses or license renewals and maintenance service agreements to most of its customers for the software products sold to them. The Company had previously recognized revenues related to the licenses at the time of delivery and license renewals at the time of renewal. Following discussions with the staff of the Securities and Exchange Commission, the Company revised its revenue recognition policy for transactions entered into after August 1, 1999 to recognize revenues resulting from these licenses and renewals over the term of the arrangement, which is generally twelve months.

As a result of this revision, the Company has restated its financial statements as of and for the year ended July 31, 2000 only. As a result of this revision, the Company's revenues have decreased and net loss has increased for the year ended July 31, 2000 by $1,256,000 or $0.21 per share.

The Company has reclassified amortization of industry specific applications from depreciation and amortization to cost of products and services sold for all periods shown. This has no impact on earnings.

The Company is amending only the following sections of the Report on Form 10-K:

Part II, Item 6. Selected Financial Data

Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Part II, Item 8. Financial Statements and Supplementary Data

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PART II

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain financial information with respect to the Company as of and for each of the five years in the period ended July 31, 2000, which was derived from audited Financial Statements and Notes thereto of ARI Network Services, Inc. Audited Financial Statements and Notes as of July 31, 2000 and 1999 and for each of the three years in the period ended July 31, 2000, and the report of Ernst & Young LLP thereon are included elsewhere in this Report. The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Financial Statements and Notes thereto included elsewhere herein.

STATEMENT OF OPERATIONS DATA:
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED JULY 31			
	2000	1999	1998	199
Network and other services revenues	$ 9,743	$ 8,616	$ 5,811	$ 5
Software revenues	1,289	2,822	1,431	
Professional services revenues	2,272	1,450	722	
Total revenues	13,304	12,888	7,964	6
Operating expenses:				
Cost of network and other services sold	1,415	1,431	1,327	1
Cost of software sold*	3,614	2,543	1,333	
Cost of professional services sold	1,965	1,234	407	
Depreciation and amortization (exclusive of amortization of Industry specific application included in cost of sales	1,778	1,773	1,021	
Network operations	2,048	1,017	708	1
Selling, general and administrative	8,214	6,995	4,586	4
Network construction and expansion	2,779	2,786	2,198	1
Operating expenses before amounts capitalized	21,813	17,779	11,580	11
Less capitalized portion	(1,729)	(1,802)	(1,546)	(1
Net operating expenses	20,084	15,977	10,034	9
Operating loss	(6,780)	(3,089)	(2,070)	(3
Other income (expense)	(822)	(326)	(70)	
Net loss	$ (7,602)	$ (3,415)	$ (2,140)	$ (3
Weighted average common shares outstanding	6,002	5,061	4,119	3
Basic and diluted net loss per share	$ (1.27)	$ (0.67)	$ (0.52)	$ (

SELECTED BALANCE SHEET DATA:

Working capital (deficit)	$ (4,680)	$ (3,476)	$ 762	$
Capitalized network system (net)**	11,901	14,052	9,122	8
Total assets	18,488	20,438	12,808	11
Current portion of long-term debt and capital lease obligations	933	713	58	
Total long-term debt and capital lease obligations	2,695	3,511	1,653	
Total shareholders' equity	7,159	9,756	8,962	8

* Includes amortization of industry specific applications of $3,224, $2,057, $1,121, $772 and $657.

** Fiscal 1999 includes a reclassification of $5,208 from goodwill as a result of the finalization of the purchase price allocation for the NDI acquisition.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SUMMARY

Total revenue grew 3% during fiscal 2000 compared to fiscal 1999, while revenues in the Equipment Industry grew 15%. Management attributes the less than expected increase in total revenue to the changes in revenue recognition required by Statement of Position 98-9 (which requires recognition of the Company's software licenses and renewals in multiple element arrangements over the term of the arrangement), late delivery of the Company's communications software and to a 12% decline in non-Equipment Industry revenues. The development delays negatively affected our expected recurring revenues by delaying deployment of the software to customers who had already signed with us. The delay also affected non-recurring revenues because the existing accounts could not be referenced as a fully deployed account and because the development team was assigned to existing accounts, and therefore was not available to work on newly signed accounts. Net loss grew as overall expenditures continued, without the corresponding increase in revenues, to address the software development issues and position the Company to resume its revenue growth.

REVENUES

Management reviews the Company's recurring vs. non-recurring revenue in the aggregate and within the Equipment Industry and all other industries. The Equipment Industry has been a growing percentage of our revenue over the past three years, representing approximately two thirds of the Company's revenue in fiscal 2000. As more fully described in Note 11 of the Notes to our Financial Statements, we revised our accounting policy for the recognition of revenue for software licenses and renewals in multiple element arrangement effective August 1, 1999. As a result of this revision, we have restated our financial statements for the year ended July 31, 2000 as presented herein.

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

REVENUE BY INDUSTRY
(IN THOUSANDS)

	YEAR ENDED JULY 31					
INDUSTRY:	2000	1999	PERCENT CHANGE	1999	1998	P C
Equipment Industry						
Recurring	$ 5,621	$ 3,243	73%	$ 3,243	$ 606	
Non-recurring	2,864	4,157	(31%)	4,157	1,588	
Subtotal	8,485	7,400	15%	7,400	2,194	
Other Revenues						
Recurring	4,483	4,841	(7%)	4,841	4,600	
Non-recurring	336	647	(48%)	647	1,170	
Subtotal	4,819	5,488	(12%)	5,488	5,770	
Total Revenue						
Recurring	10,104	8,084	25%	8,084	5,206	
Non-recurring	3,200	4,804	(33%)	4,804	2,758	
Grand Total	$13,304	$12,888	3%	$12,888	$ 7,964	

Recurring revenues are derived from catalog subscription fees, software maintenance and support fees, software license renewals, network traffic and support fees and other miscellaneous subscription fees. Recurring revenues increased in fiscal 2000 and fiscal 1999, compared to the prior year, primarily due to increases in the Equipment Industry revenues driven by the Powercom and NDI acquisitions. Recurring revenue, as a percentage of total revenue, increased from 65% in fiscal 1998 and 63% in fiscal 1999 to 76% in fiscal 2000 primarily due to increases in the customer base in the Equipment Industry caused by the Powercom and NDI acquisitions and to a drop in non-recurring revenues. Management believes a ratio of approximately two thirds recurring revenue to one third non-recurring revenue is desirable in order to establish an appropriate level of base revenue while continuing to add new

sales to drive future increases in recurring revenue. This revenue mix may fluctuate from quarter to quarter or year to year.

Non-recurring revenues are derived from initial software licenses and professional service fees. Non-recurring revenues increased in fiscal 1999, compared to the prior year, primarily due to increased new business in the Equipment Industry. These new sales decreased in fiscal 2000, compared to fiscal 1999, as the Company experienced delays in the development of customized communications software and the recognition of software licenses and renewals over the twelve month period of the arrangement, beginning in fiscal 2000. The Company has installed its TradeRoute(R) software at over 3,000 dealer locations as of the end of fiscal 2000. Management believes that non-recurring revenues will increase during fiscal 2001 because most of the development issues have been solved, although these revenues will be recognized at a slower rate than prior to the revenue recognition change. This positions the Company for a more solid and determinable revenue stream.

Equipment Industry

The Equipment Industry comprises several vertical markets including outdoor power, recreation vehicles, motorcycles, manufactured housing, farm equipment, marine, construction, power sports, floor maintenance, auto parts after market and others. Management's strategy is to expand the Company's electronic parts catalog software and services and dealer communication business with manufacturers and distributors and their dealers in the existing vertical markets and to expand to other similar markets in the future. Revenues from all of the Company's acquisitions are included in the Equipment Industry revenues. Recurring revenues in the Equipment Industry increased in fiscal 2000 and fiscal 1999, compared to the prior year, primarily due to the acquisitions of Powercom and NDI, both of which had substantial recurring revenue bases. Non-recurring revenues in the Equipment Industry decreased in fiscal 2000, compared to the prior year, primarily due to the recognition of software licenses and renewals over a twelve month period and delays in the delivery of the Company's customized communications software. Non-recurring revenues in the Equipment Industry increased in fiscal 1999, compared to the prior year, due to increased software and professional services sold to new and existing manufacturer customers, primarily in the recreation vehicle market. Management expects recurring and non-recurring revenues in the Equipment Industry to increase at a higher percentage of total revenues in fiscal 2001, as management continues to focus attention and resources in this industry.

Non-Equipment Industry Business

The Company's business outside of the Equipment Industry includes sales of database management services to the agricultural inputs and railroad industries, electronic communications services to the agricultural inputs industry, and the on-line provision of information for republication to the non-daily newspaper publishing industry. Other than a slight increase in recurring revenues in fiscal 1999 due to a price increase, both recurring and non-recurring revenues in this business decreased over the prior year in fiscal 2000 and in fiscal 1999. Management believes the decline in non-recurring revenues may signal that the Company is approaching saturation of the available market for the products and services offered by the Company in these industries and that consolidation in the agricultural customer base is the primary reason for the decline in recurring revenues. Management expects revenues in the non-Equipment Industry business will decline in fiscal 2001.

Our five-year contract with the Association of American Railroads expired in December, 2000. Our five-year contract with the Associated Press, on which our business in the non-daily newspaper publishing industries depends, expired in December 2000 and has been extended to September 14, 2001. Management is currently negotiating with the Associated Press to renew the contract, and, based on discussions we have had, management believes that if the contract is renegotiated, margins are likely to decline, although there is no assurance that this will be the case.

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OPERATING EXPENSES

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

OPERATING EXPENSES
(IN THOUSANDS)

	YEAR ENDED J			
	2000	1999	PERCENT CHANGE	
Cost of products and services sold	$ 6,994	$ 5,208	34%	$
Network operations	2,048	1,017	101%	
Selling, general & administrative	8,214	6,995	17%	
Network construction and expansion	2,779	2,786	0%	
Depreciation and amortization (exclusive of amortization of industry specific applications included in cost of products and services sold)	1,778	1,773	0%	
Less capitalized portion	(1,729)	(1,802)	(4%)	
Net operating expenses	$ 20,084	$ 15,977	26%	$

The categories of operating expense generally increased over the past two fiscal years primarily as a result of the Powercom and NDI acquisitions completed on September 15, 1998 and May 13, 1999, respectively.

Cost of products and services sold consists primarily of amortization of industry specific applications, royalties, telecommunications, distribution costs, customization and catalog production labor and temporary help fees. Cost of products and services sold increased in fiscal 2000 and fiscal 1999, compared to the prior year, primarily as a result of increased revenues and a change in the mix of products and services sold. Cost of products and services sold as a percentage of total revenue increased to 53% in fiscal 2000, from 40% in fiscal 1999 and 39% in fiscal 1998 primarily due to development cost overruns and amortization of industry specific applications. Cost of professional services sold as a percentage of professional services revenue was 86% in fiscal 2000 compared to 85% in fiscal 1999 and 56% in fiscal 1998. The increases in fiscal 2000 and fiscal 1999, compared to fiscal 1998, were due to costs of professional services which were not invoiced to the customer. The cost of these services was in excess of the customer's expected cost to complete for several major software customization projects in the Equipment Industry. The Company accrues estimated costs to complete projects when the estimated cost to complete exceeds anticipated billings. These excess costs were absorbed by the Company and had a negative impact on margins in the professional services category of revenue. Most of these projects were completed by the second quarter of fiscal 2001. Network and other services cost of sales as a percentage of network and other services revenue was 15% in fiscal 2000 compared to 17% in fiscal 1999 and 23% in fiscal 1998. The cost of these services, as a percentage of revenue, decreased over the past three years due to reduced telecommunications costs. Software cost of sales as a percentage of software revenue was 280% in fiscal 2000, compared to 90% in fiscal 1999 and 93% in fiscal 1998. The cost of software as a percentage of software revenue increased significantly in fiscal 2000, compared to fiscal 1999 and fiscal 1998, due to lower software license revenues with higher software amortization costs. Management expects gross margins to be approximately between 50% and 60% in fiscal 2001 and to fluctuate slightly from quarter to quarter based on the mix of products and services sold.

Network operations costs consist primarily of data center operations, software maintenance agreements for the Company's core network, catalog data maintenance and customer support. Network operations costs increased significantly in fiscal 2000 compared to fiscal 1999 and fiscal 1998 due to increased staffing in the catalog data maintenance area from the May 13, 1999 acquisition of NDI. Management expects these costs to continue to increase, but at a slower rate

than revenues.

Selling, general and administrative expenses ("SG&A") increased in fiscal 2000, compared to fiscal 1999 and fiscal 1998, due to additional costs absorbed in the Powercom and NDI acquisitions. SG&A, as a percentage of revenue, increased to 62% in fiscal 2000 from 54% in fiscal 1999 after having steadily decreased for each of the four previous fiscal years due to the reduction in revenue in fiscal 2000 as a result of the recognition of software licenses and

renewals over a twelve month period and additional costs absorbed from the acquisition of NDI without a corresponding increase in revenue. Management expects SG&A to decline as a percentage of sales in the future.

The Company's technical staff (in-house and contracted) is allocated between network construction and expansion and software customization services for customer applications. Therefore, management expects fluctuations between software customization services and development expenses from quarter to quarter, as the mix of development and customization activities will change based on customer requirements. During fiscal 2000, our technical resources were focused primarily on customization projects for our customers in the recreation vehicles market that are in the process of implementing our TradeRoute(R) dealer communications system, development of Web-based communications and cataloging software and increased year 2000 compliance efforts in November and December 1999. During fiscal 1999 development resources were focused primarily on the development of TradeRoute(R) and PLUS(1)(R). We expect our technical resources to continue to focus on software customization and development of Web-based software in fiscal 2001, although the mix may fluctuate quarter to quarter based on customer requirements. We expect software customization and development expenses to increase during fiscal 2001 due to additional focus on the development of our Web-based products.

Depreciation and amortization expenses increased substantially in fiscal 2000 and fiscal 1999 compared to fiscal 1998 due primarily to increased goodwill recognized in connection with the Company's acquisition of Powercom in September 1998. As a percentage of total revenue, depreciation and amortization was 13% in fiscal 2000, 14% in fiscal 1999 and 13% in fiscal 1998. Management expects depreciation and amortization expenses to continue at the current rate in fiscal 2001, barring any additional acquisitions.

Capitalized development costs represented 62% of network construction and expansion expense in fiscal 2000, compared to 65% and 70% in fiscal 1999 and fiscal 1998, respectively. Capitalized expenses decreased from fiscal 1998 and fiscal 1999 to fiscal 2000, as a percentage of network construction and expansion expense, due to the fact that the Company's development resources were focused on software customization projects and Year 2000 compliance projects, both of which are expensed.

OTHER ITEMS

Interest expense increased $481,000 in fiscal 2000, compared to fiscal 1999, due to additional financing by the Company under its RFC facility (described below) and the Debenture sold to Rose Glen (also described below). Interest expense increased $187,000 in fiscal 1999, compared to fiscal 1998, due to additional borrowings under the Company's line of credit with WITECH. The Company expects interest expense to increase in fiscal 2001, as the Company amortizes non-cash interest expense associated with the Debenture. See "Liquidity and Capital Resources".

Net loss increased $4,187,000 in fiscal 2000, compared to the prior year, primarily due to lower than expected new sales, the recognition of software licenses and renewals over a twelve month period, increased costs from delays in development and the increase in non-cash amortization expense resulting from the Company's acquisition of NDI. Net loss increased $1,275,000 in fiscal 1999, compared to the prior year, primarily due to the increase in non-cash amortization expense resulting from the two acquisitions completed in fiscal 1999. As the Company continues its acquisition program, non-cash amortization of goodwill and other intangible assets from the Company's acquisitions may cause net losses to continue.

The Company's Year 2000 readiness program was completed on schedule. All of the Company's products have either been discontinued or have Year 2000 compliant versions, which were shipped prior to December 31, 1999, with some minor exceptions that were addressed prior to December 31, 1999 with distribution of patches to a small number of customers to enable them to continue to use the Company's software until the complete Year 2000 compliant version had been implemented. Over the last two years, the Company has spent $420,000 on the Year 2000 program out of a total expected expenditure of $550,000. The Company has not been a party to any litigation or arbitration proceeding to date involving its products or services related to Year 2000 compliance issues. However, there can be no assurance that we will not in the future be required to defend our products or services in such proceedings, or to negotiate resolutions of claims based on Year 2000 issues. The costs of defending and resolving Year 2000-related disputes, regardless of the merits of such disputes, and any potential liability on the Company's part for Year 2000-related damages, including consequential damages, could have an adverse effect on the Company's business and financial results.

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LIQUIDITY AND CAPITAL RESOURCES

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

CASH FLOW INFORMATION
(IN THOUSANDS)

	YEAR ENDED JULY 31			
	2000	1999	PERCENT CHANGE	1999
Net cash provided by (used in) operating activities before changes in working capital	$(2,316)	$ 415	n/a	$ 41
Net cash used in investing activities	(1,792)	(1,815)	1%	(1,81
Subtotal	(4,108)	(1,400)	(193%)	(1,40
Effect of net changes in working capital	1,153	(74)	n/a	(7

Net cash used in operating and investing activities	$(2,955)	$(1,474)	(100%)	$(1,47
	=======	=======		======

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

Total cash flows from operating and investing activities declined from fiscal 1999 to fiscal 2000 due to reduced cash flows from operations before working capital changes, $1,256,000 of which was a decrease in revenue due to the adoption of SOP 98-9, and improved from fiscal 1998 to fiscal 1999 because of increased cash flows from operations before working capital changes. The analysis reveals that the primary reason for the Company's cash flow performance is the performance of its underlying business, rather than changes in investment or working capital timing.

Net cash provided by (used in) operating activities before changes in working capital decreased in fiscal 2000, compared to the prior year, primarily due to lower than expected revenues and increased costs as a result of delays in development. Net cash provided by operating activities before changes in working capital increased in fiscal 1999, compared to the prior year, due to increased revenues and tight cost controls. Net cash used in investing activities increased in fiscal 2000 and fiscal 1999, compared to fiscal 1998, due to increased costs attributable to the development of the Company's Web-based communications and catalog software in fiscal 2000 and a new release of the Company's TradeRoute(R) software in fiscal 1999. The effect of net changes in working capital is dependent on the timing of payroll and other cash disbursements and may vary significantly from year to year. In fiscal 2000, cash provided by working capital was higher, primarily due to higher unearned income balances caused by the Company's change in revenue recognition policy. In fiscal 1998, use of cash for working capital was higher primarily due to an increase in accounts receivable related to increased revenue in the fourth quarter of fiscal 1998, compared to the same period in fiscal 1997, and the timing of cash disbursements. The Company expects that positive cash flow from operations will resume in the first quarter of fiscal 2001, but that operating losses will continue in fiscal 2001 due to non-cash amortization expenses. The Company expects to fund research and development costs in fiscal 2001 with excess cash from operations and the proceeds of its current financing instruments described below.

At July 31, 2000, the Company had cash and cash equivalents of approximately $563,000 compared to approximately $127,000 at July 31, 1999.
The following table sets forth, for the periods indicated, certain information related to the Company's debt derived from the Company's audited financial statements.

DEBT SCHEDULE
(IN THOUSANDS)

	JULY 31 2000	JULY 31 1999
Debt to Shareholder:		
Current portion of line of credit	$ -	$ 246
Current portion of notes payable	361	-
Long-term portion of line of credit payable	-	2,754
Long-term portion of notes payable	389	-
Debt Discount (common stock warrants)	(76)	-
Total Debt to Shareholder	674	3,000
Subordinated Debenture:		
Long-term notes payable other	4,000	-
Debt discount (common stock warrants and options)	(2,158)	-
Total Subordinated Debenture	1,842	-
Other Debt:		
Current portion of notes payable other	461	385
Long-term notes payable other (net of discount)	326	734
Total Other Debt	787	1,119
Total Debt	$ 3,303	$ 4,119

On April 27, 2000, the Company issued and sold pursuant to a Securities Purchase Agreement, dated as of April 25, 2000, by and among the Company and RGC International Investors, LDC (the "Investor"), (i) a convertible subordinated debenture in the amount of $4,000,000 due on April 27, 2003 (the "Debenture"), and convertible into shares of the Company's common stock, (ii) warrants to purchase 600,000 shares of Common Stock (the "Warrants"), and (iii) an investment option to purchase 800,000 shares of Common Stock (the "Investment Option"). The Investment Option expires on October 27, 2001 and the Warrants expire on April 27, 2005. The Debenture is convertible into Common Stock at $4 per share and the Warrants and Investment Option are exercisable at $6 per share. The Company is required to maintain listing of its common stock on the Nasdaq National Market, the Nasdaq Small Cap Market, the New York Stock Exchange or the American Stock Exchange; failure to meet this requirement would result in the Debenture becoming fully due at 130% of principal and accrued interest. At any time after October 27, 2000, the Company can require the Investor to convert the amount owed under the Debenture into Common Stock at $4.00 per share provided that: (i) the closing bid price of the Common Stock has been greater than $6.60 for twenty (20) consecutive trading days and (ii) the Company's resale registration statement has been effective for at least three (3) months. At any time after April 27, 2001, the Company can require the Investor to exercise the Investment Option if the closing bid price of the Common Stock is greater than $9.90 for twenty (20) consecutive trading days and the Company's resale registration statement has been effective for at least three (3) months. As long as $500,000 or more principal amount of the Debenture is outstanding, the Company agreed not to: (i) pay any dividends or make any other distribution on our common stock, other than stock dividends and stock splits; (ii) repurchase or redeem any shares of our capital stock, except in exchange for common stock or preferred stock; (iii) incur or assume any liability for borrowed money, except our existing debt, debt from a bona fide financial lending institution, indebtedness to trade creditors, borrowings used to repay the debenture, indebtedness assumed or incurred in connection with the

acquisition of a business, product, license or other asset, refinancing of any of the above, and indebtedness that is subordinate to the debenture; (iv) sell or otherwise dispose of assets outside the normal course of business, except the sale of a business, product, license or other asset that our board of directors determines is in the best interests of us and our shareholders, and sales of assets with a value not exceeding $500,000 in any 12-month period following the issuance of the debenture; (v) lend money or make advances to any person not in the ordinary course of business, except loans to subsidiaries or joint ventures approved by a majority of our independent directors, guarantee another person's liabilities, except, among other things, guarantees made in connection with the acquisition of a business, product, license or other asset. If exercised, the Investment Option would contribute an additional $4,800,000 of working capital to the Company.

The Company is currently not in compliance with the Nasdaq National Market requirements including the dollar minimum bid price, the $5 million public float and $4 million net tangible asset test. If the Company is delisted, and

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if the Company is unable to obtain waivers from the Investors, shareholders could be materially and adversely affected.

ARI has a line of credit with WITECH that has been in place since October 4, 1993 (the "WITECH Credit Facility"). On September 30, 1999, ARI and WITECH restructured the $3.0 million outstanding under the WITECH Credit Facility to provide for (i) a $1.0 million revolving line of credit (the "WITECH Line") which expires on December 31, 2001; (ii) a $1.0 million term loan (the "WITECH Term Loan") payable in equal monthly principal installments over three years, commencing November 1, 1999; and (iii) WITECH's purchase of $1.0 million of ARI's common stock at $5.125 per share. The WITECH Line bears interest at prime plus 2.0% and the WITECH Term Loan bears interest at prime plus 3.25%. In conjunction with obtaining the WITECH Credit Facility, since 1993, ARI has issued to WITECH 350 shares of its non-voting cumulative preferred stock and total warrants for the purchase of up to 280,000 shares of its common stock, including (i) warrants for the purchase of 250,000 shares at $2.125 per share and (ii) warrants for the purchase of 30,000 shares of its common stock at $4.00 per share. The exercise price under the warrants is reduced if ARI issues stock at less than the then current exercise price. WITECH also purchased 20,000 shares of non-voting cumulative preferred stock on July 15, 1997. Of the 280,000 warrants to purchase shares of Common Stock that were issued to WITECH (i) warrants to purchase 175,000 shares of Common Stock at $2.125 expired on October 1, 2000; (ii) warrants to purchase 75,000 shares of Common Stock at $2.125 expire on January 1, 2002; and (iii) warrants to purchase 30,000 shares of Common Stock at $4.000 expire on October 1, 2006.

On December 21, 1999, the Company and WITECH amended the WITECH Line to enable the Company to borrow an additional Five Hundred Thousand Dollars ($500,000) under the WITECH Line (the "Bridge Loan"). The Bridge Loan bore interest at prime plus 2.0%. As consideration for the Bridge Loan, ARI paid a closing fee of $50,000 to WITECH.

On April 27, 2000, the Company used a part of the proceeds from the sale of the Debenture to (i) pay down the outstanding amount due under the WITECH Line and (ii) repay the Bridge Loan and the interest and closing fee associated therewith. The WITECH Line terminates on December 31, 2001. As of May 25, 2001 there were no amounts outstanding under the WITECH Line and $472,000 was outstanding under the WITECH term loan.

The only financial covenant in the WITECH Credit Facility is that ARI must maintain a net worth (calculated in accordance with generally accepted accounting principles) of at least $5.3 million. ARI was in compliance at July 31, 2000 but is currently not in compliance with the financial covenant in the Agreement and intends to seek a waiver. If the Company is unable to obtain a waiver, the Company would lose an essential source of liquidity.

As part of ARI's acquisition of Powercom from Briggs & Stratton Corporation ("Briggs") in September 1998, Briggs agreed to provide ARI with a working capital line of credit in the amount of $250,000 (the "Briggs Line"). ARI agreed to exhaust all available credit under the WITECH Line before borrowing any amounts under the Briggs Line. The Briggs Line bore interest at prime plus 2% and was secured by a first position lien against all accounts receivable generated from customers of Powercom that were assigned to ARI as part of the acquisition. The Briggs Line was repaid in full and cancelled on October 7, 1999.

On September 28, 1999, ARI and RFC Capital Corporation ("RFC") executed a Receivables Sales Agreement (the "Sale Agreement") establishing a $3.0 million working capital facility (the "RFC Facility"). The three-year Sale Agreement allows RFC to purchase up to $3.0 million (the "Purchase Commitment") of ARI's accounts receivable. The Purchase Commitment may be increased in increments of $1.0 million upon mutual agreement and a payment by ARI of $10,000 for each $1.0 million increase. Under the Sale Agreement, RFC purchases 90% of eligible receivables. In connection with the Sale Agreement ARI was required to pay a Commitment Fee of $45,000 on September 28, 1999, $30,000 on September 28, 2000, and $15,000 on September 28, 2001. In addition, ARI is obligated to pay a monthly program fee equal to the greater of (a) $3,000 or (b) the amount of the purchased but uncollected receivables times the prime rate plus 2%. ARI may terminate the Sale Agreement prior to three year term by paying 2.0% of the Purchase Commitment during the second year, and 1.0% of the Purchase Commitment during the third year. Initial funding was actually $1,045,000, of which $182,000 was immediately used to pay off the Briggs Line. As of May 25, 2001, the balance of the RFC Facility was $664,000.
The RFC Facility states that the Company must be in compliance with the WITECH facility, which it currently is not. If the Company is unable to obtain a waiver from RFC, the Company would lose an essential source of liquidity.

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Management believes that funds generated from operations, the RFC Facility, the Debenture and the WITECH Line will be adequate to fund the Company's operations and investments through fiscal 2001 if the necessary waivers are obtained. If management is unable to obtain the necessary waivers, the Company will be in default and owe in excess of $6 million, which would have a material adverse effect on the Company. Management is working diligently to obtain the necessary waivers, but there can be no assurance that these efforts will be successful. Management is also analyzing its anticipated cash flows under a variety of growth scenarios ranging from no growth to modest growth. Management believes that, provided the defaults can be avoided, either (i) sufficient cash can be generated from the business to fund operations and a modest level of investment or (ii) that the cash profile of the business can be restructured to be self-funding.

The Company believes that earnings before interest, taxes, depreciation and amortization ("EBITDA") is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA decreased from positive $727,000 in fiscal 1999 to negative $1,807,000 in fiscal 2000 primarily due to money spent to address the software development issues without

corresponding revenue and to the change in revenue recognition. EBITDA increased from $72,000 in fiscal 1998 to $727,000 in fiscal 1999 primarily due to increased revenues and cost controls over cash expenditures. Management believes that EBITDA will be positive in fiscal 2001, although there can be no assurance that this will occur.

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

FORWARD LOOKING STATEMENTS

Certain statements contained in this Form 10-K are forward looking statements including revenue growth, future cash requirements and sources of liquidity. Expressions such as "believes," "anticipates," "expects," and similar expressions are intended to identify such forward looking statements. Several important factors can cause actual results to materially differ from those stated or implied in the forward looking statements. Such factors include, but are not limited to the growth rate of ARI's selected market segments, the positioning of ARI's products in those segments, consequences of year 2000 issues, variations in demand for and cost of customer services and technical support, customer adoption of Internet-enabled applications and their willingness to upgrade from earlier versions of software, ARI's ability to release new software applications and upgrades on a timely basis, ARI's ability to establish and maintain strategic alliances, ARI's ability to manage its costs, ARI's ability to manage its business in a rapidly changing environment, ARI's ability to finance capital investments, and ARI's ability to implement its acquisition strategy to increase growth.

Projected revenues and, therefore, profitability and cash flows are difficult to estimate because ARI's revenues and operating results may vary substantially from quarter to quarter, driven primarily by variations in non-recurring revenues from software license and customization fees. License fee revenues are based on contracts signed and products delivered. Non-recurring revenues are affected by the time required to close large license fee and development agreements, which cannot be predicted with any certainty due to customer requirements and decision-making processes.

Recurring revenues are also difficult to estimate. Recurring revenues from maintenance and subscription fees may be estimated based on the number of subscribers to ARI's services but will be affected by the renewal ratio, which cannot be determined in advance. Recurring revenues from network traffic fees and transaction fees are difficult to estimate as they are determined by usage. Usage is a function of the number of subscribers and the number of transactions per subscriber. Transactions include product ordering, warranty claim processing, inventory and sales reporting, parts number updates and price updates. ARI cannot materially affect or predict the volume of transactions per customer.

Although ARI has recently introduced and plans to expand its Internet-enabled Windows products, the marketplace is highly competitive and there can be no assurance that a customer will select ARI's software and services over that of a competitor. The environment in which ARI competes is characterized by rapid technological changes, dynamic customer demands, and frequent product enhancements and product introductions. Some of ARI's current and potential competitors have greater financial, technical, sales, marketing and advertising resources than ARI. The widespread acceptance of the Internet may increase the usage of ARI's product applications but may dramatically change the manner in which ARI charges for its services.

For a discussion of additional risks and uncertainties which may impact the Company please look at the section titled "Risk Factors" in the Company's Registration Statement on Form S-3 filed on May 12, 2000, as amended.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ARI's Financial Statements and related notes for the fiscal years ended July 31, 2000, 1999 and 1998 together with the report thereon of ARI's independent auditors, Ernst & Young LLP, are attached hereto as Exhibit A-1.

ITEM 14. FINANCIAL STATEMENTS, FINANCIAL STATEMENT SCHEDULES, EXHIBITS AND REPORTS ON FORM 8-K

(A)1.
FINANCIAL STATEMENTS

Report of independent auditors on Financial Statements and Financial Statement Schedule.

Balance sheets - July 31, 2000 and 1999.

Statements of operations for each of the three years in the period ended July 31, 2000.

Statements of shareholders' equity for each of the three years in the period

ended July 31, 2000.

Statements of cash flows for each of the three years in the period ended July 31, 2000.

Notes to financial statements - July 31, 2000.

The Financial Statements are located immediately following the signature page.

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Consent of Ernst & Young LLP.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Milwaukee, State of Wisconsin on this 1st day of June, 2001.

ARI NETWORK SERVICES, INC.

By:

Brian E. Dearing,
Chairman, President & CEO & Acting CFO,
& Acting CAO

Report of Ernst & Young LLP, Independent Auditors

To the Board of Directors and Shareholders
ARI Network Services, Inc.

We have audited the accompanying balance sheets of ARI Network Services, Inc. (the Company) as of July 31, 2000 and 1999, and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended July 31, 2000. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

Since the date of completion of our audit of the accompanying financial statements and initial issuance of our report thereon dated September 15, 2000, the Company, as discussed in Note 12, has been notified of certain Nasdaq National Market requirements that have not been maintained, which, if not cured, would cause the Company to be delisted from the Nasdaq National Market. Any delisting will cause the Company's subordinated debenture to be in default and due on demand. Additionally, as of January 31, 2001, the Company is in violation of a restrictive covenant under its loan agreement with a shareholder. Also, the Company's line of credit with a shareholder expires in December 2001; accordingly, the Company does not have long-term credit availability. Note 12 describes management's plans to address these issues.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at July 31, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended July 31, 2000, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

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As discussed in Note 11, the balance sheet at July 31, 2000, and the statements of operations, shareholders' equity and cash flows for the year then ended, have been restated.

Milwaukee, Wisconsin
September 15, 2000, except for
Notes 11 and 12, as to which
the dates are May 21, 2001
and May 15, 2001,

respectively

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ARI Network Services, Inc.

Balance Sheets
(Dollars in Thousands, Except Per Share Data)

	JULY 31	
	2000	
ASSETS (Note 3)		
Current assets:		
Cash	$ 563	$
Trade receivables, less allowance for doubtful accounts of $697 in 2000 and $278 in 1999	3,282	
Prepaid expenses and other	109	
Total current assets	3,954	
Equipment and leasehold improvements:		
Network system hardware and software	4,389	
Leasehold improvements	239	
Furniture and equipment	846	
	5,474	
Less accumulated depreciation and amortization	5,038	
Net equipment and leasehold improvements	436	
Goodwill, less accumulated amortization of $1,413 in 2000 and $755 in 1999	1,876	
Deferred financing costs, less accumulated amortization of $59 in 2000	321	
Network system:		
Network platform	11,467	
Industry-specific applications	29,317	
	40,784	
Less accumulated amortization	28,883	
	11,901	
	$18,488	

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	JULY 31 2000	
LIABILITIES AND SHAREHOLDERS' EQUITY	(restated)	
Current liabilities:		
Line of credit payable to shareholder	$ -	$
Current portion of notes payable to shareholder	361	
Current portion of notes payable	461	
Accounts payable	836	
Unearned income	4,373	
Accrued payroll and related liabilities	1,182	
Other accrued liabilities	1,310	
Current portion of capital lease obligations	111	
Total current liabilities	8,634	
Line of credit payable to shareholder	-	
Notes payable to shareholder	313	
Notes payable	2,168	
Unearned income	-	
Capital lease obligations	214	
Total noncurrent liabilities	2,695	
Commitments (Note 5)		
Shareholders' equity:		
Cumulative preferred stock, par value $.001 per share, 1,000,000 shares authorized; 20,350 shares issued and outstanding	-	
Common stock, par value $.001 per share, 25,000,000 shares authorized; 6,168,270 and 5,097,432 shares issued and outstanding in 2000 and 1999, respectively	6	
Common stock warrants and options	2,459	
Common stock to be issued	-	
Additional paid-in capital	91,781	
Accumulated deficit	(87,087)	
Total shareholders' equity	7,159	
	$18,488	$

See accompanying notes.

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ARI Network Services, Inc.

Statements of operations
(Dollars in Thousands, Except Per Share Data)

	YEAR ENDED JULY 31		
	2000	1999	
Net revenues:	(restated)		
Network and other services	$ 9,743	$ 8,616	$
Software	1,289	2,822	
Professional services	2,272	1,450	
	13,304	12,888	
Operating expenses:			
Cost of products and services sold			
Network and other services	1,415	1,431	
Software	3,614	2,543	
Professional services	1,965	1,234	
	6,994	5,208	
Depreciation and amortization*	1,778	1,773	
Network operations	2,048	1,017	
Selling, general and administrative	8,214	6,995	
Network construction and expansion	2,779	2,786	
	21,813	17,779	
Less capitalized portion	(1,729)	(1,802)	
Total operating expenses	20,084	15,977	
Operating loss	(6,780)	(3,089)	
Other income (expense):			
Interest expense	(793)	(312)	
Other, net	(29)	(14)	
	(822)	(326)	
Net loss	$ (7,602)	$ (3,415)	$
Net loss per share	$ (1.27)	$ (.67)	

* exclusive of amortization of industry-specific applications included in cost of products and services sold

See accompanying notes.

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ARI Network Services, Inc.

Statements of Shareholders' Equity
(Dollars in Thousands)

	Number of Shares Iss[ued and] Outstanding	
	Preferred Stock	
Balance July 31, 1997	20,000	3
Issuance of common stock (net of offering costs of $54)	-	
Issuance of common stock in connection with acquisition of Empart Technologies, Inc.	-	
Issuance of common stock under stock purchase plan	-	
Net loss	-	
Balance July 31, 1998	20,000	4
Issuance of preferred stock	350	
Issuance of common stock in connection with acquisitions	-	
Issuance of common stock under stock purchase plan and from exercise of stock options	-	
Net loss	-	
Balance July 31, 1999	20,350	5
Issuance of common stock in connection with acquisitions	-	
Issuance of common stock as payment on line of credit	-	
Issuance of common stock for professional services received	-	
Issuance of common stock under stock purchase plan and from exercise of stock options	-	
Issuance of common stock warrants and options in connection with notes payable	-	
Net loss (restated)	-	
Balance July 31, 2000 (restated)	20,350	6

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Common Stock to be Issued		Par Value		Common Stock Warrants and Options	Additional Paid-in Capital	Acc[umulated] D[eficit]
Number of Shares	Amount	Preferred Stock	Common Stock			

-	$ -	$ -	$4	$ -	$82,873	$(
-	-	-	-	-	1,496	
-	-	-	-	-	654	
-	-	-	-	-	5	
-	-	-	-	-	-	
-	-	-	4	-	85,028	(
-	-	-	-	-	-	
550,019	2,406	-	1	-	1,784	
-	-	-	-	-	18	
-	-	-	-	-	-	
550,019	2,406	-	5	-	86,830	(
(550,019)	(2,406)	-	1	-	2,405	
-	-	-	-	-	1,000	
-	-	-	-	-	211	
-	-	-	-	-	1,335	
-	-	-	-	2,459	-	
-	-	-	-	-	-	
-	$ -	$ -	$6	$2,459	$91,781	$(

See accompanying notes.

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ARI Network Services, Inc.

Statements of Cash Flows
(In Thousands)

	YEAR ENDED JUL	
	2000	1999
OPERATING ACTIVITIES	(restated)	
Net loss	$(7,602)	$(3,41
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of network platform	656	69
Amortization of industry-specific applications	3,224	2,05
Amortization of goodwill	658	58
Amortization of debt discount and deferred financing fees	284	
Depreciation and other amortization	464	49
Net change in receivables, prepaid expenses and other current assets	(90)	43

Net change in accounts payable, unearned income and accrued liabilities	1,243	(50
Net cash provided by (used in) operating activities	(1,163)	34
INVESTING ACTIVITIES		
Purchase of equipment and leasehold improvements	(63)	(5
Cash received in acquisitions	-	4
Industry-specific applications costs capitalized	(1,729)	(1,80
Net cash used in investing activities	(1,792)	(1,81
FINANCING ACTIVITIES		
Borrowings (repayments) under line of credit	(1,000)	1,38
Borrowings under notes payable	4,000	8
Payments of capital lease obligations and notes payable	(690)	(7
Debt issuance costs incurred	(254)	
Proceeds from issuance of common stock	1,335	1
Net cash provided by financing activities	3,391	1,40
Net increase (decrease) in cash	436	(6
Cash at beginning of year	127	19
Cash at end of year	$ 563	$ 12
Cash paid for interest	$ 437	$ 31
NONCASH INVESTING AND FINANCING ACTIVITIES		
Capital lease obligations incurred for - Network system hardware	$ 328	$ -
Issuance of common stock for acquisitions	-	4,191
Issuance of common stock as payment on line of credit	1,000	-
Conversion of line of credit to notes payable to shareholder	1,000	-
Issuance of common stock warrants and options	2,459	-
Issuance of common stock for professional services:		
Network system hardware and software	85	-
Deferred financing costs	126	-

See accompanying notes.

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ARI Network Services, Inc.

Notes to Financial Statements

July 31, 2000

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

ARI Network Services, Inc. (the Company) operates in one business segment and

provides business-to-business e-commerce solutions to manufacturers in selected industries with shared service networks and distribution channels. Disaggregated operating expense information is not provided to the chief operating decision maker of the Company. The Company's e-commerce services use telecommunications technology and software to help customers conduct business electronically, computer-to-computer, with minimal changes to their internal business systems. The Company focuses on the U.S., Canadian, European and Australian manufactured equipment industry as well as certain non-equipment industries, including the U.S. and Canadian agribusiness industry, the U.S. and Canadian freight transportation industry and the U.S. non-daily newspaper publishing industry. The Company provides both electronic catalog and transaction processing software and services, enabling dealers and distributors in a shared distribution and service network to electronically look up parts, service bulletins and other technical reference information, and to exchange electronic business documents such as purchase orders, invoices, warranty claims and status inquiries with the manufacturers. The Company's customers are located primarily in the United States, Europe and Canada. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the U.S. dollar are included in the results of operations as incurred. Transaction gains and losses were insignificant in each of the periods reported.

REVENUE RECOGNITION

Revenue for use of the network and for information services is recognized in the period such services are utilized.

Revenue from annual or periodic maintenance fees is recognized ratably over the period the maintenance is provided. Revenue from catalog subscriptions is recognized over the subscription term.

ARI Network Services, Inc.

Notes to Financial Statements

July 31, 2000

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Prior to the adoption of Statement of Position (SOP) 98-9 on August 1, 1999, the Company recognized revenue allocable to software licenses in multiple element arrangements upon delivery of the software product to the end user. Upon adoption of SOP 98-9 on August 1, 1999, 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 and other arrangements with payment terms longer than normal not to be 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 collectibility is not considered probable, revenue is recognized when the fee is collected.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential include customizing complex features and functionality in the products' 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. Revenue on arrangements with customers who are not the ultimate users (resellers) is deferred if there is any uncertainty on the ability and intent of the reseller to sell such software independent of their payment to the Company.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

USE OF ESTIMATES

The preparation of the Company's financial statements in conformity with generally accepted accounting principles 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.

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

	Years
Network system hardware and software	2 - 10
Leasehold improvements	10
Furniture and equipment	2 - 5

NETWORK CONSTRUCTION AND EXPANSION AND SOFTWARE DEVELOPMENT

The Company has developed a basic network and telecommunications platform which is the foundation of its network. The platform can be used on different hardware and is not subject to the frequency of technological changes that sometimes occur with hardware or industry-specific applications.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company also develops and purchases industry-specific software applications for personal computers and mainframes which, when utilized with the platform, give rise to the Company's products and services tailored to its targeted industries.

Certain software development costs and network construction and expansion costs are capitalized when incurred. Capitalization of these costs begins upon the establishment of technological feasibility. The establishment of technological feasibility and the ongoing assessment of recoverability of software and network system costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life and changes in software and hardware technologies.

The annual amortization of the platform and the industry-specific software applications is the greater of the amount computed using (a) the ratio that current gross revenues for the network or an industry-specific product bear to the total of current and anticipated future gross revenues for the network or an industry-specific product or (b) the straight-line method over the estimated economic life of the product (20 years - platform, 3 years - industry-specific software applications). Amortization starts when the product is available for general release to customers.

All other network construction and expansion expenditures are charged to expense in the period incurred.

GOODWILL

Goodwill, representing the excess of cost over net assets of businesses acquired, is stated at cost and is amortized on a straight-line basis over five years.

IMPAIRMENT OF LONG-LIVED ASSETS

Equipment and leasehold improvements, network system costs and goodwill 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.

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ARI Network Services, Inc.

Notes to Financial Statements (continued)

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Such analyses necessarily involve judgment. The Company evaluated the ongoing

value of its long-lived assets as of July 31, 2000 and 1999, and determined that there was no significant impact on the Company's results of operations.

DEFERRED FINANCING COSTS

Costs incurred to obtain long-term financing are amortized using the interest method over the term of the related debt.

CAPITALIZED INTEREST COSTS

In 2000, 1999 and 1998, interest costs of $76,000, $56,000 and $19,000, respectively, were capitalized and included in the network system.

OTHER ACCRUED LIABILITIES

Other accrued liabilities include accrued royalties of $486,000 and $319,000 at July 31, 2000 and 1999, respectively.

COMPREHENSIVE INCOME

Net loss for 2000, 1999 and 1998 is the same as comprehensive income defined pursuant to Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income."

NET LOSS PER SHARE

The basic and diluted weighted-average shares used in the net loss per share calculation are 6,002,000, 5,061,000 and 4,119,000, respectively, in 2000, 1999 and 1998. Basic and diluted net loss per share is the same for all periods as the impact of all dilutive securities is antidilutive.

RECLASSIFICATIONS

Certain 1999 and 1998 amounts have been reclassified to conform to the 2000 presentation.

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, which establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133, which will be effective for the Company beginning August 1, 2000, requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The Company does not expect the potential effect of adopting the provisions of SFAS No. 133, as amended, to have a significant impact on its financial statements.

2. ACQUISITIONS

The Company has accounted for its acquisitions using the purchase method of accounting and accordingly, the purchase price was allocated to assets acquired and liabilities assumed based upon their respective fair values at the date of acquisition. The financial statements include the operating results of the acquisitions from their respective dates of acquisition.

In September 1998, the Company acquired certain assets used in the operation of Briggs & Stratton Corporation's Powercom-2000 business (Powercom). Aggregate consideration for the acquisition consisted of 840,000 shares of the Company's common stock and the assumption of certain liabilities totaling $2,291,000. The excess of the purchase price over the fair value of net assets acquired of $2,782,000 for Powercom has been recorded as goodwill.

On May 13, 1999, the Company acquired the assets of Network Dynamics, Inc. (NDI). On this date, NDI was merged with and into the Company and the separate corporate existence of NDI ceased. Common stock to be paid as consideration to the former shareholders of NDI was held in escrow until the Total NDI Value, as defined, was determined in August 1999 upon completion of an audit of the balance sheet as of May 13, 1999. Aggregate consideration for the acquisition consisted of 550,019 shares of the Company's common stock, which were issued in September 1999, and the assumption of certain liabilities totaling $3,623,000. The purchase price in excess of net tangible assets acquired was recorded as goodwill until a final valuation by an independent appraisal firm to allocate the purchase price was completed in December 1999. The Company then allocated the purchase price in excess of net tangible assets acquired to industry-specific applications.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

2. ACQUISITIONS (CONTINUED)

The following unaudited pro forma results of operations for the year ended July 31, 1999, assumes that the acquisitions had occurred on August 1, 1998 (in thousands, except per share data):

	1999
Net revenues	$15,482
Net loss	(4,533)
Basic and diluted net loss per share	(0.81)

The pro forma results do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on August 1, 1998, nor are they necessarily indicative of future operating results.

3. LINE OF CREDIT AND NOTES PAYABLE TO SHAREHOLDER

At July 31, 1999, the Company had a $3,000,000 revolving line of credit agreement with a shareholder that was to expire on December 31, 2001. On

September 30, 1999, the Company and the shareholder restructured and amended the line of credit agreement in order to reduce the line of credit from $3,000,000 to $1,000,000, establish a $1,000,000 term loan payable and convert $1,000,000 of the line of credit into 195,122 shares of common stock. The term loan is payable in equal monthly installments over three years commencing November 1, 1999, and bears interest at prime (9.5% at July 31, 2000) plus 3.25%. The line of credit expires December 31, 2001. The Company is required to pay a fee of .025% per month on the unused portion of the line of credit. Borrowings under the line of credit bear interest at prime plus 2%. No amounts are outstanding under the line of credit at July 31, 2000. In connection with this amendment, the Company issued a warrant to purchase 30,000 shares of the Company's common stock at $4 per share. These warrants are exercisable at any time through September 2006 and have been valued at $105,000 for financial statement purposes. The value allocated to the warrants, which reduce the carrying value of the debt, was measured at the date of grant because the number of shares was fixed and determinable. The value was determined based upon a Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 6%, dividend yield of 0%, expected common stock market price volatility factor of .72 and an expected life of the warrants of six years. The debt discount is being amortized straight-line over the three year term of the debt. The unamortized balance of the debt discount at July 31, 2000 was $76,000. The entire agreement is secured by

3. LINE OF CREDIT AND NOTES PAYABLE TO SHAREHOLDER (CONTINUED)

substantially all assets of the Company other than accounts receivable sold under the receivable sales agreement described in Note 4. The agreement contains various restrictive covenants including maintenance of a minimum level of net worth and restrictions on additional indebtedness.

On December 21, 1999, the Company and shareholder amended the line of credit agreement to provide the Company with an additional borrowing of $500,000 as a bridge loan. The bridge loan bore interest at prime plus 3.25%. On April 27, 2000, the Company paid the balance outstanding under the bridge loan.

Future maturities of notes payable to shareholder as of July 31, 2000, are as follows (in thousands):

Fiscal year ending	
2001	$361
2002	333
2003	56
	$750

In connection with the origination of the line of credit agreement with the shareholder and various extensions of the agreement, in addition to the warrants discussed above, the Company has issued the shareholder warrants for the purchase of up to 250,000 shares of its common stock at $2.125 per share. On September 30, 2000, 175,000 warrants will expire and on December 31, 2001, 75,000 warrants will expire as to any shares of common stock not issued.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

4. NOTES PAYABLE

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

	2000	1
Term loan	$ 266	$
Note payable to bank	479	
Note payable to Briggs & Stratton Corporation, paid in 2000	-	
Convertible subordinated debenture	4,000	
Less debt discount for convertible subordinated debenture	(2,158)	
Other	42	
	2,629	
Less current maturities	461	
	$2,168	$

On April 27, 2000, the Company issued RGC International Investors, LDC (RGC) (i) a convertible subordinated debenture (the Debenture) for $4,000,000 due on April 27, 2003, (ii) warrants to purchase 600,000 shares of common stock at $6 per share (the Warrants), and (iii) an investment option to purchase 800,000 shares of common stock at $6 per share (the Investment Option). The Investment Option expires on October 27, 2001, and the Warrants expire on April 27, 2005. The value allocated to the Warrants and Investment Option, which reduced the carrying value of the debt, were measured at the date of grant because the number of shares was fixed and determinable. The value was determined based upon a Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 6%, dividend yield of 0%, expected common stock market price volatility factor of .80, an expected life of the Investment Option of eighteen months and an expected life of the Warrants of five years. A debt discount was recorded for the fair value of the Warrants and Investment Option of $2,354,000. The Debenture bears interest at 7% and is convertible into common stock at $4 per share. At any time after October 27, 2000, the Company can require RGC to

convert the amount owed under the Debenture into common stock at $4 per share provided that the closing bid price of the Company's common stock has been greater than $6.60 for 20 consecutive trading days. At any time after April 27, 2002, the Company can require RGC to exercise

ARI Network Services, Inc.

Notes to Financial Statements (continued)

the Investment Option if the closing bid price of the Company's common stock is greater than $9.90 for 20 consecutive trading days.

4. NOTES PAYABLE (CONTINUED)

Under the terms of the Debenture and the related Investment Option and Warrants, the Debenture is convertible and the Investment Option and Warrants are exercisable by RGC only to the extent that the number of shares of common stock issuable, together with the number of shares of common stock owned by RGC and its affiliates, generally would not exceed 4.9% of the Company's outstanding common stock at the time of conversion or exercise. In certain circumstances where the Company has the right to force conversion of the Debenture and exercise of the Investment Option, RGC's percentage ownership may exceed 4.9% but cannot exceed 9.9%.

As part of the consulting fee paid in conjunction with obtaining the RGC financing, the Company issued warrants for the purchase of 8,000 shares of its common stock at $7.03 per share. These warrants expire on April 27, 2005.

The term loan requires monthly principal and interest payments of approximately $8,000 through May 2003. The note payable to bank bears interest at 9.75% which is payable monthly through December 2001.

Future maturities of notes payable as of July 31, 2000, are as follows (in thousands):

Fiscal year ending	
2001	$ 461
2002	248
2003	4,078
	$4,787

ARI Network Services, Inc.

Notes to Financial Statements (continued)

4. NOTES PAYABLE (CONTINUED)

On September 28, 1999, the Company closed and commenced funding under a Receivable Sale Agreement (the RFC Agreement) with RFC Capital Corporation (RFC) pursuant to which RFC has agreed to purchase from the Company certain receivables generated by the Company in the ordinary course of the Company's business. The RFC Agreement allows for RFC to purchase up to $3,000,000 of the Company's eligible receivables. Under the Agreement, RFC purchases 90% of the eligible receivables from the Company from time to time upon presentation thereof for a purchase price equal to approximately the net value of such receivables. Net value is designed to yield RFC an effective rate of 11.5% plus allow RFC to retain a holdback of 5% in the face amount of the receivables, net of collections, against future collection risk. For the year ended July 31, 2000, the Company incurred $71,000 of financing expense relating to this agreement.

Under the RFC Agreement, the Company performs certain servicing, administrative and collection functions with respect to the receivables sold to RFC. Also, pursuant to the terms of the RFC Agreement, the Company has granted to RFC a security interest in and to the Company's U.S. receivables not sold to RFC and the Company's customer base, excluding non U.S. customers, relating to the generation of such accounts receivable.

5. CAPITAL AND OPERATING LEASES

The Company leases office space under operating lease arrangements expiring in 2001 through 2006. The Company is generally liable for its share of increases in the landlord's direct operating expenses and real estate taxes up to 5% of the previous years rent. Total rental expense for the operating leases was $616,000 in 2000, $400,000 in 1999 and $487,000 in 1998.

Minimum lease payments under remaining capital and operating leases are as follows (in thousands):

Fiscal year ending	Capital Leases	Operating
2001	$154	$
2002	151	
2003	99	
2004	-	
2005	-	
Thereafter	-	
Total minimum lease payments	404	$

Amounts representing interest and taxes	79
Present value of minimum capital lease payments	325
Less amounts payable in one year	111
	$214

6. SHAREHOLDERS' EQUITY

At July 31, 2000, the Company has 20,350 shares of Series A Preferred Stock outstanding. The shares are entitled to cumulative annual dividends equal to the product of $100 and prime plus 2% payable quarterly, as and when declared by the Board of Directors. Prior to August 1, 2002, dividends payable may be paid, at the Company's option, in lieu of cash, in additional shares of Series A Preferred Stock. The Company may redeem outstanding shares at any time at the redemption price of $100 per share plus accrued and unpaid dividends.

In the event of liquidation or dissolution of the Company, the holders of shares of Series A Preferred Stock shall be entitled to receive $100 per share plus accrued and unpaid dividends before any distribution is made to the holders of common stock. Accumulated dividends in arrears at July 31, 2000, are $725,000.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

7. STOCK PLANS

The Company's 1991 Stock Option Plan (Stock Option Plan) had 850,000 shares of common stock authorized for issuance. Options granted under the Stock Option 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, or (b) nonqualified stock options.

Any incentive stock option that is granted under the Stock Option Plan may 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 may be granted at the exercise price established by the Stock Option Committee, which may 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 Stock Option 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 Stock Option 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 Stock Option 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 meet certain targets or goals, prior to exercising any options.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

7. STOCK PLANS (CONTINUED)

Changes in option shares under the Stock Option Plan are as follows:

	2000		1999		
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options
Outstanding at the beginning of the year	675,849	$ 5.58	528,715	$ 6.45	350,685
Granted	181,950	8.36	213,175	2.83	229,499
Exercised	(223,136)	1.89	(784)	2.18	-
Forfeited	(121,443)	9.63	(65,257)	3.68	(51,469
Outstanding at the end of the year	513,220	$ 7.20	675,849	$ 5.58	528,715
Exercisable	308,774	$ 7.55	429,763	$ 8.01	318,282
Available for grant	72,210		132,717		280,635

The weighted average contractual life of options outstanding at July 31, 2000 was 7.3 years. The range of exercise prices for options outstanding at July 31, 2000 was $2.00 to $32.00

The Company's 1992 Employee Stock Purchase Plan (Stock Purchase Plan) has 62,500 shares of common stock reserved for issuance and 46,488 shares have been issued through July 31, 2000. All employees of the Company, other than executive officers, with six months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions.

The Company's 1993 Director Stock Option Plan (Director Plan) has 150,000 shares of common stock reserved for issuance to nonemployee directors. Options under the Director Plan are granted at the fair market value of the stock on the grant

date.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

7. STOCK PLANS (CONTINUED)

Each option granted under the Director Plan is exercisable one year after the date of grant and cannot expire later than ten years from the date of grant. Changes in option shares under the Director Plan are as follows:

	2000		1999		
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options
Outstanding at the beginning of the year	49,879	$ 5.44	35,433	$ 6.44	28,500
Granted	42,261	8.41	14,446	2.66	15,208
Exercised	(16,509)	3.46	-	-	-
Forfeited	(8,545)	11.62	-	-	(8,275
Outstanding at the end of the year	67,086	$ 6.91	49,879	$ 5.44	35,433
Exercisable	49,879	$ 4.77	35,433	$ 6.44	25,229
Available for grant	66,405		100,121		114,567

The weighted average contractual life of options outstanding at July 31, 2000 was 7.9 years. The range of exercise prices for options outstanding at July 31, 2000 was $1.78 to $17.00.

Certain nonemployee directors have been granted stock options aggregating 57,500 shares of common stock at $2.50 to $9 per share.

ARI Network Services, Inc.

Notes to Financial Statements (continued)

7. STOCK PLANS (CONTINUED)

As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company follows Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its stock option plans. Had the Company accounted for its stock option plans based upon the fair value at the grant date for options granted under the plan, based on the provisions of SFAS No. 123, the Company's pro forma net loss and pro forma net loss per share would have been as follows (for purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period):

	YEAR ENDED JULY 31		
	2000	1999	19
Pro forma net loss (in thousands)	$(8,647)	$(3,996)	$(
Pro forma net loss per share	$(1.44)	$(0.79)	$

Pro forma information regarding net loss and net loss per share is required by SFAS No. 123, and has been determined as if the Company had accounted for its employee stock options using a Black-Scholes option pricing model with the following assumptions: risk-free interest rates ranging from 5.5% to 6%, dividend yield of 0%; expected common stock market price volatility factors ranging from .6 to 1.0 and an expected life of the options of ten years.

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ARI Network Services, Inc.

Notes to Financial Statements (continued)

8. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and income tax purposes. Significant components of the Company's deferred tax liabilities and assets as of July 31 are as follows (in thousands):

	2000	19
Deferred tax assets:		
Net operating loss carryforwards	$31,723	$3
Other	2,208	

Total deferred tax assets	33,931	3
Valuation allowance for deferred tax assets	(30,895)	(2
Net deferred tax asset	3,036	
Deferred tax liabilities -		
Network system	3,036	
Net deferred taxes	$ -	$

As of July 31, 2000, the Company has unused net operating loss carryforwards for federal income tax purposes of $37,637,000 expiring in 2007 through 2020.

In addition, the Company has unused net operating loss carryforwards for federal income tax purposes of $10,048,000 expiring in 2001 and 2002, of which not more than $444,000 annually can be utilized to offset taxable income. Also, the Company has unused net operating loss carryforwards for federal income tax purposes of $33,656,000 expiring between 2003 and 2007, of which not more than $3,655,000 annually can be utilized to offset taxable income. Use of the net operating loss carryforwards is restricted under Section 382 of the Internal Revenue Code because of changes in ownership in 1987 and 1992.

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ARI Network Services, Inc.

Notes to Financial Statements (continued)

8. INCOME TAXES (CONTINUED)

A reconciliation between income tax expense and income taxes computed by applying the statutory federal income tax rate to net loss is as follows (in thousands):

	2000	1999	
Computed income taxes at 34%	$(2,585)	$(1,161)	
Permanent items	435	7	
Net operating loss carryforward	2,150	1,154	
Income tax expense	$ -	$ -	$

9. 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 15%, up to a maximum of $10,500 in calendar 2000 (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. The Company has not made

any contribution to the 401(k) Plan since its inception.

10. MAJOR CUSTOMERS

During fiscal 2000 and 1999, sales to any one customer did not exceed 10% of net revenues. Sales to one customer were 12% of net revenues during 1998.

11. RESTATEMENT

As a result of discussions with the Securities and Exchange Commission that concluded on May 21, 2001, the Company has restated its financial statements as of and for the year ended July 31, 2000 to defer revenue recognition allocable to software licenses in multiple element arrangements under SOP 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9. SOP 98-9, which included more restrictive requirements for establishing vendor specific objective evidence of fair value in multiple element arrangements, was effective for transactions entered into by the Company beginning August 1, 1999. The net effect of the restatement for the year ended July 31, 2000 was to decrease software revenue by $1,256,000 and increase net loss and net loss per share by $1,256,000 and $0.21, respectively. The effect on the balance sheet as of

July 31, 2000 was an increase in unearned income of $1,256,000 and an increase in accumulated deficit of $1,256,000.

12. SUBSEQUENT EVENTS

On March 29, 2001, the Company received a letter from the Nasdaq National Market (Nasdaq) stating that the Company's common stock failed to maintain a minimum market value of public float of $5 million over 30 consecutive trading days. The Company has been provided 90 days to become compliant with this Nasdaq requirement. On May 15, 2001, the Company received a letter from Nasdaq stating that the Company's common stock failed to maintain a minimum bid price of $1.00 over 30 consecutive trading days. The Company has been provided 90 days to become compliant with this Nasdaq requirement. Unless the Company demonstrates compliance with the requirements or appeals the decisions, the Company's common stock will be delisted from Nasdaq and trading in the Company's common stock would thereafter be conducted in the over-the-counter markets such as the OTC Bulletin Board.

The Debenture described in Note 4 requires the Company to maintain the listing of its common stock on Nasdaq, the Nasdaq Small Cap Market, the New York Stock Exchange or the American Stock Exchange. Failure to cure a violation under the Debenture within 10 days is considered a default which would result in the subordinated debenture becoming due and payable at 130% of the outstanding principal and accrued interest balances as well as an increase in the stated interest rate from 7% to 17%.

The Company's loan agreement with a shareholder described in Note 3 requires maintenance of a minimum net worth of $5.3 million at all times. As of January 31, 2001, the Company is in violation of this covenant, resulting in the note payable to shareholder and line of credit payable to shareholder being due and

payable. The line of credit expires December 31, 2001. The Company is in discussions with the shareholder to reduce the net worth requirement.