MCKESSON CORP
Form 10-K
May 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended March 31, 2012

OR

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

For the transition period from ______ to ______

Commission File Number 1-13252

McKESSON CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3207296**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One Post Street, San Francisco, California	**94104**
(Address of principal executive offices)	**(Zip Code)**

(415) 983-8300

(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	*(Name of each exchange on which registered)*
Common Stock, $0.01 par value	**New York Stock Exchange**

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

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

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

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 þ No ¨

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

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

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

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant s most recently completed second fiscal quarter, September 30, 2011, was approximately $17.8 billion.

Number of shares of common stock outstanding on April 16, 2012: 235,397,188

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its 2012 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

McKESSON CORPORATION

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McKESSON CORPORATION

PART I

Item 1. Business.
General

McKesson Corporation (McKesson, the Company, the Registrant or we and other similar pronouns), is a Fortune 15 corporation that delive
pharmaceuticals, medical supplies and health care information technologies that make health care safer while reducing costs.

The Company s fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, all references in this document to a particular year shall mean the Company s fiscal year.

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act,) are available free of charge on our website (www.mckesson.com under the Investors Financial Information SEC Filings caption) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC or the Commission). The content on any website referred to in this Annual Report on Form 10-K is not incorporated by reference into this report, unless expressly noted otherwise.

The public may also read or copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers, including the Company, that file electronically with the SEC. The address of the website is http://www.sec.gov.

Business Segments

We operate in two segments. The McKesson Distribution Solutions segment distributes ethical and proprietary drugs, medical-surgical supplies and equipment and health and beauty care products throughout North America. This segment also provides specialty pharmaceutical solutions for biotech and pharmaceutical manufacturers, and practice management, technology, clinical support and business solutions to oncology and other specialty practices operating in the community setting. In addition, this segment sells financial, operational and clinical solutions for pharmacies (retail, hospital, alternate site) and provides consulting, outsourcing and other services. This segment includes a 49% interest in Nadro, S.A. de C.V. (Nadro), one of the leading pharmaceutical distributors in Mexico.

The McKesson Technology Solutions segment delivers enterprise-wide clinical, patient care, financial, supply chain, strategic management software solutions, pharmacy automation for hospitals, as well as connectivity, outsourcing and other services, including remote hosting and managed services, to healthcare organizations. This segment also includes our Payer group of businesses, which includes our InterQual® clinical criteria solution, medical management tools, claims payment solutions, network performance tools and care management programs. This segment s customers include hospitals, physicians, homecare providers, retail pharmacies and payers from North America, the United Kingdom, Ireland, other European countries and Israel.

Net revenues for our segments for the last three years were as follows:

(Dollars in billions)		**2012**			**2011**			**2010**	
Distribution Solutions	$	119.4	97%	$	108.9	97%	$	105.6	97%
Technology Solutions		3.3	3%		3.2	3%		3.1	3%
Total	$	122.7	100%	$	112.1	100%	$	108.7	100%

McKESSON CORPORATION

Distribution Solutions

McKesson Distribution Solutions consists of the following businesses: U.S. Pharmaceutical Distribution, McKesson Canada, Medical-Surgical Distribution, McKesson Pharmacy Systems and Automation and McKesson Specialty Health. This segment also includes our 49% interest in Nadro.

U.S. Pharmaceutical Distribution: This business supplies pharmaceuticals and/or other healthcare-related products to customers in three primary customer channels: (1) retail national accounts (including national and regional chains, food/drug combinations, mail order pharmacies and mass merchandisers); (2) independent retail pharmacies; and (3) institutional healthcare providers (including hospitals, health systems, integrated delivery networks, clinics and alternate site providers). This business also provides solutions and services to pharmaceutical manufacturers. This business sources materials and products from a wide-array of different suppliers, including the production of certain generic pharmaceutical drugs through a contract-manufacturing program.

Our U.S. pharmaceutical distribution business operates and serves thousands of customer locations through a network of 28 distribution centers, as well as a primary redistribution center, a strategic redistribution center and two repackaging facilities, serving all 50 states and Puerto Rico. We invest in technology and other systems at all of our distribution centers to enhance safety and reliability and provide the best product availability for our customers. For example, in all of our distribution centers we use Acumax® Plus, an award-winning technology that integrates and tracks all internal inventory-related functions such as receiving, put-away and order fulfillment. Acumax® Plus uses bar code technology, wrist-mounted computer hardware and radio frequency signals to provide customers with real-time product availability and industry-leading order quality and fulfillment in excess of 99.9% adjusted accuracy. In addition, we offer Mobile Manager℠, which integrates portable handheld technology with Acumax® Plus to give customers complete ordering and inventory control. We also offer McKesson Connect℠, an Internet-based ordering system that provides item lookup and real-time inventory availability as well as ordering, purchasing, third-party reconciliation and account management functionality. Together, these features help ensure customers have the right products at the right time for their facilities and patients.

To maximize distribution efficiency and effectiveness, we follow the Six Sigma methodology an analytical approach that emphasizes setting high-quality objectives, collecting data and analyzing results to a fine degree in order to improve processes, reduce costs and minimize errors. We continue to implement information systems to help achieve greater consistency and accuracy both internally and for our customers.

The major offerings of the McKesson U.S. Pharmaceutical Distribution business by customer group can be categorized as retail national accounts, independent retail pharmacies and institutional healthcare providers.

Retail National Accounts Business solutions that help national account customers increase revenues and profitability. Solutions include:

- Central Fill℠ Prescription refill service that enables pharmacies to more quickly refill prescriptions remotely, more accurately and at a lower cost, while reducing inventory levels and improving customer service.
- Redistribution Centers Two facilities totaling over 500 thousand square feet that offer access to inventory for single source warehouse purchasing, including pharmaceuticals and biologicals. These distribution centers also provide the foundation for a two-tiered distribution network that supports best-in-class direct store delivery.
- EnterpriseRx® A Software as a Service (SaaS) pharmacy management system, that allows large retail chain, health system, and retail independent pharmacies to meet demand for prescriptions while maximizing profits and optimizing operations.
- RxPak℠ Bulk-to-bottle repackaging service that leverages our purchasing scale and supplier relationships to provide pharmaceuticals at reduced prices, help increase inventory turns and reduce working capital investment.
- Inventory Management An integrated solution comprising forecasting software and automated replenishment technologies that reduce inventory-carrying costs.
- McKesson OneStop Generics® Generic pharmaceutical purchasing program that helps pharmacies maximize their cost savings with a broad selection of generic drugs, low pricing and one-stop shopping.

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Independent Retail Pharmacies Solutions for managed care contracting, branding and advertising, merchandising, purchasing, operational efficiency and automation that help independent pharmacists focus on patient care while improving profitability. Solutions include:

- Health Mart® Health Mart® is a national network of more than 2,900 independently-owned pharmacies and is one of the industry s most comprehensive pharmacy franchise programs. Health Mart® provides franchisees with managed care that drives pharmacy benefit manager recognition, branding that drives consumer recognition along with its Health Mart private label line of products, in-store programs that drive manufacturer and payer recognition and community advocacy programs that drive industry recognition. Health Mart® helps franchisees grow their businesses by focusing on the three principles of successful retailing:
  - Attract new customers;
  - Maximize the value of current customers; and
  - Enhance business efficiency.
- AccessHealth® Comprehensive managed care and reconciliation assistance services that help independent pharmacies save time, access competitive reimbursement rates and improve cash flow.
- McKesson Reimbursement Advantage℠ (MRA) MRA is one of the industry s most comprehensive reimbursement optimization packages, comprising financial services (automated claim resubmission), analytic services and customer care.
- McKesson OneStop Generics® described above.
- EnterpriseRx® described above.
- Sunmark® Complete line of more than 700 products that provide retail independent pharmacies with value-priced alternatives to national brands.
- FrontEdge Strategic planning, merchandising and price maintenance program that helps independent pharmacies maximize store profitability.
- McKesson Home Health Care Comprehensive line of more than 1,800 home health care products, including durable medical equipment, diabetes supplies, self-care supplies and disposables from national brands and the Sunmark® line.

Institutional Healthcare Providers Electronic ordering/purchasing and supply chain management systems that help customers improve financial performance, increase operational efficiencies and deliver better patient care. Solutions include:

- McKesson Pharmacy Optimization® An experienced group of pharmacy professionals providing consulting services and pharmacy practice resources. McKesson Pharmacy Optimization® develops customized and quantifiable solutions that help hospitals create and sustain financial, operational and clinical results.
- Fulfill-Rx℠ Ordering and inventory management system that integrates McKesson pharmaceutical distribution services with our automation solutions, thus empowering hospitals to optimize the often complicated and disjointed processes related to unit-based cabinet replenishment and inventory management.
- Asset Management Award-winning inventory optimization and purchasing management program that helps institutional providers lower costs while ensuring product availability.
- SKY Packaging Blister-format packaging containing the most widely prescribed dosages and strengths in generic oral-solid medications. SKY Packaging enables acute care, long-term care and institutional pharmacies to provide cost-effective, uniform packaging.
- McKesson OneStop Generics® Generic pharmaceutical purchasing program that enables acute care and alternate site pharmacies to capture the full potential of purchasing generic pharmaceuticals.
- McKesson 340B Solution Suite Solutions that help providers manage, track and report on medication replenishment associated with the federal 340B Drug Pricing Program.
- High Performance Pharmacy® Framework that identifies and categorizes hospital pharmacy best practices to help improve clinical outcomes and financial results. The High Performance Pharmacy Assessment Tool enables hospital pharmacies to measure against comparable institutions and chart a step-by-step path to high performance.

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McKesson Canada: McKesson Canada, a wholly-owned subsidiary, is one of the largest pharmaceutical distributors in Canada. McKesson Canada, through its network of 16 distribution centers, provides logistics and distribution to more than 800 manufacturers delivering their products to retail pharmacies, hospitals, long-term care centers, clinics and institutions throughout Canada. Beyond pharmaceutical distribution, logistics and order fulfillment, McKesson Canada has automated over 2,500 retail pharmacies and is also active in hospital automation solutions, dispensing more than 100 million doses each year. In partnership with other McKesson businesses, McKesson Canada provides a full range of services to Canadian manufacturers and healthcare providers, contributing to the quality and safety of care for patients. On March 25, 2012, we acquired substantially all of the assets of Drug Trading Company Limited, the independent banner business of the Katz Group Canada Inc. (Katz Group), and Medicine Shoppe Canada Inc., the franchise business of the Katz Group. The acquisition of the assets from the Drug Trading Company Limited consists of a marketing and purchasing arm of more than 850 independently owned pharmacies in Canada. The acquisition of Medicine Shoppe Canada Inc. consists of the franchise business of providing services to more than 160 independent pharmacies in Canada.

Medical Surgical Distribution: This business provides medical-surgical supply distribution, equipment, logistics and other services to healthcare providers including physicians offices, surgery centers, extended care facilities, homecare and occupational health sites through a network of 28 distribution centers within the U.S. This business is a leading provider of supplies to the full range of alternate-site healthcare facilities, including physicians offices, clinics and surgery centers (primary care), long-term care, occupational health facilities and homecare sites (extended care). Through a variety of technology products and services geared towards the supply chain, our Medical-Surgical Distribution business is focused on helping its customers operate more efficiently while providing one of the industry s most extensive product offerings, including our own private label line. This business also includes ZEE® Medical, one of the most extensive product offerings in the industry of first aid, safety and training solutions, providing services to industrial and commercial customers. This business offers an extensive line of products and services aimed at maximizing productivity and minimizing the liability and cost associated with workplace illnesses and injuries.

McKesson Pharmacy Systems and Automation: This business supplies integrated pharmacy management systems, automated dispensing systems and related services to retail, outpatient, central fill, specialty and mail order pharmacies. Its primary offering is EnterpriseRx®, a Software as a Service (SaaS) pharmacy management system, that allows large retail chain, health system, and retail independent pharmacies to meet demand for prescriptions while maximizing profits and optimizing operations. We also own a 39% interest in Parata, which sells automated pharmacy and supply management systems and services to retail and institutional pharmacies.

McKesson Specialty Health: This business provides solutions for oncology and other specialty practices operating in communities across the country, as well as for pharmaceutical and biotech suppliers who manufacture specialty drugs and vaccines. Through expertise in specialty drug distribution, commercialization, revenue cycle and practice management and reimbursement support, McKesson Specialty Health allows the community patient care delivery system and facilitates collaboration among community healthcare providers, drug manufacturers and payers. We provide direct-to-physician specialty distribution services, ensuring supply chain safety and delivery of specialty drugs in manufacturer recommended conditions. Third party logistics, or 3PL, are offered primarily for vaccine distribution, including our exclusive distributor relationship in the Center for Disease Control and Prevention s (CDC) Vaccines for Children program. We also offer our industry leading Lynx® integrated technologies, the iKnowMed℠ Electronic Health record, and clinical and practice management tools, all of which help community practices improve inventory management, practice workflow and reimbursement processes, as well as deliver business efficiencies and clinical-decision support. McKesson Specialty Health works with manufacturers across all phases of the product development and commercialization lifecycle, including clinical research, to optimize delivery of complex medication to patients. Through custom distribution and safety programs, we help support appropriate product utilization, as well as the development and management of Risk Evaluation Mitigation Strategies (REMS), reimbursement, healthcare informatics and patient access programs, and to enable manufacturers to deliver cost effective patient access to needed therapies. McKesson Specialty Health supports The US Oncology Network and US Oncology Research. The US Oncology Network unites one of the largest network of community oncologists in the United States, and through collaboration and shared purpose, provides the clinical, research, technology and business resources to ensure the growth and vitality of these independent, community-based oncology practices. US Oncology Research is one of the nation s largest research networks, specializing in Phase I Phase IV oncology clinical trials.

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Technology Solutions

Our Technology Solutions segment provides a comprehensive portfolio of software, automation, support and services to help healthcare organizations improve quality and patient safety, reduce the cost and variability of care and better manage their resources and revenue stream. This segment also includes our InterQual® clinical criteria solution, medical management tools, claims payment solutions, network performance tools and care management programs. Technology Solutions markets its products and services to integrated delivery networks, hospitals, physician practices, home healthcare providers, retail pharmacies and payers. Our solutions and services are sold internationally through subsidiaries and/or distribution agreements in Canada, United Kingdom, Ireland, other European countries and Israel.

The product portfolio for the Technology Solutions segment is designed to address a wide array of healthcare clinical and business performance needs ranging from medication safety and information access to revenue cycle management, resource utilization and physician adoption of electronic health records (EHR). Analytics software enables organizations to measure progress as they automate care processes for optimal clinical outcomes, business and operating results and regulatory compliance. To ensure that organizations achieve the maximum value for their information technology investment, we also offer a wide range of services to support the implementation and use of solutions as well as assist with business and clinical redesign, process re-engineering and staffing (both information technology and back-office).

Key solution areas are as follows:

Clinical and financial management: We provide comprehensive clinical and financial information systems for hospitals and health systems of all sizes. These systems are designed to improve the safety and quality of patient care and improve clinical, financial and operational performance. Clinical functionality includes a data repository, care planning, physician order entry and documentation, nursing documentation with bar-coded medication administration, laboratory, radiology, pharmacy, surgical management, emergency department and ambulatory EHR systems, a Web-based physician portal and a comprehensive solution for homecare. Revenue management solutions are designed to improve financial performance by reducing days in accounts receivable, preventing insurance claim denials, reducing costs and improving productivity. Solutions include online patient billing, contract management, electronic claims processing and coding compliance checking. These solutions streamline patient access and help organizations to forecast financial responsibility for constituents before and during care, allowing providers to collect their reimbursements more quickly and at a lower cost.

Enterprise imaging: In addition to document imaging to facilitate maintenance and access to complete medical records, we offer medical imaging and information management systems for healthcare enterprises, including a picture archiving communications system, a radiology information system and a comprehensive cardiovascular information system. Our enterprise-wide approach to medical imaging enables organizations to take advantage of specialty-specific workstations while building an integrated image repository that manages all of the images and information captured throughout the care continuum.

Performance management: Performance management solutions are designed to enhance an organization s ability to plan and optimize quality care delivery. Enterprise visibility and performance analytics provide business intelligence that enables providers to manage capacity, outcomes, productivity and patient flow. Workforce management solutions assist caregivers with staffing and maintaining labor rule continuity between scheduling, time and attendance and payroll. A comprehensive supply chain management solution integrates enterprise resource planning applications, including financials, materials, human resources/payroll, with scheduling, point of use, surgical and anesthesia services and enterprise-wide analytics.

Automation: Automation solutions include technologies that help hospitals re-engineer and improve their medication use processes. Examples include centralized pharmacy automation for dispensing unit-dose medications, unit-based cabinet technologies for secure medication storage and rapid retrieval and an anesthesia cart for dispensing of medications in the operating room. Based on a foundation of bar-code scanning technology, these integrated solutions are designed to reduce errors and bring new levels of safety to patients.

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Physician practice solutions: We provide a complete solution for physician practices of all sizes that includes software, revenue cycle outsourcing and connectivity services. Software solutions include practice management and EHR software for physicians of every size and specialty. Our physician practice offering also includes outsourced billing and collection services as well as services that connect physicians with their patients, hospitals, retail pharmacies and payers. Revenue cycle outsourcing enables physician groups to avoid the infrastructure investment and administrative costs of an in-house billing office. Services include clinical data collection, data input, medical coding, billing, contract management, cash collections, accounts receivable management and extensive reporting of metrics related to the physician practice.

Connectivity: Through our vendor-neutral RelayHealth® and its intelligent network, the Company provides health information exchange and revenue cycle management solutions that streamline clinical, financial and administrative communication between patients, providers, payers, pharmacies, manufacturers, government and financial institutions. RelayHealth® helps to accelerate the delivery of high-quality care and improve financial performance through online consultation of physicians by patients, electronic prescribing by physicians, point-of-service resolution of pharmacy claims by payers, pre-visit financial clearance of patients by providers and post-visit settlement of provider bills by payers and patients. RelayHealth® securely processes more than 16 billion financial and clinical transactions annually.

In addition to the product offerings described above, Technology Solutions offers a comprehensive range of services to help organizations derive greater value, enhance satisfaction and return on investment throughout the life of the solutions implemented. The range of services includes:

Technology Services: Technology services supports the smooth operation of numerous organizations information systems by providing the technical infrastructure designed to maximize application accessibility, availability, security and performance.

Outsourcing Services: With these services, we help providers focus their resources on delivering healthcare while managing their revenue cycle operations and information technology through a comprehensive suite of managed services. Services include full and partial revenue cycle outsourcing, remote hosting, managing hospital data processing operations, payroll processing, and business office administration.

Professional Services: Professional services help customers achieve business results from their software or automation investment. A wide array of service options is available, including consulting for business and/or clinical process improvement and re-design as well as implementation, project management, technical and education services relating to all products in the Technology Solutions segment.

Payer Group: The following suite of services and software products is marketed to payers, hospitals and government organizations to help manage the cost and quality of care:

- InterQual® Criteria for clinical decision support and utilization management;
- Claims payment solutions to facilitate accurate and efficient medical claim payments;
- Business intelligence tools for measuring, reporting and improving clinical and financial performance;
- Network management tools enable health plans to transform the performance of their networks;
- Disease management programs to improve the health status and health outcomes of patients with chronic conditions;
- Nurse advice services to provide health information and recommend appropriate levels of care; and

Clinical and analytical software to support utilization, case and disease management workflows.

Business Combinations and Discontinued Operation

We have undertaken strategic initiatives in recent years designed to further focus on our core healthcare businesses and enhance our competitive position. We expect to continue to undertake such strategic initiatives in the future. These initiatives are detailed in Financial Notes 2 and 7, "Business Combinations" and "Discontinued Operation," to the consolidated financial statements appearing in this Annual Report on Form 10-K.

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Competition

In every area of healthcare distribution operations, our Distribution Solutions segment faces strong competition, both in price and service, from national, regional and local full-line, short-line and specialty wholesalers, service merchandisers, self-warehousing chains, manufacturers engaged in direct distribution, third-party logistics companies and large payer organizations. In addition, this segment faces competition from various other service providers and from pharmaceutical and other healthcare manufacturers as well as other potential customers of the segment, which may from time-to-time decide to develop, for their own internal needs, supply management capabilities that would otherwise be provided by the segment. Price, quality of service, innovation and, in some cases, convenience to the customer are generally the principal competitive elements in this segment.

Our Technology Solutions segment experiences substantial competition from many firms, including other software services firms, consulting firms, shared service vendors, certain hospitals and hospital groups, payers, care management organizations, hardware vendors and internet-based companies with technology applicable to the healthcare industry. Competition varies in size from small to large companies, in geographical coverage and in scope and breadth of products and services offered.

Intellectual Property

The principal trademarks and service marks of our Distribution Solutions segment include: AccessHealth®, AccessMED®, Acumax®, Advancing Cancer Care in America®, Business of Pharmacy℠, BoP®, CaresRx℠, Central Fill℠, Closed Loop Distribution℠, Comprehensive Strategic Alliance (CSA)℠, Cypress℠, Cypress Plus®, Edwards Medical Supply®, Empowering Healthcare®, EnterpriseRx®, Expect More From Moore℠, FrontEdge , Fulfill-Rx℠, Heal Living Well After Cancer®, Health Mart®, Heart Profilers & Design®, High Performance Pharmacy®, Iknowchart , iKnowMed℠, Innovent®, LoyaltyScript®, Lynx®, Market Focus℠, Max Impact®, McKesson®, McKesson Advantage℠, McKesson Connect℠, McKesson Empowering Healthcare®, McKesson High Volume Solutions℠, McKesson Max Rewards®, McKesson OneStop Generics®, McKesson Pharmacy Central℠, McKesson Pharmacy Optimization®, McKesson Priority Express OTC℠, McKesson Reimbursement Advantage℠, McKesson Supply Manager℠, MediNet , Medi-Pak®, Mobile Manager℠, Moore Medical®, Moorebrand®, Nexcura®, Northstarx®, Oncology Today℠, Oncology Today Translating Knowledge Into Cancer Care®, OncologyRx Care Advantage®, Onmark®, OTN®, Pharma360®, PharmacyRx , Pharmaserv®, Radmap , Research & Education®, RX Pak℠, RxOwnership®, Selectplus Oncology®, ServiceFirst℠, Staydry®, Sterling Medical Services®, Sunmark®, Supply Management Online℠, The Supply Experts®, The US Oncology Network℠, TrialScript®, Triangle Design®, United We Win℠, US Cancer Alliance℠, US Oncology®, Valu-Rite®, XVIII B Medi Mart®, Zee Medical Service®, and ZEE®.

The substantial majority of technical concepts and codes embodied in our Technology Solutions segment s computer programs and program documentation are protected as trade secrets. The principal trademarks and service marks for this segment are: AcuDose-Rx®, ANSOS One-Staff , Ask-A-Nurse®, Care Fully Connected , CareEnhance®, Connect-RN , Connect-Rx®, CRMS , DataStat®, ePremis®, Episode Profiler , E-Script , Fulfill-Rx℠, HealthQuest , Horizon Admin-Rx , Horizon Clinicals®, Horizon Enterprise Revenue Management™, HorizonWP®, InterQual®, Lytec®, MedCarousel®, Medisoft®, ORSOS One-Call , PACMED , PakPlus-Rx , Paragon®, Pathways 2000®, Patterns Profiler , Per-Se , Per-Se Technologies®, PerYourHealth.com®, Practice Partner®, Premis®, ProIntercept®, ProMed®, ProPBM®, RelayHealth®, ROBOT-Rx®, SelfPace®, Series 2000 , STAR 2000 , SupplyScan , TRENDSTAR® and WebVisit .

We also own other registered and unregistered trademarks and service marks and similar rights used by our business segments. Many of the principal trademarks and service marks are registered in the United States, or registrations have been applied for with respect to such marks, in addition to certain other jurisdictions. The United States federal registrations of these trademarks have terms of ten or twenty years, depending on date of registration, and are subject to unlimited renewals. We believe that we have taken all necessary steps to preserve the registration and duration of our trademarks and service marks, although no assurance can be given that we will be able to successfully enforce or protect our rights thereunder in the event that they are subject to third-party infringement claims. We do not consider any particular patent, license, franchise or concession to be material to our business. We also hold copyrights in, and patents related to, many of our products.

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Other Information about the Business

Customers: During 2012, sales to our ten largest customers accounted for approximately 52% of our total consolidated revenues. Sales to our two largest customers, CVS Caremark Corporation (CVS) and Rite Aid Corporation (Rite Aid), accounted for approximately 16% and 10% of our total consolidated revenues. At March 31, 2012, accounts receivable from our ten largest customers were approximately 49% of total accounts receivable. Accounts receivable from CVS, Wal-Mart Stores, Inc. (Walmart) and Rite Aid were approximately 17%, 10% and 9% of total accounts receivable. We also have agreements with group purchasing organizations (GPOs), each of which functions as a purchasing agent on behalf of member hospitals, pharmacies and other healthcare providers. The accounts receivables balances are with individual members of the GPOs. Substantially all of these revenues and accounts receivable are included in our Distribution Solutions segment.

Suppliers: We obtain pharmaceutical and other products from manufacturers, none of which accounted for more than approximately 6% of our purchases in 2012. The loss of a supplier could adversely affect our business if alternate sources of supply are unavailable. We believe that our relationships with our suppliers, on the whole, are good. The ten largest suppliers in 2012 accounted for approximately 45% of our purchases.

A significant portion of our distribution arrangements with the manufacturers provides us compensation based on a percentage of our purchases. In addition, we have certain distribution arrangements with pharmaceutical manufacturers that include an inflation-based compensation component whereby we benefit when the manufacturers increase their prices as we sell our existing inventory at the new higher prices. For these manufacturers, a reduction in the frequency and magnitude of price increases, as well as restrictions in the amount of inventory available to us, could have a material adverse impact on our gross profit margin.

Research and Development: Our development expenditures primarily consist of our investment in software held for sale. We spent $487 million, $471 million and $451 million for development activities in 2012, 2011 and 2010 and of these amounts, we capitalized 10%, 14% and 17%. Development expenditures are primarily incurred by our Technology Solutions segment. Our Technology Solutions segment s product development efforts apply computer technology and installation methodologies to specific information processing needs of hospitals and other customers. We believe that a substantial and sustained commitment to such expenditures is important to the long-term success of this business. Additional information regarding our development activities is included in Financial Note 1, Significant Accounting Policies, to the consolidated financial statements appearing in this Annual Report on Form 10-K.

Environmental Regulation: Our operations are subject to regulations under various federal, state, local and foreign laws concerning the environment, including laws addressing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes and the cleanup of contaminated sites. We could incur substantial costs, including cleanup costs, fines and civil or criminal sanctions and third-party damage or personal injury claims, if in the future we were to violate or become liable under environmental laws.

We are committed to maintaining compliance with all environmental laws applicable to our operations, products and services and to reducing our environmental impact across all aspects of our business. We meet this commitment through an environmental strategy and sustainability program.

We sold our chemical distribution operations in 1987 and retained responsibility for certain environmental obligations. Agreements with the Environmental Protection Agency and certain states may require environmental assessments and cleanups at several closed sites. These matters are described further in Financial Note 19, Other Commitments and Contingent Liabilities, to the consolidated financial statements appearing in this Annual Report on Form 10-K.

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The liability for environmental remediation and other environmental costs is accrued when the Company considers it probable and can reasonably estimate the costs. Environmental costs and accruals, including that related to our legacy chemical distribution operations, are presently not material to our operations or financial position. Although there is no assurance that existing or future environmental laws applicable to our operations or products will not have a material adverse impact on our operations or financial condition, we do not currently anticipate material capital expenditures for environmental matters. Other than the expected expenditures that may be required in connection with our legacy chemical distribution operations, we do not anticipate making substantial capital expenditures either for environmental issues, or to comply with environmental laws and regulations in the future. The amount of our capital expenditures for environmental compliance was not material in 2012 and is not expected to be material in the next year.

Employees: On March 31, 2012, we employed approximately 37,700 persons compared to 36,400 and 32,500 on March 31, 2011 and 2010.

Financial Information About Foreign and Domestic Operations: Information as to foreign and domestic operations is included in Financial Notes 1 and 22, Significant Accounting Policies and Segments of Business, to the consolidated financial statements appearing in this Annual Report on Form 10-K.

Forward-Looking Statements

This Annual Report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of Part II of this report and the Risk Factors in Item 1A of Part I of this report, contains forward-looking statements within the meaning of section 27A of the Securities Act of 1933, as amended and section 21E of the Securities Exchange Act of 1934, as amended. Some of these statements can be identified by use of forward-looking words such as believes, expects, anticipates, may, will, should, seeks, app intends, plans or estimates, or the negative of these words, or other comparable terminology. The discussion of financial trends, strategy, plans or intentions may also include forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected, anticipated, or implied. Although it is not possible to predict or identify all such risks and uncertainties, they may include, but are not limited to, the factors discussed in Item 1A of Part I of this report under Risk Factors. The reader should not consider the list to be a complete statement of all potential risks and uncertainties.

These and other risks and uncertainties are described herein and in other information contained in our publicly available SEC filings and press releases. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date such statements were first made. Except to the extent required by federal securities laws, we undertake no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.

Item 1A. Risk Factors.

The risks described below could have a material adverse impact on our financial position, results of operations, liquidity and cash flows. Although it is not possible to predict or identify all such risks and uncertainties, they may include, but are not limited to, the factors discussed below. Our business operations could also be affected by additional factors that are not presently known to us or that we currently consider not to be material to our operations. The reader should not consider this list to be a complete statement of all risks and uncertainties.

We are subject to legal proceedings that could have a material adverse impact on our financial position and results of operations.

From time-to-time and in the ordinary course of our business, we and certain of our subsidiaries may become involved in various legal proceedings involving antitrust, commercial, employment, environmental, intellectual property, regulatory, tort and other various claims. All such legal proceedings are inherently unpredictable, and the outcome can result in excessive verdicts and/or injunctive relief that may affect how we operate our business or we may enter into settlements of claims for monetary damages. In some cases, substantial non-economic remedies or punitive damages may be sought. For some complaints filed against the Company, we are currently unable to estimate the amount of possible losses that might be incurred should these legal proceedings be resolved against the Company.

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McKESSON CORPORATION

The outcome of litigation and other legal matters is always uncertain and outcomes that are not justified by the evidence or existing law can occur. The Company believes that it has valid defenses to the legal matters pending against it and is defending itself vigorously. Nevertheless, it is possible that resolution of one or any combination of more than one legal matter could result in a material adverse impact on our financial position or results of operations. For example, we are involved in a number of legal proceedings described in Financial Note 19, Other Commitments and Contingent Liabilities, to the accompanying consolidated financial statements that could have such an impact, including legal proceedings alleging that we engaged in illegal conduct that caused average wholesale prices to rise for certain prescription drugs during specified periods.

Litigation is costly, time-consuming and disruptive to normal business operations. The defense of these matters could also result in continued diversion of our management s time and attention away from business operations, which could also harm our business. Even if these matters are not resolved against us, the uncertainty and expense associated with unresolved legal proceedings could harm our business and reputation. For additional information regarding certain of the legal proceedings in which we are involved, see Financial Note 19, Other Commitments and Contingent Liabilities, to the accompanying consolidated financial statements.

Changes in the United States healthcare industry and regulatory environment could have a material adverse impact on our results of operations.

Our products and services are primarily intended to function within the structure of the healthcare financing and reimbursement system currently being used in the United States. In recent years, the healthcare industry in the United States has changed significantly in an effort to reduce costs. These changes have included cuts in Medicare and Medicaid reimbursement levels, consolidation of pharmaceutical and medical-surgical supply distributors and the development of large, sophisticated purchasing groups. We expect the healthcare industry in the United States to continue to change and for healthcare delivery models to evolve in the future.

Changes in the healthcare industry s or our pharmaceutical suppliers pricing, selling, inventory, distribution or supply policies or practices could significantly reduce our revenues and net income. Due to the diverse range of healthcare supply management and healthcare information technology products and services that we offer, such changes could have a material adverse impact on our results of operations, while not affecting some of our competitors who offer a narrower range of products and services.

The majority of our U.S. pharmaceutical distribution business agreements with manufacturers are structured to ensure that we are appropriately and predictably compensated for the services we provide; however, failure to successfully renew these contracts in a timely and favorable manner could have a material adverse impact on our results of operations. In addition, branded pharmaceutical price inflation can be the partial economic basis of some of our distribution business agreements with pharmaceutical manufacturers. If the frequency or rate of branded price increases slows, it could have a material adverse impact on our results of operations.

In addition, we distribute generic pharmaceuticals, which can be subject to both price deflation and price inflation. Healthcare and public policy trends indicate that the number of generic drugs will increase next year as a result of the expiration of certain drug patents. In recent years, our financial results have improved from our generic drug offerings combined with an increase in the number of generic drug formularies available in the marketplace. Changes in the availability, pricing trends or reimbursement of these generic drugs, or changes in the rate of increase in the number of generic drugs, could have a material adverse impact on our results of operations.

Generic drug manufacturers are increasingly challenging the validity or enforceability of patents on branded pharmaceutical products. During the pendency of these legal challenges, a generics manufacturer may begin manufacturing and selling a generic version of the branded product prior to the final resolution to its legal challenge over the branded product s patent. To the extent we source, contract manufacture, and distribute such generic products, the brand-name company could assert infringement claims against us. While we generally obtain indemnification against such claims from generic manufacturers as a condition of distributing their products, there can be no assurances that these rights will be adequate or sufficient to protect us.

McKESSON CORPORATION

In recent years, pharmaceutical suppliers have been subject to increasing consolidation. As a result, a small number of very large companies control a significant share of the market. Accordingly, we depend on fewer suppliers for our products and therefore we may be less able to negotiate price terms with suppliers.

Many healthcare organizations also have consolidated to create larger healthcare enterprises with greater market power. If this consolidation trend continues, it could reduce the size of our target market and give the resulting enterprises greater bargaining power, which may lead to erosion of the prices for our products and services. In addition, when healthcare organizations combine they often consolidate infrastructure including IT systems, which in turn may erode our customer and revenue base.

6,486,411

3,644,384

Gross profit

3,641,138

2,547,339

6,603,270

5,349,974

Operating expenses:

Selling and marketing

579,941

412,570

931,743

731,434

Depreciation and amortization

489,004

564,855

968,867

				1,117,386
Bad debt expense	51,690	7,728	117,498	7,728
Salaries and wages	1,183,184	552,714	2,271,451	1,089,090
Professional services, including non-cash compensation	236,562	115,188	497,432	254,299
General and adminstrative	725,679	619,455	1,572,285	1,190,546
Total operating expenses	3,266,060	2,272,510	6,359,276	4,390,483

Income from operations

375,078

274,829

243,994

959,491

Other income and (expenses):

Gain (loss) on sale of assets

(58
)

4,219

(12,338
)

4,610

Beneficial conversion feature

(2,208,334
)

(5,192
)

(2,208,334
)

(11,761
)
Amortization of debt discount and capitalized cost of debt

(2,069,033
)

-

(2,803,691
)

-

Liquidation damages

(133,833
)

-

(133,833
)

-

Fair market value of warrants issued

-

-

-

(9,489
)
Gain on forgiveness of debt

-

3,335

-

6,976

Interest expense

(211,615
)

(86,862
)

(461,406
)

(165,885
)
Interest income

128,303

94,629

219,049

179,041

Other income and (expenses)

39,192

(22,142
)

80,392

(54,645
)
Income taxes

(13,741
)

7,751

(66,565
)

(66,811
)
Total other expenses

(4,469,119
)

(4,262
)

(5,386,726
)

(117,964
)
Net income (loss) before minority interest in subsidiary

(4,094,041
)

270,567

(5,142,732
)

841,527

Minority interest in subsidiary	(558,571)	(145,532)	(805,845)	(512,745)
Net income (loss)	(4,652,612)	125,035	(5,948,577)	328,782
Dividend required for preferred stockholders	(65,598)	-	(65,598)	-
Net income (loss) applicable to common shareholders	(4,718,210)	125,035	(6,014,175)	328,782
Other comprehensive gain:				

Translation adjustment	195,269	437,660	121,779	316,840
Comprehensive income (loss)	$ (4,522,941)	$ 562,695	$ (5,892,396)	$ 645,622
Net income (loss) per share:				
Basic	$ (0.27)	$ 0.01	$ (0.34)	$ 0.02
Diluted	$ (0.27)	$ 0.01	$ (0.34)	

$

0.02

Weighted average number of shares outstanding

Basic

17,514,634

14,064,968

17,280,675

13,981,426

Diluted

17,514,634

14,444,665

17,280,675

14,361,123

See accompanying notes to these unaudited consolidated financial statements.

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NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Six Months Ended December 31, 2006		2005	
Cash flows from operating activities:				
Net income (loss) attributable to common shareholders	$	(6,014,175)	$	328,782
Adjustments to reconcile net income (loss) applicable to common shareholder to net cash used in operating activities:				
Depreciation and amortization		1,320,111		1,334,476
Bad debt expense		117,498		7,728
Gain on settlement of debt		-		(6,976)
(Gain) loss on sale of assets		12,338		(4,610)
Minority interest in subsidiary		805,845		512,745
Stock issued for services		41,380		126,334
Stock issued for convertible note payable interest		311,868		-
Fair market value of warrants and stock options granted		-		9,489
Beneficial conversion feature		2,208,334		11,761
Amortization of debt discount and capitalized cost of debt		2,803,691		-
Changes in operating assets and liabilities:				
(Increase) in assets:				
Accounts receivable		(2,141,889)		(1,774,513)
Other current assets		(1,501,990)		(1,937,157)
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses		419,886		679,111
Payment for acquisition		(4,027,753)		-
Net cash used in operating activities		(5,644,856)		(712,830)
Cash flows from investing activities:				
Purchases of property and equipment		(417,833)		(1,466,505)
Sales of property and equipment		131,775		109,483
Net (purchases) proceeds of certificates of deposit		1,739,581		(1,296,272)
Increase in intangible assets		(935,439)		(454,228)
Net cash provided by (used in) investing activities		518,084		(3,107,522)
Cash flows from financing activities:				
Dividend to preferred shareholders payable		65,598		-
Proceeds from sale of common stock		-		-
Proceeds from the exercise of stock options		219,223		384,062
Capital contributed from sale of subsidiary stock		-		4,031,001
Reduction in restricted cash		4,533,555		(206,900)
Proceeds from loans from officers		165,000		-
Capital lease obligations & loans (net)		390,128		91,541
Net cash provided by financing activities		5,373,504		4,299,704
Effect of exchange rate changes in cash		(33,353)		33,494
Net increase in cash and cash equivalents		213,379		512,846
Cash and cash equivalents, beginning of period		2,493,768		1,371,727
Cash and cash equivalents, end of period	$	2,707,147	$	1,884,573

See accompanying notes to these unaudited consolidated financial statements.

NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

	For the Six Months Ended December 31,			
		2006		2005
SUPPLEMENTAL DISCLOSURES:				
Cash paid during the period for:				
Interest	$	269,340	$	123,581
Taxes	$	-	$	12,454
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Common stock issued for intangible assets	$	203,186	$	-
Common stock issued for conversion of convertible debenture	$	-	$	50,000
Common stock issued for settlement of debt	$	-	$	-
Common stock issued for payment of note payable and related interest	$	339,368	$	71,018
Preferred stock issued for conversion of convertible note payable	$	5,500,000	$	-

See accompanying notes to these unaudited consolidated financial statements.

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NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The Company designs, develops, markets, and exports proprietary software products to customers in the automobile finance and leasing, banking and financial services industries worldwide. The Company also provides system integration, consulting, IT products and services in exchange for fees from customers.

The consolidated condensed interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these consolidated condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-KSB for the year ended June 30, 2006. The Company follows the same accounting policies in preparation of interim reports. Results of operations for the interim periods are not indicative of annual results.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, McCue Systems, Inc. ("McCue"), NetSol Technologies Limited ("UK"), NetSol-Abraxas Australia Pty Ltd. ("Abraxas"), NetSol-CQ Limited ("CQ"), and its majority-owned subsidiaries, NetSol Technologies (Pvt), Ltd.("PK Tech"), NetSol Connect (Pvt), Ltd. (now, NetSol Akhter Pvt. Ltd.) ("Connect"), TIG-NetSol (Pvt) Limited ("TIG"), and NetSol Omni (Private) Limited ("Omni"). All material inter-company accounts have been eliminated in consolidation.

For comparative purposes, prior year's consolidated financial statements have been reclassified to conform to report classifications of the current year.

NOTE 2 - USE OF ESTIMATES:

The preparation of financial statements, in conformity with generally accepted accounting principles in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS:

In February 2006, FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". SFAS No. 155 amends SFAS No 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". SFAS No. 155, permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on the qualifying special-purpose entity from

holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for all financial instruments acquired or issued after the beginning of the Company's first fiscal year that begins after September 15, 2006. Management is still in the process of determining the effect of SFAS No. 155 on the consolidated financial position or results of operations of the Company.

In March 2006 FASB issued SFAS 156 'Accounting for Servicing of Financial Assets' this Statement amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement:

1. Requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract.

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2. Requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable.

3. Permits an entity to choose 'Amortization method' or 'Fair value measurement method' for each class of separately recognized servicing assets and servicing liabilities.

4. At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value.

5. Requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

This Statement is effective as of the beginning of the Company's first fiscal year that begins after September 15, 2006. Management is still in the process of determining the effect of the statement on the consolidated financial position.

In September 2006, FASB issued SFAS 157 'Fair Value Measurements'. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on the consolidated financial statements.
In September 2006, FASB issued SFAS 158 'Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)' This Statement improves financial reporting by requiring an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements:

1. A brief description of the provisions of this Statement
2. The date that adoption is required
3. The date the employer plans to adopt the recognition provisions of this Statement, if earlier.

The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The management is

currently evaluating the effect of this pronouncement on the consolidated financial statements.

In July 2006, the FASB released FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. This statement is effective for fiscal years beginning after December 15, 2006. Management is currently in the process of evaluating the expected effect of FIN 48 on our results of operations and financial position.

NOTE 4 - EARNINGS/(LOSS) PER SHARE:

Earnings per share is calculated in accordance with the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), “Earnings per share”. Basic net income per share is based upon the weighted average number of common shares outstanding. Diluted net income per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

For the six months ended December 31, 2006		**Net Income**	**Shares**		**Per Share**
Basic earnings per share:					
Net income (loss)	$	(5,948,577)	17,280,675	$	(0.34)
Effect of dilutive securities *					
Stock options			-		
Warrants			-		
Diluted earnings per share	$	(5,948,577)	17,280,675	$	(0.34)

For the six months ended December 31, 2005		**Net Income**	**Shares**		**Per Share**
Basic earnings per share:					
Net income available to common shareholders	$	328,782	13,981,426	$	0.02
Effect of dilutive securities					
Stock options			563,292		
Warrants			2,169		
Diluted earnings per share	$	328,782	14,546,887	$	0.02

* As there is a loss, these securities are anti-dilutive. The basic and diluted earnings per share is the same for the six months ended December 31, 2006

NOTE 5 - FOREIGN CURRENCY:

The accounts of NetSol Technologies UK, Ltd., and NetSol-CQ Ltd. use the British Pound; NetSol Technologies, (PVT), Ltd, NetSol Connect PVT, Ltd., NetSol Omni, and NetSol-TiG use Pakistan Rupees; and NetSol Abraxas Australia Pty, Ltd. uses the Australian dollar as the functional currencies. NetSol Technologies, Inc., and subsidiary McCue Systems, Inc., use the U.S. dollar as the functional currency. Assets and liabilities are translated at the exchange rate on the balance sheet date, and operating results are translated at the average exchange rate throughout the period. Accumulated translation losses amounted to $297,881 at December 31, 2006 and are classified as an item of accumulated other comprehensive loss in the stockholders’ equity section of the consolidated balance sheet. During the six months ended December 31, 2006 and 2005, comprehensive income in the consolidated statements of operation included translation income of $121,779 and $316,840, respectively.

NOTE 6 - OTHER CURRENT ASSETS

Other current assets consist of the following at December 31, 2006:

Prepaid Expenses	$ 1,367,297
Advance Income Tax	146,915
Employee Advances	188,789
Security Deposits	96,957
Other Receivables	257,420
Other Assets	49,756
Total	$ 2,107,134

NOTE 7- INTANGIBLE ASSETS:

Intangible assets consist of product licenses, renewals, enhancements, copyrights, trademarks, trade names, customer lists and goodwill. The Company evaluates intangible assets, goodwill and other long-lived assets for impairment, at least on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows. Recoverability of intangible assets, other long-lived assets and, goodwill is measured by comparing their net book value to the related projected undiscounted cash flows from these assets, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. If the net book value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss. Potential impairment of goodwill after July 1, 2002 has been evaluated in accordance with SFAS No. 142. The SFAS No. 142 is applicable to the financial statements of the Company beginning July 1, 2002.

As part of intangible assets, the Company capitalizes certain computer software development costs in accordance with SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” Costs incurred internally to create a computer software product or to develop an enhancement to an existing product are charged to expense when incurred as research and development expense until technological feasibility for the respective product is established. Thereafter, all software development costs are capitalized and reported at the lower of unamortized cost or net realizable value. Capitalization ceases when the product or enhancement is available for general release to customers.

The Company makes on-going evaluations of the recoverability of its capitalized software projects by comparing the amount capitalized for each product to the estimated net realizable value of the product. If such evaluations indicate that the unamortized software development costs exceed the net realizable value, the Company writes off the amount by which the unamortized software development costs exceed net realizable value. Capitalized and purchased computer software development costs are being amortized ratably based on the projected revenue associated with the related software or on a straight-line basis over three years, whichever method results in a higher level of amortization.

Product licenses and customer lists were comprised of the following as of December 31, 2006:

	Product Licenses	Customer Lists	Total
Intangible asset - June 30, 2006	$ 10,920,327	$ 5,438,594	$ 16,358,921
Additions	1,048,112	12,500	1,060,612
Effect of translation adjustment	90,818	-	90,818
Accumulated amortization	(6,264,791)	(2,676,367)	(8,941,158)

Net balance - December 31, 2006	$	5,794,466	$	2,774,727	$	8,569,193
Amortization expense:						
Six months ended Dec. 31, 2006	$	457,628	$	347,322	$	804,950
Six months ended Dec. 31, 2005	$	661,360	$	314,310	$	975,670

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The above amortization expense includes amounts in “Cost of Revenues” for capitalized software development costs of $42,846 and $25,362 for the six months ended December 31, 2006 and 2005, respectively.

At December 31, 2006 and 2005, product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, included unamortized software development and enhancement costs of $3,452,255 and $1,968,081, respectively, as the development and enhancement is yet to be completed. Software development amortization expense was $105,900 and $55,475 for the six months ended December 31, 2006 and 2005, respectively.

Amortization expense of intangible assets over the next five years is as follows:

	FISCAL YEAR ENDING					
Asset	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	TOTAL
Product Licences	$ 917,589	$ 898,751	$ 763,338	$ 302,777	$ 141,604	$ 3,024,059
Customer Lists	694,644	694,644	694,644	475,164	215,631	2,774,727
	$ 1,612,233	$ 1,593,395	$ 1,457,982	$ 777,941	$ 357,235	$ 5,798,786

There were no impairments of the goodwill asset in the six months ended December 31, 2006 and 2005.

NOTE 8 - DEBTS

NOTES PAYABLE

Notes payable as of December 31, 2006 consist of the following:

Name	Balance at 12/31/06	Current Maturities	Long-Term Maturities
Professional Liability Insurance	$ 4,990	$ 4,990	$ -
Noon Group	540,870	540,870	-
Subsidiary Capital Leases	166,956	166,956	-
	$ 712,816	$ 712,816	$ -

In June 2002, the Company signed a settlement agreement with a former employee for payment of past services rendered. The Company agreed to pay the employee a total of $75,000. The agreement called for monthly payments of $1,500 per month until paid. The balance owing at June 30, 2006 was $16,300. In July 2006, the full amount of $16,300 plus $2,934 of interest was paid on this debt.

In January 2006, the Company renewed its directors and officers’ liability insurance for which the annual premium is $185,000. In January 2006, the Company arranged financing with AFCO Credit Corporation with a down payment of $19,007 with the balance to be paid in nine monthly installments of $19,007 each. The balance owing as of December 31, 2006 was $0.

In February 2005, the Company received a loan from Noon Group in the amount of $500,000. The note carries an interest rate of 9.75% per annum and is due in one year. The maturity date of the loan may be extended at the option of the holder for an additional year. In March, 2006, the note was extended for another year. During the six months ended December 31, 2006, $24,576 of accrued interest was recorded for this loan. Total accrued interest added to the loan at December 31, 2006 was $40,870.

In addition, the various subsidiaries had current maturities of capital leases of $166,956 as of December 31, 2006.

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BANK NOTE

The Company's Pakistan subsidiary, NetSol Technologies (Private) Ltd., has one loan with a bank, secured by the Company's assets. This note consists of the following as of December 31, 2006:

TYPE OF LOAN	MATURITY DATE	INTEREST RATE		BALANCE USD
Export Refinance	Every 6 months	9%	$	1,229,911
Total			$	1,229,911

OTHER PAYABLE - ACQUISITION

CQ System

In June 2006, the final installment for the purchase of CQ Systems was determined based on the audited revenues for the twelve month period ending March 31, 2006. Based on the earn-out formula in the purchase agreement, £2,087,071 or $3,785,210 was due in cash and stock. On June 12, 2006, 884,535 shares of the Company's restricted common stock were issued to the former shareholders of CQ Systems. As of June 30, 2006, a payable to former CQ Systems shareholders consisting of the cash portion of $1,936,530 and an interest expense of $31,810 for a total of $1,968,340 was shown as "Other Payable - Acquisition" in the consolidated financial statements. In July 2006, the cash was paid to the former shareholders.

McCue Systems

On June 30, 2006, the acquisition with McCue Systems, Inc. ("McCue") closed (see Note 14). As a result, the first installment consisting of $2,117,864 cash and 958,213 shares of the Company's restricted common stock was recorded. The cash portion was shown as "Other Payable - Acquisition" and the stock was shown as "Shares to Be Issued" as of June 30, 2006. During the six months ended December 31, 2006, $2,059,413 of the cash portion of was paid to the McCue shareholders leaving a balance to be paid of $58,451. This represents the few remaining McCue shareholders that have not been located as of this date. In July 2006 the stock was issued.

DUE TO OFFICERS

The officers of the Company from time to time loan funds to the Company. One of the officers has deferred the increase in his wages. During the six months ended December 31, 2006, $37,500 of accrued wages was added to the balance due to officers and $41,102 was remitted to one officer against the amounts owing to him. In addition, the board of directors authorized a bonus in the amount of $50,000 each to the three founding officers for recognition of past service and the growth in the Company. In addition, one subsidiary had $33,573 due to an officer of the subsidiary.

On September 1, 2006, an officer of the Company loaned $165,000 to the Company for its immediate short-term cash needs in the corporate office. The loan has a maturity date of three months and is interest free. The terms of the loan were approved by the Company's board of directors.

The balance of due to officers as of December 31, 2006 was $400,533.

NOTE 9 - DIVIDEND PAYABLE - PREFERRED SHAREHOLDERS

On October 30, 2006, the convertible notes payable (see note 11) were converted into 5,500 shares of Series A 7% Cumulative Convertible Preferred Stock. The dividend is to be paid quarterly, either in cash or stock at the Company's election. The dividend due for the quarter ended December 31, 2006 was $65,598 and is reflected in these consolidated financial statements.

NOTE 10 - CONVERTIBLE DEBENTURE

On March 24, 2004, the Company entered into an agreement with several investors to acquire Series A Convertible Debentures (the “Bridge Loan”) whereby a total of $1,200,000 in debentures were procured through Maxim Group, LLC. The Company received a net of $1,049,946 after placement expenses. In addition, the beneficial conversion feature of the debenture was valued at $252,257. The Company had recorded this as a contra-account against the loan balance and amortized the beneficial conversion feature over the life of the loan.

Under the terms of the Bridge Loan agreements, and supplements thereto, the debentures bore an interest at the rate of 10% per annum, payable on a quarterly basis in common stock or cash at the election of the Company. The maturity date was 24 months from the date of signing, or March 26, 2006. Pursuant to the terms of a supplemental agreement dated May 5, 2004 between NetSol and the debenture holders, the conversion rate was set at one share for each $1.86 of principal.

In addition, each debenture holder was entitled to receive at the time of conversion warrants equal to one-half of the total number of shares issued. The total number of warrants that may be granted was 322,582. The warrants expire in five years and have an exercise price of $3.30 per share. The fair value of the warrants was calculated and recorded using the Black-Scholes method at the time of granting, when the debenture was converted. During the three months ended September 30, 2005, one debenture holder converted its note into common stock. As part of the conversion, warrants to purchase a total of 13,441 common shares were issued to the note holder. The warrants were valued using the fair value method at $9,489 and was recorded as an expense in the accompanying consolidated financial statements for the three months ended September 30, 2005.

NOTE 11 - CONVERTIBLE NOTE PAYABLE

On June 15, 2006, the Company entered into an agreement with 5 accredited investors whereby the Company issued 5 convertible notes payable for an aggregate principal value of $5,500,000. These notes had an interest at the rate of 12% per annum and were due in full one year from the issuance date or on June 15, 2007 (the “Financing”). The Convertible Notes could immediately convert into shares of common stock of the Company at the conversion value (initially set at one share per $1.65 of principal dollar) to the extent that such conversion does not violate Nasdaq Market Place rules. Upon the approval of the stockholders, to the extent not already converted into common shares, the Convertible Notes Payable will immediately convert into shares of Preferred Stock. On October 18, 2006, the shareholders approved the shares and on October 30, 2006 the notes were converted into 5,500 shares of Series A 7% Cumulative Preferred Stock (see note 12). During the six months ended December 31, 2006, $223,667 of interest was accrued. As of October 30, 2006, a total of $251,167 in accrued interest had been recorded on the notes. On December 13, 2006, the note holders agreed to accept shares of the Company’s common stock in payment of the interest owed to them. In addition, the note holders required the Company to issue a total of 60,000 shares of the Company’s common stock valued at $88,201 as a premium to receive payment in shares rather than cash. This amount is included in “interest expense” in the accompanying consolidated financial statements.

The beneficial conversion feature expense based on the net value of the loan after reducing the proceeds by the value of the warrants issued was $2,208,334.

The common stock shares issued under this financing agreement, including warrants, are to be registered within 120 days after closing (or October 19, 2006). If the Company does not meet the registration requirement, the Company shall pay in cash as liquidated damages for such failure and not as a penalty to each Holder an amount equal to one percent (1%) of such Holder's Purchase Price paid by such Holder pursuant to the Purchase Agreement for each thirty (30) day period until the applicable Event has been cured. The registration statement was not effective until January 19, 2007. As of December 31, 2006, the Company accrued $133,833 as liquidation damages due and the amount is included in “Accrued Liabilities” in the accompanying consolidated financial statements.

As part of the agreement, the investors received warrants to purchase 1,666,668 shares of the Company's common stock. The warrants have an exercise price of $2.00 and expire in five years. These warrants were valued using the Black-Scholes model at $2,108,335 and have been capitalized as a contra-account against the note balance in these consolidated financial statements. These costs are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. As the loans were converted on October 30, 2006, the balance of $2,022,363 was amortized and recorded as "amortization of debt discount" in the accompanying consolidated financial statements.

The Black-Scholes pricing model used the following assumptions:

Risk-free interest rate	6.00%
Expected life	5 years
Expected volatility	100%
Dividend yield	0%

In connection with this financing the Company paid $474,500 in cash for placement agent fees and legal fees. These costs were capitalized and are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. As the loans were converted on October 30, 2006, the balance of $454,729 of these costs were amortized and recorded as "amortization of capitalized cost of debt" in the accompanying consolidated financial statements.

As part of the financing, warrants to purchase 266,666 shares of the Company's common stock were issued to the placement agent as part of their fee. The warrants have an exercise price of $1.65 and expire in two years. These warrants were valued using the Black-Scholes model at $340,799 and have been capitalized in these consolidated financial statements. These costs are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. As the loans were converted on October 30, 2006, the balance of $326,599 of these costs were amortized and recorded as "amortization of capitalized cost of debt" in the accompanying consolidated financial statements.

The Black-Scholes pricing model used the following assumptions:

Risk-free interest rate	6.00%
Expected life	2 years
Expected volatility	100%
Dividend yield	0%

NOTE 12 - STOCKHOLDERS' EQUITY:

EQUITY TRANSACTIONS

PREFERRED STOCK

On October 30, 2006, the convertible notes payable (see note 11) were converted into 5,500 shares of Series A 7% Cumulative Convertible Preferred Stock. The preferred shares are valued at $1,000 per share or $5,500,000. The preferred shares are convertible into common stock at a rate of $1.65 per common share. The total shares of common stock that can be issued under these Series A Preferred Stock is 3,333,333. As of December 31, 2006, none of the preferred shares had been converted into common stock. On January 19, 2007, the Form S-3 statement to register the underlying common stock and related dividends became effective.

The Series A Convertible Preferred Stock carries certain liquidation and preferential rights. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, before any distribution of assets of the Corporation can be made to or set apart for the holders of Common Stock, the holders of Convertible Preferred Stock shall be entitled to receive payment out of such assets of the Corporation in an amount equal to $1,000 per share of Convertible Preferred Stock then outstanding, plus any accumulated and unpaid dividends thereon (whether or not earned or declared) on the Convertible Preferred Stock. In addition, the Convertible Preferred Stock ranks senior to all classes and series of Common Stock and existing preferred stock and to each other class or series of preferred stock established hereafter by the Board of Directors of the Corporation, with respect to dividend rights, redemption rights, rights on liquidation, winding-up and dissolution and all other rights in any manner, whether voluntary or involuntary.
Private Placements

In August 2004, the Company sold 190,476 shares of the Company's common stock for $200,000 in a private placement. As of June 30, 2006, $128,000 had been received and a total of 87,143 shares were issued to the purchaser. During the quarter ended September 30, 2006, 34,762 shares were issued on amounts previously received. The remaining balance of $72,000 or 68,571 shares are included in "Shares to Be Issued" on the accompanying financial statements.

Services

In October 2005, the Company entered into an agreement with a vendor whereby the Company agreed to issue $2,500 worth of stock per month as payment for services rendered. The stock is to be issued after the end of each quarter. The Company issued 8,175 shares of its common stock valued at $15,000 during the six months ended December 31, 2006 and recorded 3,942 shares of common stock valued at $6,250 to “Stock to Be Issued” under this agreement as of December 31, 2006. The agreement was terminated on December 15, 2006.

In July 2005, the Board of Directors and officers were granted the right to receive shares of the Company’s common stock if certain conditions were met during their 2005 - 2006 term of office. These conditions were met and a total of 15,000 restricted Rule 144 common shares were issued in August 2006. The shares were valued at the fair market value at the date of grant of $23,100 or $1.54 per share.

In January 2006, the Company entered into an agreement with two consultants whereby the Company agreed to issue shares of the Company’s restricted common stock for their services. During the six months ended December 31, 2006, the Company issued 74,326 shares of restricted common stock valued at $137,361 and recorded 48,402 shares of common stock valued at $65,827 to “Stock to Be Issued” under this agreement as of December 31, 2006.

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In October 2006, the Company entered into an agreement with a consultant whereby the Company agreed to issue 25,000 shares of the Company's restricted common stock at the signing of the agreement. The shares were valued at $36,250 or $1.45 per share.

Business Combinations:

In June 2006, the Company completed the acquisition of McCue Systems, Inc. (see Note 14). As part of this agreement, the Company issued 931,770 shares of its restricted common stock valued at $1,584,009 to the shareholders of McCue Systems.

Options and Warrants Exercised

During the six months ended December 31, 2006, the Company issued 490,000 shares of its common stock for the exercise of options valued at $790,500. Of this, $742,500 was recorded as "Stock Subscription Receivable" and $15,000 was a cashless exercise whereby the exercise price was applied against amounts owed by the Company to a Director. In addition, 3,030 shares of the Company's common stock valued at $5,000 was issued against payments made in the previous quarter and was recorded as a reduction in "Shares to Be Issued."

Payment of Interest

On December 13, 2006, the Company issued a total of 230,863 shares of the Company's common stock valued at $339,137 or $1.47 per share to the convertible note holders as payment of the interest due to them (see note 11). This payment included 60,000 shares valued at $88,201 as premium shares to accept payment of the interest in the Company's common stock rather than cash. These shares are to be registered.

STOCK SUBSCRIPTION RECEIVABLE

Stock subscription receivable represents stock options exercised and issued that the Company has not yet received the payment from the purchaser as they were in processing when the quarter ended.

During the six months ended December 30, 2006, issued a total of $742,500 of new receivables and received payments of $97,000. The balance at December 31, 2006 was $944,750.

COMMON STOCK PURCHASE WARRANTS AND OPTIONS

From time to time, the Company issues options and warrants as incentives to employees, officers and directors, as well as to non-employees.

Common stock purchase options and warrants consisted of the following during the six months ended December 31, 2006:

	# shares	Exercise Price		Aggregated Intrinsic Value
Options:				
Outstanding and exercisable, June 30, 2006	8,585,500	$0.75 to $5.00	$	269,125
Granted	-			
Exercised	(544,075)			

		$0.75 to $1.75		
Expired	-			
Outstanding and exercisable, December 31, 2006	8,041,425	$0.75 to $5.00	$	73,875
Warrants:				
Outstanding and exercisable, June 30, 2006	2,598,937	$1.75 to $5.00	$	13,333
Granted	-			
Exercised	-			
Expired	-			
Outstanding and exercisable, December 31, 2006	2,598,937	$1.65 to $5.00	$	-

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There were no options granted or vested during the six months ended December 31, 2006.

During the six months ended December 31, 2005, a total of 1,320,000 options were granted to employees of the Company and are fully vested and expire ten years from the date of grant unless the employee terminates employment, in which case the options expire within 30 days of their termination. The exercise price of the options ranges from $1.65 to $2.89. No expense was recorded for the granting of these options.

Prior to July 1, 2006, the Company measured stock compensation expense using the intrinsic value method of accounting in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations (APB No. 25).

The company adopted SFAS No. 123-R effective July 1, 2006 using the modified prospective method. Under this transition method, stock compensation expense recognized in the six months ended December 31, 2006 includes compensation expense for all stock-based compensation awards vested during the six months ended December 31, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123-R. As there were no options granted or vested since the implementation of SFAS 123-R, no expense has been recorded during the six months ended December 31, 2006.

For periods presented prior to the adoption of SFAS No. 123R, pro forma information regarding net income and earnings per share as required by SFAS No. 123R has been determined as if the Company had accounted for its employee stock options under the original provisions of SFAS No. 123. The fair value of these options was estimated using the Black-Scholes option pricing model. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. The pro forma expense to recognize and adjusted net earnings per share for the six months ended December 31, 2005 is as follows:

		12/31/2005
Net income - as reported	$	328,782
Stock-based employee compensation expense, included in reported net loss, net of tax		-
Total stock-based employee compensation expense determined under fair-value-based method for all rewards, net of tax		(1,496,750)
Pro forma net loss	$	(1,167,968)
Earnings per share:		
Basic, as reported		0.02
Diluted, as reported		0.02
Basic, pro forma		(0.08)
Diluted, pro forma		(0.08)

Pro forma information regarding the effect on operations is required by SFAS 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that statement. Pro forma information using the Black-Scholes method at the date of grant based on the following assumptions:

Risk-free interest rate	3.25%
Expected life	10 years
Expected volatility	54% - 57%

Dividend yield	0%

Impact of adoption of SFAS No. 123-R for the six months ended December 31, 2006:

There was no stock compensation expense measured in accordance with SFAS No. 123-R since there were no options granted or vested during the six months ended December 31, 2006.

Methods of estimating fair value:

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Under both SFAS No. 123-R and under the fair value method of accounting under SFAS No. 123 (i.e., SFAS No. 123 Pro Forma), the fair value of stock options is determined using the Black-Scholes model.

Under SFAS No. 123-R, the company's expected volatility assumption is based on the historical volatility of the Company's stock. The expected life assumption is primarily based on historical exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

SFAS No. 123-R requires forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

Warrants:

On October 11, 2006, the Company entered into an agreement with a consultant whereby the Company agreed to grant the consultant a total of 100,000 warrants with an exercise price of $1.85 and 100,000 warrants with an exercise price of $3.70. The warrants vest equally over the term of the agreement on a quarterly basis commencing on January 11, 2007 and vest only upon completion of the quarter's service as earned. The warrants are exercisable until October 10, 2011. As of December 31, 2006, none of the warrants had vested and therefore, no expense was recorded.

During the six months ended December 31, 2005, one debenture holder converted their note into common stock. As part of the conversion, warrants to purchase a total of 13,441 common shares were issued to the note holder. The warrants expire in five years and have an exercise price of $3.30 per share. The warrants were valued using the fair value method at $9,489 or $0.71 per share and recorded the expense in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

Risk-free interest rate	3.25%
Expected life	5 years
Expected volatility	56%
Dividend yield	0%

NOTE 13 - SEGMENT INFORMATION

The following table presents a summary of operating information and certain year-end balance sheet information for the six months ended December 31:

	2006	2005
Revenues from unaffiliated customers:		
North America	$ 2,352,580	$ 3,750
Europe	2,965,701	3,905,282
Asia - Pacific	7,771,400	5,085,326
Consolidated	$ 13,089,681	$ 8,994,358
Operating income (loss):		
North America	$ (1,961,374)	$ (1,751,237)
Europe	(223,055)	1,129,632
Asia - Pacific	2,428,423	1,581,096
Consolidated	$ 243,994	$ 959,491
Identifiable assets:		
North America	$ 13,408,591	$ 5,481,627
Europe	5,513,095	4,740,834
Asia - Pacific	21,720,171	17,071,638
Consolidated	$ 40,641,857	$ 27,294,099
Depreciation and amortization:		
North America	$ 769,931	$ 964,522
Europe	116,616	72,232
Asia - Pacific	433,564	297,721
Consolidated	$ 1,320,111	$ 1,334,475
Capital expenditures:		
North America	$ 9,898	$ -
Europe	46,617	143,007
Asia - Pacific	429,483	1,323,498
Consolidated	$ 485,998	$ 1,466,505

NOTE 14 - MINORITY INTEREST IN SUBSIDIARY

The Company had minority interests in several of its subsidiaries. The balance of the minority interest as of December 31, 2006 was as follows:

SUBSIDIARY	MIN INT %	MIN INT BALANCE AT 12/31/06
PK Tech	28.13%	$ 1,098,675
NetSol-TiG	49.90%	1,066,773
Connect	49.90%	267,443
Omni	49.90%	-

Total	$	2,432,891

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NetSol Technologies, Limited ("PK Tech")

In August 2005, the Company's wholly-owned subsidiary, NetSol Technologies (Pvt), Ltd. ("PK Tech") became listed on the Karachi Stock Exchange in Pakistan. The Initial Public Offering ("IPO") sold 9,982,000 shares of the subsidiary to the public thus reducing the Company's ownership by 28.13%. Net proceeds of the IPO were $4,890,224. As a result of the IPO, the Company is required to show the minority interest of the subsidiary on the accompanying consolidated financial statements.

For the six months ended December 31, 2006 and 2005, the subsidiary had net income of $2,124,813 and $843,706, of which $597,710 and $264,357 was recorded against the minority interest. The balance of the minority interest at December 31, 2006 was $1,098,675.

NetSol-TiG:

In December 2004, NetSol forged a strategic relationship with a UK based public company TIG Plc. A Joint Venture was signed by the two companies to create a new company, TiG NetSol Pvt Ltd. ("NetSol-TiG"), with 50.1% ownership by NetSol Technologies, Inc. and 49.9% ownership by TiG. The agreement anticipates TiG's technology business to be outsourced to NetSol's CMM Level 5 Center of Excellence offshore development facility.

During year ended June 30, 2005, the Company invested $253,635 and TiG invested $251,626 and the subsidiary began operations during the quarter ended March 31, 2005.

For the six months ended December 31, 2006 and 2005, the subsidiary had net income of $500,455 and $444,219, of which $249,727 and $221,665 was recorded against the minority interest, respectively. The balance of the minority interest at December 31, 2006 was $1,066,773.

NetSol Connect:

In August 2003, the Company entered into an agreement with United Kingdom based Akhter Group PLC ("Akhter"). Under the terms of the agreement, Akhter Group acquired 49.9 percent of the Company's subsidiary; Pakistan based NetSol Connect PVT Ltd. ("Connect"), an Internet service provider ("ISP"), in Pakistan through the issuance of additional Connect shares. As part of this Agreement, Connect changed its name to NetSol Akhter. The partnership with Akhter Computers is designed to rollout connectivity and wireless services to the Pakistani national market.

As of June 30, 2006, a total of $751,356 had been transferred to Connect, of which $410,781 was from Akhter and a total of $40,000 cash was distributed to each partner as a return of capital. During the quarter ended September 30, 2006 an additional $20,000 was distributed as a return of capital.

For the six months ended December 31, 2006 and 2005, the subsidiary had net loss of $67,401 and net income of $53,553, respectively, of which ($33,633) and $7,138 respectively, was recorded against the minority interest. The balance of the minority interest at December 31, 2006 was $267,443.

NetSol Omni

In February 2006, the Company purchased for $60,012 50.1% of the outstanding shares in Talk Trainers (Private) Limited, now known as NetSol Omni ("Omni"), a Pakistan corporation which provides educational, professional courses, training and Human Resource services to the corporate sector. The major stockholder of Omni was Mr. Ayub Ghuari, brother to the executive officers of the Company, and therefore the acquisition was recorded at historical cost as the entities are under common control. As the effects of this transaction are immaterial to the Company overall, no pro forma information is provided. During the quarter ended June 30, 2006, Talk Trainers changed their name to

NetSol Omni.

For the six months ended December 31, 2006, the subsidiary had a net loss of $27,944, of which ($7,959) was recorded against the minority interest. The balance of the minority interest at December 31, 2006 was $0.

NOTE 15 - ACQUISITION OF McCUE SYSTEMS

On May 6, 2006, the Company entered into an agreement to acquire 100% of the issued and outstanding stock of with McCue Systems, Inc. ("McCue"), a California corporation. The acquisition closed on June 30, 2006. The initial purchase price was estimated at $8,471,455 of which one-half was due at closing payable in cash and stock. The other half is due in two installments over the next two years based on revenues after the audited December 31, 2006 and 2007 financial statements are completed. On the closing date, $2,117,864 payable and 958,213 shares to be issued valued at $1,628,979, adjusted for the market value at closing, was recorded. In July 2006, $2,057,227 in cash was paid and 930,781 of the shares were issued. In November 2006, an additional shareholder of McCue tendered their shares in exchange for 989 of the Company's common shares and $2,186 cash (see note 12).

The following is the proforma financial information of the Company for the six months ended December 31, 2005 assuming the transaction had been consummated at the beginning of the fiscal year ended June 30, 2006:

		For the six months ended Dec. 31, 2005 (Unaudited)
Statement of Operations:		
Revenues	$	12,368,907
Cost of Sales		4,918,978
Gross Profit		7,449,929
Operating Expenses		6,168,105
Income (loss) from operations		1,281,824
Other income and (expenses)		(74,490)
Income (loss) before minority interest		1,207,334
Minority interest in subsidiary		(512,745)
Net Income (loss)	$	694,589
Earnings Per Share:		
Basic	$	0.05
Diluted	$	0.04

NOTE 16- SUBSEQUENT EVENTS

In January 2007, the dividend payable to preferred shareholders was paid with 51,380 shares of the Company's common stock.

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Item 2. Management's Discussion and Analysis Or Plan Of Operation

The following discussion is intended to assist in an understanding of the Company's financial position and results of operations for the quarter and six months ending December 31, 2006.

Forward-Looking Information.

This report contains certain forward-looking statements and information relating to the Company that is based on the beliefs of its management as well as assumptions made by and information currently available to its management. When used in this report, the words "anticipate", "believe", "estimate", "expect", "intend", "plan", and similar expressions as they relate to the Company or its management, are intended to identify forward-looking statements. These statements reflect management's current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should any of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this report as anticipated, estimated or expected. The Company's realization of its business aims could be materially and adversely affected by any technical or other problems in, or difficulties with, planned funding and technologies, third party technologies which render the Company's technologies obsolete, the unavailability of required third party technology licenses on commercially reasonable terms, the loss of key research and development personnel, the inability or failure to recruit and retain qualified research and development personnel, or the adoption of technology standards which are different from technologies around which the Company's business ultimately is built. The Company does not intend to update these forward-looking statements.

INTRODUCTION

NetSol Technologies, Inc. (“NetSol” or the “Company”) is an end-to-end information technology (“IT”) and business consulting services provider for the lease and finance, banking and financial services industries. Since it was founded in 1997, the Company has developed enterprise solutions that help clients use IT more efficiently in order to improve their operations and profitability and to achieve business results. The Company’s focus has remained the lease and finance, banking and financial services sectors. The Company operates on a global basis with locations in U.S., China, UK, Australia, Thailand, and Pakistan. By utilizing its worldwide resources, the Company believes it has been able to deliver high quality, cost-effective IT products and IT services. The Company’s subsidiary, NetSol Technologies Ltd. (“NetSol PK”) develops the majority of the software for the Company. NetSol PK was the first software company in Pakistan in 1998 to achieve the ISO 9001 accreditation and was again the first software company in Pakistan to obtain Carnegie Mellon’s Software Engineering Institute (“SEI”) Capable Maturity Model (“CMM”) Level 4 assessment in 2004 and CMMI Level 5 in 2006. The company has launched implementation of ISO 27001 (previously BS 7799) which is a gold standard and a set of best practices for Information Security Management.

The two recent acquisitions, of CQ Systems in the United Kingdom and McCue Systems, in the United States, add an onshore development capacity. The capacity and capability of these locations provide the Company with contingency development capability in the event of any unforeseen crises at the Lahore facility. So far, the Lahore development facility has operated smoothly without any interruption since 1996. Currently about 80% of the Company’s software development takes place in the Lahore technology campus with the remaining 20% in US and UK.

NetSol offers a broad spectrum of IT products and IT services which management believes deliver a high return on investment for its customers. NetSol PK has nearly perfected its delivery capabilities by continuously investing in maturing its software development and Quality Assurance (“QA”) processes. NetSol PK believes its key competitive advantage is its ability to build high quality enterprise applications using its offshore development facility in Lahore, Pakistan while also utilizing our facilities in Beijing, China. A major portion of NetSol’s revenues are derived from exports in general and LeaseSoft in particular. NetSol PK was recently awarded the highest “Export of IT Services” award in 2006 by the prime Minster of Pakistan. The use of the facility in Pakistan as the basis for software

development, configuration and professional services represents a cost-effective and economical cost arbitrage model that is based on the globally acclaimed advantages of outsourcing and offshore development. In the areas of professional services, the Company is now changing its focus from just being a custom development facility to offering high-end services like systems integration and technology consulting services. NetSol management believes that the use of this model will only further benefit the Company in its penetration of US, European, developed and developing country markets.

The Company offers a broad array of professional services to clients in the global commercial markets and specializes in the application of advanced and complex IT enterprise solutions to achieve its customers' strategic objectives. Its service offerings include bespoke software development, software analysis and design, testing services, offshore as well as onsite quality assurance services, consultancy in quality engineering and process improvement including assistance in implementation of ISO and CMMI quality standards, business process reengineering, consultancy in Basel-II, business intelligence, information security, systems integration, system reengineering, maintenance and support of existing systems and project management.

The Company is divided into two groups, the Global Product Group and the Global Services Group; and three regions: North America, Europe and Asia Pacific. The North American Region is headed by John McCue as President, founder and Chief Executive Officer of the Company's newly acquired subsidiary, McCue Systems, Inc. based in Burlingame, California. McCue has 35 years of experience in developing business solutions for the equipment and vehicle leasing industry as a provider of lease/loan portfolio management software for banks, leasing companies and manufacturers. Its flagship product, LeasePak, simplifies lease/loan administration and asset management by accurately tracking leases, loans and equipment from origination through end-of-term and disposition. The LeasePak brand is recognized in the US and Canadian marketplace and is configured to handle the unique tax and regulation requirements of North America. LeasePak is complementary to NetSol's LeaseSoft offering and its geographic specificity complements LeaseSoft in regions in which LeaseSoft does not currently have coverage or domain support knowledge. In order to best leverage the cost arbitrage and enhance gross margins, NetSol US operation (after the McCue acquisition) has already begun training 15 developers and programmers in the Lahore development facility to reduce dependency in the high-cost base in Silicon Valley. The integration of both back end and front end of McCue with NetSol is on track and the Company expects to yield positive results by the end of fiscal year 2007.

McCue provides the leasing technology industry in the development of Web-enabled and Web-based tools to deliver superior customer service, reduce operating costs, streamline the lease management lifecycle, and support collaboration with origination channel and asset partners. LeasePak can be configured to run on HP-UX, SUN/Solaris or Linux, as well as for Oracle and Sybase users. And for scalability, McCue offers the LeasePak Bronze, Silver and Gold Editions for systems and portfolios of virtually all sizes and complexities. McCue's solutions provide the equipment and vehicle leasing infrastructure at leading Fortune 500 banks and manufacturers, as well as for some of the industry's leading independent lessors, including Cisco, Hyundai, JP Morgan/Chase, KeyCorp Leasing, Bank of Tokyo Mitsubishi, La Salle National Bank, National City Capital Corp., ORIX, and Volkswagen Credit.

With common customers and common goals, we believe the acquisition of McCue provides a complimentary North American presence to our global offering of software and services to the lease and finance industry. Not only does this provide a U.S. base of operations and footprint for NetSol, but makes NetSol the only company focusing on the commercial and consumer lease/finance marketplace with actual live implementations within nearly every region of the globe, including, U.S., Canada, Europe, Asia-Pacific and the far-East. With McCue's acquisition NetSol now has a regional solution to the biggest auto and commercial markets of North America.

The European Region is headed by former NetSol Chief Executive Officer, Naeem Ghauri. The European region will continue to capitalize on the 2005 acquisition of CQ Systems Ltd. (now NetSol-CQ). As a result of this acquisition, NetSol has access to a broad European customer base using IT solutions complementary to NetSol's LeaseSoft product. NetSol plans to leverage NetSol-CQ's knowledge base and strong presence in the asset finance market to launch LeaseSoft in the UK and continental Europe. NetSol-CQ's strong sales and marketing capability would further help NetSol gain immediate recognition and positioning for the LeaseSoft suite of products. In November 2005, CQ was re-branded as NetSol-CQ and was launched into the UK market with new branding and logo. This was part of a global strategy to have consistency in our marketing collateral across the globe. All NetSol-CQ products have been re-branded as LeaseSoft and the Enterprise product will now be known as LeaseSoft Asset.

The integration of CQ Systems with NetSol has been smooth and consistent with NetSol's planned strategy. The Company in first phase has shifted at least 25% of its development to Lahore from the Horsham facility in 2006. The goal in 2007 is to enhance this to 50% during the full calendar year. We anticipate improved gross and net margins as we implement this strategy in 2007. This phase of the transition plan has been completed whereby a dedicated team of software engineers and testers have been trained on the NetSol-CQ product suite and most of the quality assurance, documentation and some of the NetSol-CQ products core software development activities have been transitioned to Lahore.

New products introduced in the last quarter including LeaseSoft Portal and LeaseSoft Evolve have been well received by the market. LeaseSoft Evolve targeted at small portfolio companies in the UK with 250 to 2,500 agreements was implemented in record time for Kennet Equipment Finance, the first Evolve customer. LeaseSoft Portal, a new technology Microsoft.Net development, received initial orders in excess of $1 MN for new front end and middle office projects and demand is increasing.

NetSol-CQ continues to invest into enhancing its strong product line. A new version of LeaseSoft Asset was released with DIP (Document Imaging and Processing). A number of new releases are planned over this year and the management has a strong commitment to continue to invest into the LeaseSoft product suite.

NetSol will continue to manage LeaseSoft pre-sales support and deliveries by having two specialized pools of resources for each of the four products under LeaseSoft. One group focuses on software development required for customization and enhancements. The second group comprises of LeaseSoft consultants concentrating on implementation and onsite support. Both groups are being continually trained in the domain of finance and leasing, system functionality, communication skills, organizational behavior and client management.

Finally, the Asia Pacific Region is headed by former President of NetSol and current Chief Executive Officer of NetSol Technologies, Ltd. (the Company's Pakistan subsidiary), Salim Ghauri. The Asian continent, Australia and New Zealand, from the perspective of LeaseSoft marketing, are targeted by NetSol Technologies from its Lahore subsidiary, its offices in Australia and Beijing, China. NetSol PK has continued to grow its service contracts within the local Pakistani public and defense sectors. An important aspect of these contracts is that not all of them focused solely on software development and engineering.

This year, NetSol PK has gone a step further by providing both consultancy services to organizations so as to improve their quality of operations and services and, wining strategically important assignments with the E-Governance domains for organizations of national significance in Pakistan. These clients include private as well as public sector enterprises. In response, NetSol PK has created a new division known as NDD - NetSol Defense Division in Islamabad. There is a sizable budget allocated by the government of Pakistan to automate and use new technologies and systems. NetSol is in a sound position to win some of these high ticketed projects.

NetSol PK has entered into a major new development project at the provincial level to support the data entry and projects management of Land Revenue Systems. This is a very new opportunity that has been funded by Worldbank to reform land management system in Pakistan. NetSol is in a prime position to win potentially large-size contracts.

PLAN OF OPERATIONS

The change of senior management on Oct 1, 2006 resulted in the creation of three new geographic regions. The division of the Company into regions is designed for better accountability, ownership and results. The regions are comprised of North America, Europe and Asia Pacific. This restructuring is designed to provide better visibility and direction to NetSol's global operation.

NetSol also restructured the global business in two groups: Global Products and Global Services. This is a major change to provide much more focused ownership, visibility, pipeline and targeted results. The plan is to create very strong sales and marketing organizations which will work with our key resources spread out across many countries generating stronger and better coordinated results.

Management has set the following new goals for NetSol for the next 12 months:

- Fully integrate management, customers, and regional products of NetSol, NetSol-CQ, and McCue.
- Launch IT services model in the US by leveraging the offshore low-cost development capabilities.
- Expand product portfolio by enhancing current products and new releases to cater to wider global markets.
- Enhance software design, engineering and service delivery capabilities by increasing investment in training.
- Continue to invest in research and development in an amount between 7-10% of yearly budgets in financial, banking and various other domains within NetSol's core competencies.
- Recruit new sales personnel in US to grow the penetration in North American markets.
- Aggressively penetrate the booming Chinese market and continue to exploit NetSol's presence in China.

- Migrate up to 50% of development costs of US and UK operations to Lahore.
- Increase Capex, to enhance communications and development infrastructure. Roll out a second phase of construction of technology campus in Lahore to respond to a growth of new orders and customers.
- Market aggressively on a regional basis the Company's tri-product solutions by broader marketing efforts for LeaseSoft in Asia Pacific and untapped markets; aggressively grow LeasePak solutions in North America; and, further establish NetSol-CQ Enterprise solution in the European markets.

Top Line Growth through Investment in organic marketing activities. NetSol marketing activities will continue to:

- Expand the marketing and distributions of regional products solutions in four continents: North America, Europe, Asia Pacific and Africa.
- Expand relationships with all 40 customers in the US, Europe and Asia Pacific by offering enhanced product offerings.
- Product positioning through alliances and partnership.
- Capitalize on NetSol, McCue and NetSol-CQ affiliations with ELA (Equipment Leasing Association of N.A) and European leasing forums.
- Become a leading IT company in APAC in asset-based applications and capitalize on the surge in demand of NetSol products.
- Joint Ventures and new alliances.
- Be a dominant IT solutions provider in Pakistan amidst of explosive growth in the economy and automation in private and public sectors.
- Hold frequent users group meetings in North America and Asia Pacific and customers road shows to attract bigger value new contracts.

Funding and Investor Relations:

- Retained a new IR and communications firm from New York to position NetSol as a strong IT company with unlimited growth and upside outlook.
- Adequately capitalize NetSol to face challenges and opportunities presented through the most economical means and vehicles creating further stability and sustainability.
- Focus each division level to achieve optimum profitability and efficiencies to reduce the need for new external capital other than to fund major new initiatives.
- Aggressive marketing campaign on Wall Street to get the story of NetSol known to retail, institutions, micro cap funds and analysts.
- Infuse new capital from potential exercise of outstanding investors' warrants and employees' options for business development and enhancement of infrastructures.
- Continuing to efficiently and prudently manage cash flow and budgets. Subsidiaries will contribute to support the headquarters and corporate overheads.
- Expose NetSol to various small cap and technology investors' forum across North America.
- Make every effort to enhance NetSol's market capitalization in the US.

Improving the Bottom Line:

- Grow topline, enhance gross profit margins to 60% by leveraging the low-cost development facility in Lahore.
- Generate much higher revenues per developer and service group, enhance productivity and lower cost per employee overall.
- Consolidate subsidiaries and integrate and combine entities to reduce overheads and employ economies of scale.
- Continue to review costs at every level to consolidate and enhance operating efficiencies.
- Grow process automation and leverage the best practices of CMMI level 5.
- Create 3 new geographic regions: North America, Europe and Asia Pacific to leverage the infrastructure and resources and to drive direct ownership based on revenue and the bottom line. Also break the company's business in two business groups: Global Product Group and Global Services Group.
- More local empowerment and profit and loss ownership in each country office. Institute performance based compensation structure through three areas that includes both top-line and bottom-line targets.
- Cost efficient management of every operation and continue further consolidation to improve bottom line.
- Initiated steps to consolidate some of the new lines of services businesses to improve bottom line.

Management continues to be focused on building its delivery capability and has achieved key milestones in that respect. Key projects are being delivered on time and on budget, quality initiatives are succeeding, especially in maturing internal processes. Management believes that further leverage was provided by the development 'engine' of NetSol, which became CMMI Level 2 in early 2002. In a quest to continuously improve its quality standards, NetSol reached CMMI Level 4 assessment in December 2004. According to the website of SEI of Carnegie Mellon University, USA, only a few software companies in the world have announced their assessment of level 4. Now, as a result of achieving CMMI level 5 on August 11, 2006, the Company is expecting a growing demand for its products and alliances from blue chip companies worldwide. NetSol plans to further enhance its capabilities by creating similar development engines in other Southeast Asian countries with CMMI levels quality standards. This would make NetSol much more competitive in the industry and provide the capabilities for development in multiple locations. Increases in the number of development locations with these CMMI levels of quality standards will provide customers with options and flexibility based on costs and broader access to skills and technology. NetSol PK has already launched implementation of ISO 27001, a global standard and a set of best practices for Information Security Management

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MATERIAL TRENDS AFFECTING NETSOL

NetSol has identified the following material trends affecting NetSol

Positive trends:

- Outsourcing of services and software development is growing worldwide.
- The leasing and finance industry in North America has increased $260 billion and about the same size for the rest of world.
- Recent outpouring of very positive US press and research coverage by major banks such as Lehman Brothers on Pakistan outlook and NetSol growing image and name.
- The influx of US companies and investors in addition to investors from all other parts of world to Pakistan.
- The levy of Indian IT sector excise tax of 35% (NASSCOM) on software exports is very positive for NetSol. In Pakistan there is a 15 year tax holiday on IT exports of services. There are 10 more years remaining on this tax incentive.
- Cost arbitrage, labor costs still very competitive and attractive when compared with India. Pakistan is significantly under priced for IT services and programmers as compared to India.
- Pakistan is one of the fastest growing IT destinations from emerging and new markets.
- Chinese market is burgeoning and wide open for NetSol's 'niche' products and services. NetSol is gaining a strong foothold in this market.
- Only a handful of IT solutions providers in the world with global distribution network, complete end-to-end solution, and presence in the world's key and strategic markets.
- One of the few global IT companies in the leasing and finance domain with gold standard CMMI level 5 accreditation.
- NetSol and NetSol PK are both listed in one of the most visible stock indexes in their respective markets.
- Overall economic expansion worldwide and explosive growth in the emerging markets specifically.
- Continuous improvement of US and Indian relationships with Pakistan.
- Economic turnaround in Pakistan including: a steady increase in gross domestic product; much stronger dollar reserves, which is at an all time high of over $13 billion; stabilizing reforms of government and financial institutions; improved credit ratings in the western markets, and elimination of corruption at the highest level.
- Robust growth in outsourcing globally and investment of major US and European corporations in the developing countries. As demonstrated by the recently published book 'World is Flat' by Tom Friedman, there is a need for western companies to expand their businesses in emerging markets. Both Pakistan and China are in the forefront.

Negative trends:

- The disturbance in Middle East and rising terrorist activities post 9/11 worldwide have resulted in issuance of travel advisory in some of the most opportunistic markets. In addition, travel restrictions and new immigration laws provide delays and limitations on business travel.
- Negative perception and image created by extremism and terrorism in the South Asian region.
- Instability of oil prices and uncertainty about the geo-political landscape in the Middle East.
- Continuous impact of Iraq war on US and global economy.

CRITICAL ACCOUNTING POLICIES

Our financial statements and related public financial information are based on the application of accounting principles generally accepted in the United States ("GAAP"). GAAP requires the use of estimates; assumptions, judgments and subjective interpretations of accounting principles that have an impact on the assets, liabilities, and expense amounts reported. These estimates can also affect supplemental information contained in the external disclosures of NetSol including information regarding contingencies, risk and financial condition. Management believes our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently and conservatively applied. Valuations based on estimates are reviewed for reasonableness and conservatism on a consistent basis throughout NetSol. Primary areas where our financial information is subject to the use of estimates, assumptions and the application of judgment include our evaluation of impairments of intangible assets, and the recoverability of deferred tax assets, which must be assessed as to whether these assets are likely to be recovered by us through future operations. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions. We continue to monitor significant estimates made during the preparation of our financial statements.

VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS

The recoverability of these assets requires considerable judgment and is evaluated on an annual basis or more frequently if events or circumstances indicate that the assets may be impaired. As it relates to definite life intangible assets, we apply the impairment rules as required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Assets to Be Disposed Of" which requires significant judgment and assumptions related to the expected future cash flows attributable to the intangible asset. The impact of modifying any of these assumptions can have a significant impact on the estimate of fair value and, thus, the recoverability of the asset.

INCOME TAXES

We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income taxes are reported using the liability method. Deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets generated by the Company or any of its subsidiaries are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Deferred tax assets resulting from the net operating losses are reduced in part by a valuation allowance. We regularly review our deferred tax assets for recoverability and establish a valuation allowance based upon historical losses, projected future taxable income and the expected timing of the reversals of existing temporary differences. During the fiscal years ended June 30, 2006 and 2005, we estimated the allowance on net deferred tax assets to be one hundred percent of the net deferred tax assets

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CHANGES IN FINANCIAL CONDITION

Quarter Ended December 31, 2006 as compared to the Quarter Ended December 31, 2005:

Net revenues for the quarter ended December 31, 2006 were $7,227,121 as compared to $4,524,373 for the quarter ended December 31, 2005. Net revenues are broken out among the subsidiaries as follows:

	2006		2005	
North America:				
Netsol USA	$ 4,500	0.06%	$ 3,750	0.08%
McCue Systems	1,045,054	14.46%	-	0.00%
	1,049,554	14.52%	3,750	0.08%
Europe:				
Netsol UK	49,046	0.68%	970,480	21.45%
Netsol-CQ	1,428,320	19.76%	1,290,119	28.51%
	1,477,366	20.44%	2,260,599	49.96%
Asia-Pacific:				
Netsol Tech	3,651,719	50.53%	1,621,556	35.84%
Netsol Connect	287,979	3.98%	223,244	4.93%
Netsol-TiG	544,292	7.53%	346,036	7.65%
Netsol - Omni	8,114	0.11%	-	0.00%
Netsol-Abraxas Australia	208,097	2.88%	69,188	1.53%
	4,700,201	65.04%	2,260,024	49.95%
Total Revenues	$ 7,227,121	100.00%	$ 4,524,373	100.00%

This reflects an increase of $2,702,748 or 59.74% in the current quarter as compared to the quarter ended December 30, 2005. The increase is attributable mostly to growth in services business, several new license sales of LeaseSoft in China, a full quarter of revenues attributed by the newly acquired McCue Systems in the USA, growing outsourcing business of NetSol-TIG (JV) and additional maintenance work. In addition, several new business divisions were formed the latter part of last year in Lahore. The Company has experienced solid and consistent demand for IT services in the domestic sectors of Pakistan. The Company had hoped to close at least two major service contracts in Pakistan (with an approximate value of $3 million). This is now expected to occur in within the next two quarters. Organic sales, sales without the contribution from McCue, increased 28% or $1,274,428 to $5,798,801 during the quarter.

The activities for NetSol new license sales - LeaseSoft is increasingly on the rise. The current pipeline boasts over 30 plus captive auto manufacturers and non-captives globally at an advance stage of closing or decision making.

The Company added over 10 new customers in APAC and EMEA regions including several new license sales and a few new services clients. We added 2 new major auto-captive customers in China in addition to Daimler Chrysler and Toyota Leasing

Due to the revision in our pricing policy, NetSol LeaseSoft license value in APAC is in the range of $500,000 to $1.0MN, without factoring in services maintenance and implementation fees. Normally, NetSol negotiates 25-30% yearly maintenance contracts with customers. A number of large leasing companies will be looking to renew legacy

applications. This places NetSol in a very strong position to capitalize on any upturn in IT spending by these companies. NetSol is well positioned to sell several new licenses in the second half of fiscal year 2007 that could potentially increase the sales and bottom line. As the Company continues to sell more of these licenses, management believes it is possible that the margins could increase to upward of 60%.

We have added the following new business divisions in Pakistan to expand our operations:

- BI Consulting: a consulting division with the initial objective of targeting the banking industry. The implementation of the new International Basel II Accord by local banks has created a huge demand for solutions that allow banks to accurately quantify their risks of incurring losses. This is a predictive capability offered by business intelligence software; and, for that purpose we've aligned ourselves with the largest financial services software company, SunGard, which is also among the top ten software companies globally.
- Defense Division: in light of our coordination with the Pakistan Defense Sector, NetSol established its very own Defense Division to cater specifically to the growing demands in this domain and to deliver services with the professionalism and reliability that epitomizes NetSol's CMMi Level 5 standing. NetSol PK has forged an alliance with a UK company i.e Intero to work in collaboration for major defense projects in Pakistan.
- Enterprise Business Solutions (EBS): due to the dynamic nature of the business environment and the increasing demand for operational efficiency in today's world, NetSol has built its own Enterprise Business Solutions (EBS) division partnering with Oracle and DataStream. With EBS, NetSol gives companies the ability to manage, maintain and track assets, plus the ability to use this data to drive decision-making in areas such as Maintenance, Inventory, Warranty, Up-time Reliability & Risk Management.

The gross profit was $3,641,138 in the quarter ending December 31, 2006 as compared with $2,547,339 for the same quarter of the previous year for an increase of $1,093,799 or 42.94%. The gross profit percentage decreased to approximately 50% in the quarter ended December 31, 2006 from approximately56% for the quarter ended December 31, 2005. The cost of sales was $3,585,983 in the current quarter compared to $1,977,034 in the prior quarter ended December 31, 2005. The costs of sales increased due to the full integration of McCue's high-cost developers based in the US. This has adversely affected overall gross margins.

Operating expenses were $3,266,060 for the quarter ending December 31, 2006 as compared to $2,272,510, for the corresponding period last year. The increase is mainly attributable to increased selling and marketing activities, additional employees and an increase in overall activities due to our increased marketing efforts. Also contributing to the higher costs was the full integration of McCue Systems. As a percentage of sales, operating expenses were 45% and 50% for the quarters ending December 31, 2006 and 2005, respectively. Depreciation and amortization expense amounted to $489,004 and $564,855 for the quarter ended December 31, 2006 and 2005, respectively, reflecting the intangible assets purchased from the CQ Systems acquisition in February 2005 and the McCue acquisition in June 2006; as well as some of the intangibles fully amortized as of June 30, 2006. Combined salaries and wage costs were $1,183,184 and $552,714 for the comparable periods, respectively, or an increase of $630,470 from the corresponding period last year. Salaries, as a percentage of sales, were 16% for the current quarter as compared to 12% in the prior period. This increase is due to the addition of the new subsidiary, McCue Systems, three new sales offices in Pakistan, the sales office in China, increased board fees, increased travel and other expenses that supporting a large workforce entails.

Selling and marketing expenses were $579,941 and $412,570, in the quarter ended December 31, 2006 and 2005, respectively, reflecting the growing sales activity of the Company. The Company is in a growth phase and is increasing its overall sales and marketing activities. Sales and marketing was 8% of sales for the current quarter as compared to 9% in the corresponding period last year. Professional services expense increased to $236,562 in the quarter ended December 31, 2005, from $115,188 in the corresponding period last year. As a percentage of sales professional services was 3.27% and 2.55% for the quarters ending December 31, 2006 and 2005, respectively.

Income from operations was $375,078 compared to $274,829 for the quarters ended December 31, 2006 and 2005, respectively. This represents an increase of $100,249 for the quarter compared with the comparable period in the prior year.

Net loss applicable to common shareholders was $4,718,210 compared to net income of $125,035 for the quarters ended December 31, 2006 and 2005, respectively. The current fiscal quarter amount includes a net reduction of $558,571 compared to $145,532 in the prior period for the 49.9% minority interest in NetSol Connect, NetSol-TiG, and NetSol-Omni owned by another party, and the 28.13% minority interest in NetSol PK. During the current quarter, the Company also recognized an expense of $2,208,334 for the beneficial conversion feature on convertible notes and debentures as compared to $5,192. In addition, in the current quarter, the Company recognized $2,069,033 of amortized costs of debt and $133,833 of liquidation damages. Interest expense was $211,615 in the current quarter as compared to $86,862 in the comparable period. This is primarily due to the interest due on the convertible notes payable. Net loss per share, basic and diluted, was $0.27 and net income per share was $0.01 for the quarter ended December 31, 2006 and 2005, respectively.

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The net EBITDA loss was $3,749,526 compared to income of $923,986 after amortization and depreciation charges of $677,730 and $719,840, income taxes of $13,741 and ($7,751), and interest expense of $211,615 and $86,862, respectively. With the addition of the non-cash charge for the amortized costs of debt of $2,069,033 and the beneficial conversion feature expense of $2,208,334 the adjusted proforma EBITDA income would be $527,841 for the quarter ended December 31, 2006 and the adjusted proforma EBITDA earnings per share, basic and diluted, would be $0.03. Although the net EBITDA income is a non-GAAP measure of performance we are providing it because we believe it to be an important supplemental measure of our performance that is commonly used by securities analysts, investors, and other interested parties in the evaluation of companies in our industry. It should not be considered as an alternative to net income, operating income or any other financial measures calculated and presented, nor as an alternative to cash flow from operating activities as a measure of our liquidity. It may not be indicative of the Company's historical operating results nor is it intended to be predictive of potential future results.

Six Month Period Ended December 31, 2006 as compared to the Six Month Period Ended December 31, 2005:

Net revenues for the six months ended December 31, 2006 were $13,089,681 as compared to $8,994,358 for the six months ended December 31, 2005. Net revenues are broken out among the subsidiaries as follows:

	2006		2005	
North America:				
Netsol USA	$ 4,500	0.03%	$ 3,750	0.04%
McCue Systems	2,348,080	17.94%	-	0.00%
	2,352,580	17.97%	3,750	0.04%
Europe:				
Netsol UK	51,522	0.39%	1,209,152	13.44%
Netsol-CQ	2,914,179	22.26%	2,696,130	29.98%
	2,965,701	22.66%	3,905,282	43.42%
Asia-Pacific:				
Netsol Tech	5,908,538	45.14%	3,761,093	41.82%
Netsol Connect	494,732	3.78%	475,581	5.29%
Netsol-TiG	1,049,626	8.02%	691,741	7.69%
Netsol-Omni	26,259	0.20%	-	0.00%
Netsol-Abraxas Australia	292,245	2.23%	156,911	1.74%
	7,771,400	59.37%	5,085,326	56.54%
Total Net Revenues	$ 13,089,681	100.00%	$ 8,994,358	100.00%

This reflects an increase of $4,095,323 or 46% in the current six months as compared to the six months ended December 31, 2005. The increase is attributable mostly to growth in services business, several new license sales of LeaseSoft in China, a full quarter of revenues attributed by the newly acquired McCue Systems in the USA, growing outsourcing business of NetSol-TIG (JV) and additional maintenance work. In addition, several new business divisions were formed the latter part of last year in Lahore. The Company has experienced solid and consistent demand for IT services in the domestic sectors of Pakistan. The Company had hoped to close at least two major service contracts in Pakistan (with an approximate value of $3 million). This is now expected to occur in within the next two quarters. Organic sales, sales without the contribution from McCue, increased 13% or $1,181,114 to $10,175,502 during the six months ended December 31, 2006.

The activities for NetSol new license sales - LeaseSoft is increasingly on the rise. The current pipeline boasts over 30 plus captive auto manufacturers and non-captives globally at an advance stage of closing or decision making.

NetSol made a significant move by acquiring the US based software company, McCue Systems Ltd., in June 2006. The acquisition of McCue Systems has provided NetSol a very strong and seasoned management team with a mature, profitable, business with business in the United States.

The Company added a few major new customers such as DaimlerChrysler in China, Japan, and New Zealand and Toyota Leasing Thailand and China. In addition, many new customers were added in Pakistan in both the public and private sectors. In addition, McCue Systems added Hyundai Motor Financial.

Due to the revision in our pricing policy, NetSol LeaseSoft license value in APAC is in the range of $500,000 to $1.0MN, without factoring in services maintenance and implementation fees. Normally, NetSol negotiates 25-30% yearly maintenance contracts with customers. A number of large leasing companies will be looking to renew legacy applications. This places NetSol in a very strong position to capitalize on any upturn in IT spending by these companies. NetSol is well positioned to sell several new licenses in the second half of fiscal year 2007 that could potentially increase the sales and bottom line. As the Company continues to sell more of these licenses, management believes it is possible that the margins could increase to upward of 60%.

We have added the following new business divisions in Pakistan to expand our operations:

- BI Consulting: a consulting division with the initial objective of targeting the banking industry. The implementation of the new International Basel II Accord by local banks has created a huge demand for solutions that allow banks to accurately quantify their risks of incurring losses. This is a predictive capability offered by business intelligence software; and, for that purpose we've aligned ourselves with the largest financial services software company, SunGard, which is also among the top ten software companies globally.
- Defense Division: in light of our coordination with the Pakistan Defense Sector, NetSol established its very own Defense Division to cater specifically to the growing demands in this domain, and to deliver services with the professionalism and reliability that epitomizes NetSol's CMMi Level 5 standing.
- Enterprise Business Solutions (EBS): due to the dynamic nature of the business environment and the increasing demand for operational efficiency in today's world, NetSol has built its own Enterprise Business Solutions (EBS) division partnering with Oracle and DataStream. With EBS, NetSol gives companies the ability to manage, maintain and track assets, plus the ability to use this data to drive decision-making in areas such as Maintenance, Inventory, Warranty, Up-time Reliability & Risk Management.

The gross profit was $6,603,270 for the six months ending December 31, 2006 as compared with $5,349,974 for the same period of the previous year. The gross profit percentage has decreased to 50.45% in the current fiscal year from 59.48% for the six months ended December 31, 2005. The cost of sales was $6,486,411 in the current six months compared to $3,644,384 in the prior period ended December 31, 2005. The costs of sales increased due to the full integration of McCue's high-cost developers based in the US. This has adversely affected overall gross margins.

Operating expenses were $6,539,276 for the six-month period ending December 31, 2006 as compared to $4,390,483, for the corresponding period last fiscal year for an increase of $2,148,793. The increase is mainly attributable to increased selling and marketing activities and the full integration of McCue Systems. As a percentage of sales, operating expenses decreased to 48.58% from 48.81% in the prior six-month period. Depreciation and amortization expense amounted to $986,402 and $1,117,386 for the six-month period ended December 31, 2006 and December 31, 2005, respectively, reflecting the intangible assets purchased from the CQ Systems acquisition in February 2005 and the McCue acquisition in June 2006; as well as some of the intangibles fully amortized as of June 30, 2006. Combined salaries and wage costs were $2,271,451 and $1,089,090 for the six month period ended December 31, 2006 and 2005, respectively, or an increase of $1,182,361 from the corresponding period last year. As a percentage of sales, salaries was 17% as compared to 12% for the corresponding period last year. The addition of the new subsidiary, McCue Systems, three new sales offices in Pakistan, the sales office in China, increased board fees, increased travel and other expenses that supporting a large workforce entails.

Selling and marketing expenses increased to $931,743 in the six-month period ended December 31, 2006 as compared to $731,434 in the six-month period ended December 31, 2005. This reflects the Company's growing sales and marketing efforts. The Company is in a growth phase and is increasing its overall sales and marketing activities. Sales and marketing was 7% of sales for the current six months as compared to 8% in the corresponding period last year. Professional services expense increased to $497,432 in the six-month period ended December 31, 2005, from $238,346 in the corresponding period last year. As a percentage of sales, professional services was 3.8% and 2.7% for the six-month period ending December 31, 2006 and 2005, respectively.

Income from continued operations was $243,994 compared to $959,491 for the six months ended December 31, 2006 and 2005, respectively. This represents a decrease of $703,043 for the six-month period compared to the prior year.

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Net loss was $5,948,577 for the six months ended December 31, 2006 compared to net income of $328,782 for the six months ended December 31, 2005. The current six-month period amount includes a net reduction of $805,845 compared to $512,745 in the prior period for the 49.9% minority interest in NetSol Connect, NetSol-TiG, and NetSol-Omni owned by another party, and the 28.13% minority interest in NetSol PK. During the current six months, the Company also recognized $2,208,334 in beneficial conversion feature expense, $2,803,691 of amortized costs of debt and $133,833 of liquidation damages. Interest expense was $461,406 in the current six-month period as compared to $165,885 in the comparable period. This is primarily due to the interest due on the convertible notes payable. Net loss per share was $0.34, basic and diluted, for the six months ended December 31, 2006 as compared with net income per share of $0.02, basic diluted for the corresponding period last year.

The net EBITDA loss was $4,100,495 compared to income of $1,956,517 after amortization and depreciation charges of $1,320,111 and $1,395,039, income taxes of $66,565 and $66,811, and interest expense of $461,405 and $165,885, respectively. With the addition of the non-cash charge for the amortized costs of debt of $2,803,691 and the beneficial conversion feature expense of $2,208,334 the adjusted proforma EBITDA income would be $911,530 for the six months ended December 31, 2006 and the adjusted proforma EBITDA earnings per share, basic and diluted, would be $0.05. Although the net EBITDA income is a non-GAAP measure of performance we are providing it because we believe it to be an important supplemental measure of our performance that is commonly used by securities analysts, investors, and other interested parties in the evaluation of companies in our industry. It should not be considered as an alternative to net income, operating income or any other financial measures calculated and presented, nor as an alternative to cash flow from operating activities as a measure of our liquidity. It may not be indicative of the Company’s historical operating results nor is it intended to be predictive of potential future results.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash position was $2,707,147 at December 31, 2006 compared to $1,884,573 at December 31, 2005.

The Company’s current assets as of December 31, 2006 were 48.25% of total assets, an decrease of 3.39% from 51.64% as of December 31, 2005. In addition, our working capital (current assets minus current liabilities) was $13,803,804.

Net cash used for operating activities amounted to $5,644,856 for the six months ended December 31, 2006, as compared to $712,830 for the comparable period last fiscal year. The decrease is mainly due to a decrease in prepaid expenses, other assets, accounts payable and the other payable - acquisitions.

Net cash provided by investing activities amounted to $518,084 for the six months ended December 31, 2006, as compared to net cash used of $3,107,522 for the comparable period last fiscal year. The difference lies primarily in the purchase of property and equipment during the current fiscal year. The Company had net purchases of property and equipment of $286,058 compared to $1,357,022 for the comparable period last fiscal year.

Net cash provided by financing activities amounted to $5,373,504 and $4,299,704 for the six months ended December 31, 2006, and 2005, respectively. The current fiscal period included the cash inflow of $219,223 compared to $384,062 from the exercising of stock options and warrants, net proceeds of $390,128 as compared to net payments on loans and capital leases of $91,541 in the comparable period last year. In addition in the preceding year, the Company received net proceeds of $4,031,001 from the sale of a subsidiary’s common stock in an IPO on the Karachi Stock Exchange.

The Company plans on pursuing various and feasible means of raising new funding to expand its infrastructure, enhance product offerings and beef up marketing and sales activities in strategic markets. The strong growth in earnings and the signing of larger contracts with Fortune 500 customers largely depends on the financial strength of NetSol. Generally, the bigger name clients and new prospects diligently analyze and take into consideration a stronger

balance sheet before awarding big projects to vendors. Therefore, NetSol would continue its effort to further enhance its financial resources in order to continue to attract large name customers and big value contracts. The company attracted 5 new institutional investors in 2006 that invested $5.5MN listing institutional investor base to over 15%. There are over 8.0MN employees and officers options unexercised and over 2.0MN investors warrants remained to be exercised.

As a growing company, we have on-going capital expenditure needs based on our short term and long term business plans. Although our requirements for capital expenses vary from time to time, for the next 12 months, we have the following capital needs:

- The second payment of McCue Systems would be due based on the formula of 'earn out'. This could be in the range of $1.0MN to $2.0MN in cash and common stock. This is based on an earn out structure and the company expects to fund it through internal cash flow;
- Notes payable and related interest for approximately $540,870;
- Liquidity damages owed to convertible note holders of approximately $166,833;
- Working capital of $1.0 million for UK business expansion, new business development activities and infrastructure enhancements.

While there is no guarantee that any of these methods will result in raising sufficient funds to meet our capital needs or that even if available will be on terms acceptable to the Company, we will consider raising capital through equity based financing and, warrant and option exercises. We would, however, use some of our internal cash flow to meet certain obligations as mentioned above. However, the Company is very conscious of the dilution effect and price pressures in raising equity-based capital.

The methods of raising funds for capital needs may differ based on the following:

- Stock volatility due to market conditions in general and NetSol stock performance in particular. This may cause a shift in our approach to raising new capital through other sources such as secured long term debt.

- Analysis of the cost of raising capital in the U.S., Europe or emerging markets. By way of example only, if the cost of raising capital is high in one market and it may negatively affect the company's stock performance, we may explore options available in other markets.

Should global or other general macro economic factors cause an adverse climate, we would defer new financing and use internal cash flow for capital expenditures.

Item 3. Controls and Procedures

Management, under the supervision and with the participation of the chief executive officer and chief financial officer, conducted an evaluation of the disclosure controls and procedures as defined by rule 13a-15(e) as of the end of the period covered by this interim report on Form 10-QSB. Based upon that evaluation, the Chairman, Chief Financial Officer and Chief Executive Officer concluded that our disclosure controls and procedures are effective.

There has been no change, including corrective actions with regard to deficiencies or weaknesses in the Company's internal controls or in other factors that has materially affected, or is reasonably likely to materially affect, these internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities

On November 21, 2006, we issued a total of 74,326 shares to two consultants of the Company for services rendered. The issuance to the employees was made in reliance on an exemption from registration under Regulation S of the Securities Act of 1933, as amended (the “Act”).

On November 28, 2006, we issued a total of 4,334 shares to a consultant of the Company as compensation for services rendered. The issuance to this consultant was made in reliance on an exemption from registration under Section 4(2) of the Act.

On December 13, 2006, we issued a total of 260,836 shares of common stock to 5 accredited investors as payment of interest, in lieu of cash, due on a convertible note entered into between the Company and these investors in June 2006. The issuance was made in reliance on an exemption from registration under Section 4 of the Act.

On December 14, 2006, we issued a total of 25,000 shares to a consultant of the Company as compensation for services rendered. The issuance to this consultant was made in reliance on an exemption from registration under Section 4(2) of the Act.

During the period employees of the Company exercised 20,000 options in exchange for $33,000.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission Of Matters To A Vote Of Security Holders

NetSol conducted a special meeting of shareholders on October 18, 2006. The following are the items that were voted upon.

1. Issuance of Shares

The issuance the issuance and exercise of: (i) shares of common stock underlying convertible notes; (ii) shares of common stock underlying shares of preferred stock; (iii) shares of common stock as a dividend payable or redemption under the terms of the preferred stock; (iv) shares of common stock upon exercise of warrants granted to Maxim Group, LLC as part of their compensation as placement agent; and, (v) shares of common stock upon exercise of the warrants in full without limitations on the number of shares to be issued, all issued as part of a financing in the amount of $5.5 million (the “Financing”) were approved. The following sets for the voting tabulation for each director:

Total Shares Voted	For	Against	Abstain	Percent
9,372,479	8,964,736	154,240	253,503	95.65%

2. Amendment to Articles of Incorporation

The amendment to the Articles of Incorporation to permit the board to designate the rights and privileges of the Company's Preferred Stock by board resolution was approved. The following sets forth the tabulation of the shares voting for this matter.

Total Shares Voted	For	Against	Abstain	Percent
9,372,479	8,954,911	153,285	264,283	95.54%

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

Exhibits:

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CEO)
31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (CFO)
32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CEO)
32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CFO)

Reports on Form 8-K.

a) On September 11, 2006, NetSol Technologies, Inc issued a press release announcing revised guidance for the year ending June 30, 2007 and filed a current report on form 8-K attaching this release.
b) On September 25, 2006, NetSol Technologies, Inc. issued a press release announcing the results of operations and financial conditions for the year ended June 30, 2006 and filed a current report on form 8-K attaching this release.
c) On October 10, 2006, NetSol Technologies, Inc. filed a current report on form 8-K announcing the resignation of Naeem Ghauri as Chief Executive Officer and appointment of Mr. Naeem Ghauri as Chief Executive Officer and the resignation of Mr. Salim Ghauri as President of the Company.
d) On November 14, 2006, NetSol Technologies, Inc. issued a press release announcing the results of operations and financial conditions for the quarter ended September 30, 2006 and filed a current report on November 15, 2006 on form 8-K attaching this release.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NETSOL TECHNOLOGIES, INC.

Date: February 12, 2007

/s/ Najeeb Ghauri

NAJEEB GHAURI
Chief Executive Officer

Date: February 12, 2007

/s/ Tina Gilger

Tina Gilger
Chief Financial Officer

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