ARI NETWORK SERVICES INC /WI
Form 10-K
October 29, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the fiscal year ended July 31, 2012

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 000-19608

ARI Network Services, Inc.

(Name of small business issuer in its charter)

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

10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224

(Address of principal executive office)

Issuer's telephone number (414) 973-4300

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

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

Common Stock, par value $0.001 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes No ü

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Yes No ü

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

Yes ü No

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ü No

Indicate by check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (S229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company ü

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No ü

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price of the registrant's common stock on January 31, 2012 as reported on the OTC bulletin board, was $8.3 million.

As of October 19, 2012, there were 8,142,550 shares of the registrant's shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement, to be filed with the Securities and Exchange Commission no later than 120 days after July 31, 2012, for the 2013 Annual Meeting of Shareholders are incorporated by reference in Part III hereof.

ARI Network Services, Inc.

FORM 10-K

FOR THE FISCAL YEAR ENDED JULY 31, 2012

INDEX

This Annual Report on Form 10-K, including the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). All statements other than statements of historical facts are statements that could be deemed to be forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the markets in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "be "seeks," "estimates," "endeavors," "strives," "may," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, estimate, or verify, including those identified below under "Item 1A. Risk Factors" and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

PART I

Item 1. Business

Overview

ARI Network Services, Inc. ("ARI") is a leader in creating, marketing, and supporting solutions that enhance revenue and reduce costs for our customers. Our innovative, technology-enabled solutions connect the community of consumers, dealers, distributors, and manufacturers to help them efficiently service and sell more whole goods, parts, garments, and accessories ("PG&A") in selected vertical markets worldwide that include power sports, outdoor power equipment, marine, and appliances. We estimate that more than 19,000 equipment dealers, 140 manufacturers, and 195 distributors worldwide leverage our technology to drive revenue, gain efficiencies and increase customer satisfaction.

Our suite of software products, software as a service ("SaaS") and data as a service ("DaaS") solutions are designed to facilitate our customers' operations, increasing sales through additional foot and website traffic, more effective lead management, and greater conversion rates on those leads. To achieve this, our solutions allow our customers to: (i) efficiently market to their customers and prospects in order to drive increased traffic to their location and website; (ii) manage and nurture customers and prospects; (iii) increase revenues by selling whole goods and PG&A online; (iv) increase revenues by generating leads for whole goods; and (v) increase revenues and reduce costs of our dealer customers by enhancing the productivity of their parts and service operations.

Most of our solutions leverage our library of content that we have published and aggregated into a large content management system, which we take to market primarily through SaaS and DaaS business models. It is the nature of our products, along with the content and the continual management and updating of the content, which allows us to sell the majority of our products and services in a recurring revenue model. Today, our content database contains data related to more than 10 million active parts across more than 469,000 models; more than 500,000 active accessories; SKUs across more than 73,000 active products; more than 300 actively updated whole goods brands; and holds full model data and images for more than 175,000 active models.

We were incorporated in Wisconsin in 1981. Our principal executive office and headquarters is located in Milwaukee, Wisconsin. The office address is 10850 West Park Place, Suite 1200, Milwaukee, WI 53224, and our telephone number at that location is (414) 973-4300. Our principal website address is www.arinet.com. ARI also maintains operations in Cypress, California; Virginia Beach, Virginia; Floyds Knobs, Indiana; and The Netherlands.

Our Solutions

Today, we generate revenue from three primary categories of technology-enabled solutions: (i) electronic catalogs for publishing, viewing and interacting with PG&A information from Original Equipment Manufacturers (“OEMs”) and distributors; (ii) lead generation and management products and services designed to help dealers generate sales of whole goods and PG&A through efficient marketing of their products; and (iii) websites with eCommerce capabilities designed to leverage leads for sales of whole goods and PG&A through the sites and provide information to consumers in dealers’ local areas.

Electronic Catalogs

Our electronic catalog solutions, which encompass our PartSmart®, PartSmart Web™ and PartStream™ products, leverage our industry-leading content database to allow distributors and dealers to view and interact with this information to efficiently support the sales and service of equipment. We believe that our catalog solution is the fastest and most efficient in the market, as it allows multi-line dealers to quickly access data for any of the brands serviced from within the software, allowing the dealer's parts and service operations to more quickly service and sell to its customers. We derived approximately 60% of our revenues from our electronic catalog services in fiscal 2012.

PartSmart®, our CD-based electronic parts catalog, is used by dealers worldwide in the outdoor power, power sports, marine and agricultural equipment industries to increase productivity by significantly reducing parts lookup time. Our PartSmart® software allows multi-line dealers to look up parts and service information for all manufacturer product lines that the dealer carries, and integrates with more than 85 of the leading dealer business management systems. We also provide a version of our PartSmart® product to the appliance industry, known as PartSmart® IPL.

PartSmart Web™, a SaaS solution, is used by distributors and manufacturers to provide their dealers with access to parts and pricing information via the Internet.

PartStream™, a SaaS solution, is a modular, consumer-focused illustrated parts lookup application that integrates with existing dealer website platforms and shopping carts and allows consumers to quickly identify the desired part, add the part to their electronic shopping cart and check out. It leverages ARI's parts content, delivering it to PartStream™ users on demand from ARI servers.

Website Solutions

Our eCommerce enabled website solutions, which are tailored to the vertical markets we serve, provide consumers with information about the dealership and its product lines and allow consumers to purchase whole goods and PG&A through the dealers' website 24 hours a day, 7 days a week. Our website solutions include WebSiteSmart Pro®, eXceleratePro™, eXceleratePro™ 2, and LeadStorm™. We also offer a mobile solution that allows dealers' websites to be fully functional on smart mobile phones. Website services accounted for approximately 25% of revenues in fiscal 2012.

Lead Management Product

Our award-winning SaaS solution, Footsteps™, is designed to efficiently manage and nurture generated leads, increasing conversion rates and ultimately revenues. Footsteps™ connects equipment manufacturers with their dealer channel through lead consolidation and distribution, and allows the dealers to handle leads more efficiently and professionally through marketing automation and business management system integration. The product is used as a complete database of customers and prospects, and manages the dealer to customer relationship from generating email campaigns and automated responses, to providing sales teams with a daily follow-up calendar and reminder notices. We derived approximately 5% of our revenues from Footsteps™ in fiscal 2012.

Lead Generation Service

Our web-based lead generation service, SearchEngineSmart™, generates increased traffic to dealers' stores and websites through optimization of the dealers' paid search engine marketing campaigns, which include optimization for results in our dealers' local areas. We derived approximately 6% of our revenues from lead generation services in fiscal 2012.

Other Services

We also offer a suite of complementary solutions, which include software and website customization services, website hosting, and document transfer and communication services. On a combined basis, these other services accounted for approximately 5% of fiscal 2012 revenues.

Our Strategy

ARI's goal is to drive increased value to our shareholders through double digit revenue and earnings growth. We believe the following fundamental strategic pillars will allow us to continue to provide our customers with the innovative solutions and value-added services they have come to expect, which will ultimately drive the long-term growth and profitability our shareholders expect.

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

We will continue to leverage our relationships with existing customers and closely monitor and manage the level of customer churn. In fiscal 2012, our rate of customer churn improved by 19% over fiscal 2011, in large part due to our fiscal 2012 accomplishments in this area, including:

- We deployed a brand new, state-of-the-art call center to support our inside sales, customer service, technical support, and renewal teams. The call center was designed to drive increased efficiencies and activity levels within these groups, and includes the display of continuous, real time sales and support metrics throughout the call center.
- We deployed a leading customer relationship management tool ("CRM") throughout the entire organization, whereas a CRM was previously utilized only within the sales group. This company-wide implementation allows for a consistent, 360 degree view of a customer's information throughout the organization, creating further efficiencies and driving improvement in our sales order and support processes. The CRM tool also allows for critical dashboard reporting of sales and support metrics, which are utilized within the call center.
- We implemented a new OEM support team and continued to improve our online knowledge-based support, which provides answers to frequently asked questions, troubleshooting information and how-to documentation. In addition to this, we continued to proactively call our renewing customers to ensure their satisfaction and offer additional products and services.
- We developed the technology, now used by more than 90% of our catalog customers, to easily update OEM catalogs via the internet, providing our customers with up to date information and saving them time and money. In addition to this, we made improvements to our website hosting stability and have provided internet updating capabilities for all of our products.
- We deployed new editions of all of our core products during fiscal 2012 and expanded our market leading content library by adding 15 new brands of PG&A catalogs.

Drive organic growth through innovative new service offerings, differentiated content and geographic expansion

As a subscription-based, recurring revenue business, the most important drivers of future growth are increasing the level of our recurring revenue ("RR") and reducing the rate of our customer churn. We define RR as products and services which are subscription-based and renewable, including license fees, maintenance fees, catalog subscription fees and hosting fees. The improvements made with respect to our customer churn rates were previously discussed. In fiscal 2012 our RR increased 8% overall, and RR on our three core recurring products – catalog, website, and lead management – increased 9.8%. This increase was the result not only of the improvement in customer churn rates discussed above, but was also driven by progress we made during the year with respect to our organic growth strategy, which includes the following critical objectives:

- Develop and deploy innovative new solutions. We have made, and expect to continue to make, significant investments in our product management and development teams. In fiscal 2011, we realigned these teams with resources assigned to each of our core products and, in fiscal 2012, we continued to further augment our staffing in these areas. The teams will continue to research and develop new features and functionality in our existing products. The introduction of new solutions, upgrades to existing products, and new feature sets are all designed to grow our average revenue per dealer ("ARPD"), an important measure for a subscription-based business, and the increase in our customer base serves to quickly compound the benefits of an increased ARPD.

We recently deployed multiple new editions of FootSteps™, including Channel Connect for Manufacturers, Professional and Essentials for dealers. These editions enable customers to add feature upgrades and grow with the product over time. We also launched PartStream Mobile and PartStream Essentials, a lightweight edition of ARI's award winning

OEM parts eCommerce solution.

In addition to this, we have expanded our WebsiteSmart social media sharing tools, mobile unit brochures and search engine optimization tool enhancements and launched a new Discover Boating lead generation system, built on the Footsteps platform, which supports the delivery of sales leads and nurture marketing to our customers.

We have begun to develop and deploy a more scalable solution, which we refer to these as “freemium” versions of our core products, aimed at targeting the smaller dealers in our vertical markets. We will provide these smaller dealers with a basic version of the product at little or no cost and charge the dealer a variable pricing option, such as usage based pricing. The intent is that, as the dealer begins to utilize the product and realize its value proposition, the dealers will ultimately upgrade to the “premium”, feature-rich version. We believe this will open up to us a portion of the market not previously available. Furthermore, the incremental cost to provide the solutions to these customers is minimal.

· Expand geographically. Currently, only a small percentage of our revenues are generated from international operations. Our OEM customers have stated objectives to drive growth internationally, with a focus on the “BRIC” countries of Brazil, Russia, India, and China. We must continue to support our OEM customers with products and content for these markets. During fiscal 2012, we dedicated one of our business development resources solely to the purpose of obtaining new content with a focus on international manufacturers. We began to upgrade our product roadmaps to allow us to rapidly deploy our products in these markets in a scalable and efficient manner and without the need to have "boots on the ground" in those countries, much like the freemium / premium model just discussed.

- Differentiate our content. During the year, we obtained content from 15 new OEM relationships. We believe that we have the largest library of whole goods and PG&A content data in the vertical markets we serve. However, simply offering the largest content library in the markets we serve is not sufficient to drive the long term growth we expect. We must continue to enhance our value proposition through enrichment of our content or this competitive advantage will begin to lose its distinction. Content enrichment can take several forms, including the incorporation of user reviews and feedback into our existing content, further enhancing content provided to us by our OEM customers, and creating new forms of content that further our customers' ability to efficiently service and sell more whole goods and PG&A.

Lead the market with open integration to related platforms

One of our strategic advantages is our focus on integrating our solutions with dealer business management systems ("DMS") in order to pass key information, including customer and transactional data, between the systems. We currently have integration capabilities with over 90 DMS's (we refer to these relationships as "Compass Partners") and we continue to seek other strategic alliances that can be integrated with our product and service offerings. In fiscal 2012, we entered into three new DMS integration relationships and we continuously pursue integration opportunities when they arise.

Successfully execute acquisitions that align with our core strategy

Historically, acquisitions have been a significant driver of ARI's growth. Since 2007, the Company has successfully closed five strategic acquisitions while reviewing, and ultimately deciding not to pursue, a multitude of others. Our 2009 acquisition of Channel Blade Technologies ("Channel Blade") and our 2008 acquisition of the electronic parts catalog and eCommerce assets of Info Access expanded not only our product offerings but the number of markets we serve. As a result of those acquisitions, ARI is the market leader in the marine, RV and appliance markets. Although we believe organic growth will be the primary driver of our business for the foreseeable future, we will continue to evaluate acquisitions that are in alignment with our core strategy.

On August 17, 2012 we successfully acquired substantially all of the assets of Ready2Ride, Inc. ("R2R"), the first-to-market and leading provider of aftermarket fitment data to the powersports industry. The acquisition of R2R is directly aligned with our strategy to further differentiate our content.

Sales, Marketing and Support Teams

We organize our sales and marketing programs into three distinct sales channels and two geographic regions: North America and Europe.

Sales Channels

We go to market utilizing four sales teams, determined through a combination of customer, product, and geographic market. Our field sales personnel focus on building relationships with manufacturers and distributors, while our inside, telephone-based sales team focuses on selling to dealers. The dealer sales team located in the US is further divided by product (catalog sales versus other products and services) and we also have an international sales team in The Netherlands. We are also in the process of enhancing our core products to allow for online customer self-service sales capabilities.

Marketing

Our marketing strategy is designed to drive knowledge of our value proposition into the markets we serve. We use a variety of marketing programs to target and build relationships with our prospective and current customers and partners. Our primary marketing activities include:

" participation in dealer meetings, trade shows and industry events to create awareness, build our lead database and develop relationships;
" search engine marketing and online and print direct marketing to generate awareness and action;
" ongoing website development to educate prospects and provide product information, testimonials, live demonstrations and marketing collateral;
" email and phone campaigns used to capture leads;
" use of customer testimonials; and
" sales tool kits and field marketing training to enable our sales organization to more effectively develop leads and close transactions.

Customer Service and Support

Customer support is a critical part of our strategy as it is essential to retaining our existing customer base and reducing the level of customer churn. We maintain customer support operations in each of the Company's four locations. Our support representatives are available via telephone or email. We also maintain a customer satisfaction and renewal team that focuses on proactively reaching out to customers to ensure that our customers are satisfied and are receiving the most value possible from their spend with ARI.

Our Competitive Strengths

Market Leader in Core Verticals

We believe that we are one of the leaders in each of our core vertical markets and also believe we are the market leader in the outdoor power, marine, and appliance markets. Our direct relationships with approximately 19,000 dealers, 140 manufacturers, and 195 distributors allow us to cost-effectively leverage our published catalog content into a large and diversified customer base and to launch new product enhancements and technology-enabled solutions to this customer base.

Breadth and Depth of Published Content

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

Recurring Revenue Model

Approximately 84% of our revenue is subscription-based and recurring revenue. The majority of our customers are on contracts of twelve months or longer, and these contracts typically auto-renew for additional twelve month terms. This provides us with advanced visibility into our future revenues and opportunities to sell additional services to our customers. Our recurring revenue model also emphasizes the importance of maintaining a low rate of customer churn, one of the key drivers of any recurring revenue, subscription-based business. Historically, we measured customer renewal rates. Last year, we began measuring customer churn rates. Although similar, we believe that customer churn is a better management tool as it allows us to focus on the reasons we may lose customers and take action on those reasons within our control in order to reduce churn rates in the future.

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

Suite of Products Covers Entire Sales and Service Cycle

Our suite of dealer products and services and eCommerce capabilities enhance our customers' front office operations by covering the entire sales cycle, from lead generation and lead management to sales of PG&A to the consumer, both in-store and online, and our electronic catalog products allow dealers to efficiently service and repair equipment.

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

Our Markets and the Challenges We Face

Competition for our products and services varies by product and by vertical market. We believe that no single competitor today competes with us on every product and service in each of our industry verticals. In electronic catalogs, we compete primarily with Snap-on Business Solutions, which designs and delivers electronic parts catalogs, accessory sales tools, and manufacturer network development services, primarily to the automotive, power sports, outdoor power, construction, agriculture and mining markets. In addition, there is a variety of smaller companies focused on one or two specific industries.

In lead management, websites and eCommerce, our primary competitors are PowerSports Network, owned by Dominion Enterprises, and 50 Below. Competition for our website development services also comes from in-house information technology groups that may prefer to build their own web-based proprietary systems, rather than use our proven industry solutions. There are also large, general market eCommerce companies, such as IBM, which offer products and services that could address some of our customers’ needs. These general eCommerce companies do not typically compete with us directly, but they could decide to do so in the future. We believe we maintain a competitive advantage in our core vertical markets given the breadth and integration of our published catalog content into our lead management and website products.

Several of the markets we serve, including power sports, marine, and RV, are closely aligned with the state of the economy, given the "luxury" nature of the products in those verticals. In fiscal 2010 we experienced an increase in customer churn in these markets due to manufacturer bankruptcies, dealer closures, and extreme cost reduction measures by our dealers. Our customer churn rates improved in these markets in fiscal 2011 and fiscal 2012 as the effects of the economy began to lessen in those markets. It is also important to note that the impacts of a difficult economic environment are somewhat softened by the consumers' willingness in a down economy to repair existing equipment rather than purchase new equipment, which serves to amplify the importance of our published parts content provided to customers via our catalog parts lookup products and our website products.

Intellectual Property

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

Employees

As of July 31, 2012, we had 139 employees. Of these, 50 are involved in customer operations and support, 38 are in sales and marketing, 33 are engaged in maintaining or developing software and providing software customization services and 18 are involved in general and administration functions. None of these employees is represented by a union.

Fiscal Year

ARI's fiscal year ends on July 31st. Any references throughout this document to fiscal 2012 or fiscal 2011 refer to the fiscal years ended July 31, 2012 and 2011, respectively. Also note that the reference to the word "fiscal" has been removed from all tables throughout this document.

Executive Officers of the Registrant

The table below sets forth the names of ARI's executive officers as of October 19, 2012. The officers serve at the discretion of the Board of Directors.

Name	Age	Capacity Served
Roy W. Olivier	53	President, Chief Executive Officer and Director
Darin R. Janecek	44	Vice President of Finance, Chief Financial Officer, Secretary and Treasurer
Jeffery E. Horn	50	Vice President, Global Sales
Jon M. Lintvet	36	Chief Marketing Officer
Marvin A. Berg	37	Vice President, Operations

Roy W. Olivier

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

Darin R. Janecek

Mr. Janecek was appointed Vice President of Finance and Chief Financial Officer of ARI in December 2010, after having served as Vice President of Finance and Director of Finance since joining the Company in May 2009. Mr. Janecek also serves as Treasurer and Corporate Secretary. Prior to joining ARI, Mr. Janecek served in various mergers and acquisitions, corporate strategy and analysis roles at Johnson Controls, Inc. in Milwaukee, Wisconsin, and Crowe Horwath LLP, FTI Consulting, and CNA Insurance in Chicago, Illinois. Prior to that, he served in several corporate accounting roles in the manufacturing and health care industries. Mr. Janecek began his career in 1991 as an auditor with Deloitte & Touche LLP. Mr. Janecek is a certified public accountant and earned a Master of Business Administration from Loyola University, Chicago, and a Bachelor of Accounting from the University of Wisconsin - Milwaukee.

Jeffrey E. Horn

Mr. Horn was a member of ARI's management team from 2000 to 2006 and rejoined ARI in June 2011 as Interim Vice President of Global Sales. In October 2011, Mr. Horn was appointed Vice President of Global Sales, responsible for leading ARI's sales teams and the marketing communication efforts required to support them. Mr. Horn has more than 20 years of technology sales experience. Before joining ARI, Mr. Horn was Vice President at Grubb & Ellis | Apex Commercial; Director of North American Sales at CyberShift, Inc. (acquired by SumTotal Systems, Inc.) and Director of Sales with Kronos, Inc. Mr. Horn holds a Bachelor of Business Administration Real Estate/Finance from the University of North Texas.

Jon M. Lintvet

Mr. Lintvet was appointed Chief Marketing Officer of ARI in October 2011. As Chief Marketing Officer, Mr. Lintvet leads all product management, innovation and strategic marketing initiatives for ARI. Mr. Lintvet was Chief Executive Officer of Channel Blade prior to ARI's acquisition of the company in 2009. Following the acquisition, Mr. Lintvet was named ARI's Director of Business Development. In November 2010 Mr. Lintvet was promoted to Vice President of Product. Prior to Channel Blade Mr. Lintvet served in various product development roles at Capital One. Mr. Lintvet earned a Bachelor of Science from Ithaca College in Ithaca, New York.

Marvin A. Berg

Mr. Berg was appointed Vice President of Operations in April 2012, leading the Company's customer support, retention and fulfillment operations, and was named an executive officer in August 2012. Prior to this, Mr. Berg served as Director of Planning & Operations since August 2011 and Director of Finance since joining the Company in March 2010. Prior to joining ARI, Mr. Berg served in various financial positions for Time Warner Cable, Inc. and Norlight Telecommunications, both located in Milwaukee, Wisconsin. Mr. Berg was also a successful business owner/operator in Milwaukee, WI from 2001 to 2005 and was a licensed stock broker from 1997 to 2000. Mr. Berg earned a B.A. in Finance from Michigan State University.

Available Information

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

Item 1A. Risk Factors

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.

Continued unfavorable economic conditions or reduced investments in technology spending may harm our business.

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

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

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

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

- we and our users may experience interruptions in service as a result of the accidental or intentional actions of Internet users, current and former employees or others;
- unauthorized access may jeopardize the security of confidential information stored in our computer systems and our customers' computer systems, which may result in liability to our customers and also may deter potential customers;
- we may face liability for transmitting to third parties viruses that damage or impair their access to computer networks, programs, data or information;
- there may be a systemic failure of Internet communications, leading to claims associated with the general unavailability of some of our products; or
- eliminating computer viruses and alleviating other security or technical problems may require interruptions, delays or cessation of service to our customers.
- If we have any errors, defects, disruptions in service or other performance problems with our services, customers could elect not to renew, or delay or withhold payment to us, we could lose future sales or customers may make claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or litigation costs.

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

The markets for electronic catalog, websites, lead management and other technology-enabled services targeted at the equipment industry are competitive, and the eCommerce area, specifically, is rapidly changing with relatively low barriers to entry. With the introduction of new technologies and market entrants, we expect competition to remain intense. In addition, increased competition generally could result in reduced sales, reduced margin or the failure of our services to achieve or maintain more widespread market acceptance. Competition in our market is based principally upon service breadth and functionality; service performance, security and reliability; ability to tailor and customize services for a specific company, vertical market or industry; ease of use of the service; speed and ease of deployment, integration and configuration; total cost of ownership, including price and implementation and support costs;

professional services implementation; strength of customer relationships; and financial resources of the vendor. To compete effectively, we also must be able to more frequently update our services to meet market demand.

Our principal competitors include Snap-on Business Solutions, 50 Below, and Powersports Network, owned by Dominion Enterprises. Some of our actual and potential competitors enjoy competitive advantages over us, such as greater name recognition within our target vertical markets, larger marketing budgets, as well as substantially greater financial, technical and other resources. If we are not able to compete effectively, our operating results will be harmed.

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

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

Our operating results may fluctuate from quarter to quarter.

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

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

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

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

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

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

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

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

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

We are dependent on our management and employees.

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

Our common stock has a very limited trading market.

Our common stock is traded on the OTC bulletin board, which typically provides less liquidity than the NASDAQ Stock Market or other national securities exchanges. In addition, trading in our common stock has historically been extremely limited. Because of the thinness of the market for our stock, the price of our common stock may be subject to manipulation. This limited trading may adversely affect the liquidity of our common stock, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us. As a result, there could be a larger spread between the bid and the ask prices of our common stock and an investor may not be able to sell shares of our common stock when or at prices they desire.

Our shareholder rights plan may permit our board to block a takeover attempt and adversely affect the value of our common stock.

Our board of directors adopted a shareholder rights plan and declared a dividend of an associated right, which together are expected to have the effect of deterring any takeover of the Company that is not preceded by board approval of the proposed transaction. The existence of such shareholder rights plan may deter potential tender offers for our common stock or other acquisition offers and may have the effect of delaying or preventing a change of control.

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

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

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

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

Future acquisitions may result in dilution to existing shareholders.

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

We face risks with our international strategy.

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

" managing more geographically diverse operations;
" dealing with currency fluctuations;
" the increased costs of operation;
" only having a small number of employees in these markets;
" our dependence on value-added resellers and contractors to sell and service our products;
" a much smaller and more concentrated current customer base; and
" the assumption that U.S. international policy will remain favorable towards the countries in which we sell our products and services.

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

While we have been profitable in recent years, we have experienced net losses in numerous fiscal years since our organization in 1981, resulting in an accumulated deficit of $88 million at July 31, 2012. We may not be able to maintain profitability or increase profitability in the future. As a result of our historical losses, our financial position has been weakened, and our ability to finance our growth is constrained.

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

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

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

" refinance all or a portion of our debt or obtain additional financing, neither of which can be assured;
" sell some of our assets or operations;
" reduce or delay capital expenditures, research and development efforts and acquisitions; or

" revise or delay our strategic plans.

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

Item 2. Properties

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

Description of Use	Location	Square Footage	Lease Expiration	Operating Segment
Corporate headquarters	Milwaukee, WI	16,300	July 2021	North America
Product development and professional services team	Cypress, CA	6,000	July 2013	North America
Marine and RV sales and support	Virginia Beach, VA	9,800	April 2014	North America
Aftermarket fitment data development and support	Floyds Knobs, IN	2,200	April 2014	North America
European sales and support	Leiden, The Netherlands	200 m^2	April 2015	Netherlands

Item 3. Legal Proceedings

None.

Item 4. Mine Safety Disclosures

Not Applicable.

15

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

ARI's common stock is currently quoted on the OTC bulletin board under the symbol ARIS. The following table sets forth the high and low sales price for the periods indicated. OTC bulletin board quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

Fiscal Quarter Ended:	High	Low
10/31/2010	$ 0.75	$ 0.31
1/31/2011	$ 0.75	$ 0.45
4/30/2011	$ 0.80	$ 0.47
7/31/2011	$ 0.99	$ 0.48
10/31/2011	$ 0.99	$ 0.66
1/31/2012	$ 3.00	$ 1.00
4/30/2012	$ 1.95	$ 1.27
7/31/2012	$ 1.66	$ 0.90

As of October 19, 2011, there were approximately 822 holders of record of ARI common stock. We have not paid cash dividends to date and have no current intention to pay cash dividends.

During fiscal 2012, the Company did not repurchase any of its equity securities.

Item 6. Selected Financial Data

The following tables set forth certain financial information with respect to the Company for each of the previous five fiscal years, which includes information derived from ARI's audited financial statements and notes thereto for fiscal 2012 and fiscal 2011. The reports, thereon, of Wipfli LLP are included elsewhere in this report. The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the aforementioned Financial Statements and Notes. All amounts are in thousands, except per share data.

Statement of Income	2012	2011	2010	2009	2008
Net revenue	$ 22,494	$ 21,334	$ 21,484	$ 17,560	$ 16,917
Gross profit	17,228	16,847	17,131	14,160	14,046
Gross margin	76.6%	79.0%	79.7%	80.6%	83.0%
Net operating expenses	15,933	15,114	16,626	13,051	13,225
Operating income	1,295	1,733	505	1,109	821
Other expense	(13)	(332)	(630)	(221)	(28)
Income (loss) from continuing operations before provision for income taxes	1,282	1,401	(125)	888	793
Income tax benefit (expense)	(227)	1,017	1,294	(123)	590
Income from continuing operations	1,055	2,418	1,169	765	1,383
Discontinued operations	-	25	(392)	(341)	-
Net income	$ 1,055	$ 2,443	$ 777	$ 424	$ 1,383

Earnings per share:					
Income from continuing operations:					
Basic	$ 0.13	$ 0.31	$ 0.15	$ 0.11	$ 0.21
Diluted	$ 0.13	$ 0.31	$ 0.15	$ 0.11	$ 0.20
Net income:					
Basic	$ 0.13	$ 0.31	$ 0.10	$ 0.06	$ 0.21
Diluted	$ 0.13	$ 0.31	$ 0.10	$ 0.06	$ 0.20

Other Financial Data	2012	2011	2010	2009	2008
Amortization of capitalized software products	$ 1,420	$ 1,127	$ 1,054	$ 876	$ 764
Depreciation and amortization	1,414	1,688	1,640	1,054	727
Capital expenditures	699	670	541	636	119
Software development costs capitalized	1,718	1,741	1,340	759	524

	As of July 31st				
Balance Sheet Data	2012	2011	2010	2009	2008

Cash and cash equivalents	$ 1,350	$ 1,134	$ 938	$ 650	$ 1,086
Working capital deficit	(1,933)	(2,709)	(3,692)	(4,246)	(5,475)
Net capitalized software product costs	2,949	2,815	2,395	2,397	1,596
Total assets	20,509	21,099	19,777	18,607	12,193
Current portion of debt and lease obligations	$ 1,234	$ 1,289	$ 1,217	$ 726	$ 1,471
Long term debt and lease obligations	2,946	4,293	5,338	5,115	349
Total shareholders' equity	9,216	7,831	5,219	4,187	2,896
Cash flow Data	2012	2011	2010	2009	2008
Net cash provided by (used for):					
Operating activities	$ 3,507	$ 3,471	$ 1,624	$ 2,745	$ 2,027
Investing activities	(1,941)	(2,293)	(1,891)	(2,219)	(1,651)
Financing activities	(1,369)	(977)	550	(968)	(353)

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

The following discussion of our results of operations and financial condition should be read together with our audited consolidated financial statements for fiscal 2012 and fiscal 2011, including the notes thereto, which appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which as previously identified are subject to the safe harbors created under the Securities Act and Exchange Act.

Overview

Our fiscal 2012 strategies were designed to help ARI achieve double digit, sustainable recurring revenue growth and to drive improvements in the rate of customer churn. As a subscription-based, recurring revenue business, recurring revenues and customer churn rates are two of the critical drivers of growth and are monitored closely by management. During fiscal 2012 recurring revenues grew 8.0% and the rate of customer churn improved by approximately 19.0%. We have experienced recurring revenue growth in each of the last eight quarters, and recurring revenue now comprises approximately 84% of our total revenues. A number of key accomplishments contributed to this improvement, including the following:

- We deployed a brand new, state-of-the-art call center to support our inside sales, customer service, technical support, and renewal teams. The call center was designed to drive increased efficiencies and activity levels within these groups, and includes the display of continuous, real time sales and support metrics throughout the call center.
- We deployed a leading CRM throughout the entire organization, which was previously utilized only within the sales group. The company-wide implementation allows for a consistent, 360 degree view of a customer's information throughout the organization, creating further efficiencies and driving improvement in our sales order and support processes, as well as critical dashboard reporting of sales and support metrics. The company-wide deployment of the CRM is the first step in the implementation of a new, cloud-based scalable ERP system.
- We continued to proactively call renewing customers, implemented a new OEM support team and continued to improve our online knowledge-based support, which provides answers to frequently asked questions, troubleshooting information and how-to documentation.
- We developed the technology, now used by more than 90% of our catalog customers, to easily convert and upload multiple OEM catalog updates simultaneously within a matter of minutes of availability, saving our customers time and money. In addition to this, we made improvements to our website hosting stability and have provided internet updating capabilities to all of our products.
- We deployed new editions of all of our core products during fiscal 2012 and expanded our market leading content library by adding 15 new brands of PG&A catalogs. We make the majority of this new content available to customers as add-on subscription opportunities to their current service, which contributed to the addition of over 300 new dealers during fiscal 2012 in the outdoor power equipment and powersports verticals.

Operating income decreased 25.3% or $438,000 during fiscal 2012, compared to the same period last year, which resulted primarily from an increase in operating expenses. During fiscal 2012 we made investments in the business to further our strategic initiatives and drive growth. These initiatives included:

- The roll-out of an investor relations program of approximately $250,000, which included multiple investor road shows and management presentations to more than 90 potential new investors, participation in several investor conferences, and enhancements to our financial releases and earnings calls. During fiscal 2012 we saw an increase in both our average share price and average trading volume.

- We continued to further our investment in product development, which was reflected in the various product and technology upgrades previously discussed.

- We identified and began the implementation of a new cloud-based, scalable ERP system. The first phase of this implementation, the deployment of a CRM throughout the entire organization, has been completed. The implementation of the ERP system will continue into the first and second quarters of fiscal 2013.

- We expensed $177,000 in fiscal 2012 for potential sales tax liabilities as a result of on-going sales tax audits and an increase in the aggressiveness of state taxing authorities on establishing nexus precedence.

· We acquired substantially all of the assets of R2R, the first-to-market and leading provider of aftermarket fitment data to the powersports industry. This acquisition is directly aligned with our strategy to differentiate our content from the competition. A substantial portion of the legal fees associated with this acquisition were incurred in fiscal 2012.

· In an effort to provide additional strategic support and direction to the organization, we enhanced our Board of Directors by increasing the number of members and committees.

Net income decreased 56.8% or $1,388,000 from fiscal 2011 to fiscal 2012. This decrease was due to several benefits realized in fiscal 2011 that did not recur in fiscal 2012, including an income tax benefit of $1,017,000 versus an income tax expense of $227,000 in fiscal 2012, and a gain of $433,000 related to the fiscal 2011 divestiture of our AgChem EDI business, versus a gain of only $70,000 in fiscal 2012 related to this divestiture. These were partially offset by a $555,000 decrease in interest expense. Net income per share was $0.13 in fiscal 2012, compared to $0.31 in fiscal 2011, due to the aforementioned decrease in earnings.

Cash generated from operations increased 1.0% from $3,471,000 in fiscal 2011 to $3,507,000 in fiscal 2012. We used this cash to invest $2,417,000 in our technology products and infrastructure and pay down debt by $1,402,000 during fiscal 2012 compared to $2,411,000 of technology investment and $983,000 of debt repayments in fiscal 2011.

Revenue

The following table summarizes our recurring and non-recurring revenue by major product category (in thousands):

	2012	2011	Percent Change
Catalog			
Recurring revenue	$ 12,680	$ 11,848	7.0 %
Non-recurring revenue	769	801	(4.0) %
Total catalog revenue	13,449	12,649	6.3 %
Percent of revenue recurring	94.3 %	93.7 %	
Website			
Recurring revenue	4,685	4,000	17.1 %
Non-recurring revenue	892	1,025	(12.9) %

Total website revenue	5,577	5,025	11.0 %
Percent of revenue recurring	84.0 %	79.6 %	
Lead management			
Recurring revenue	842	730	15.3 %
Non-recurring revenue	171	154	11.3 %
Total lead management revenue	1,013	884	14.6 %
Percent of revenue recurring	83.1 %	82.6 %	
Lead generation			
Recurring revenue	-	-	- %
Non-recurring revenue	1,296	1,098	18.0 %
Total lead generation revenue	1,296	1,098	18.0 %
Percent of revenue recurring	- %	- %	
Other			
Recurring revenue	606	844	(28.2)%
Non-recurring revenue	553	834	(33.7)%
Total catalog revenue	1,159	1,678	(30.9)%
Percent of revenue recurring	52.3 %	50.3 %	
Total			
Recurring revenue	18,813	17,422	8.0 %
Non-recurring revenue	3,681	3,912	(5.9) %
Total revenue	$ 22,494	$ 21,334	5.4 %
Percent of revenue recurring	83.6 %	81.7 %	

Total revenue increased 5.4% or $1,160,000 during fiscal 2012, compared to fiscal 2011, and recurring revenue increased 8.0% or $1,391,000 over the same period. Furthermore, recurring revenue on our core catalog, website, and lead management products increased 9.8% or $1,629,000 during fiscal 2012. As stated above various accomplishments that were directly in line with our strategy drove new sales and an improvement in the rate of customer churn.

Catalog

Catalog revenue is generated from catalog subscriptions, software license fees, license renewal fees, software maintenance and support fees and professional services related to data conversion. Catalog revenue continues to be our largest source of revenue, representing 60% of total revenue. Catalog revenue increased 6.3% or $800,000 in fiscal 2012, compared to the same period last year. The Company experienced an increase in new recurring subscription sales from our international and U.S. operations of approximately 7.0% or $832,000 during fiscal 2012, compared to fiscal 2011. We expect to see year over year growth in catalog revenue in fiscal 2013, both organically and from revenue related to the R2R acquisition.

Website

Website revenue is generated from one-time set-up fees and recurring subscription fees on our website products, as well as transaction fees from customers' online sales generated via the websites. Website revenue comprised 25% of our total revenue in fiscal 2012. Website revenue increased 11.0% or $552,000 during fiscal 2012, compared to the same period last year. Recurring website revenue grew 17.1% during fiscal 2012, compared to fiscal 2011, due to the sale of additional new customer websites as well as up-sells to existing customers. Non-recurring website revenue decreased 12.9% during fiscal 2012 compared to fiscal 2011, as we continued to discount website set-up fees as part of our strategy to attract new customers and increase recurring revenues. We expect website revenue to continue to grow at rates higher than catalog revenue and to be a long-term source of growth for the Company.

Lead Management

Lead management revenue is generated from one time set-up fees and recurring subscription fees for the use of our Footsteps™ products. Lead management revenue increased 14.6% or $129,000 during fiscal 2012, compared to the same period last year, resulting from an increase in sales of Footsteps™ enhancements and new releases. Lead management recurring revenue increased 15.3% or $112,000 during fiscal 2012, compared to fiscal 2011. We recently deployed multiple new editions of its Lead Management product, Footsteps Channel Connect™, which offers the product's base functionality at a low price with the option to upgrade to additional functionality, which is expected to drive growth in fiscal 2013.

Lead Generation

Lead generation revenue is realized from the sale of our SearchEngineSmart™ ("SES") service. Although our SES customers typically subscribe to the service for three to six month periods, and many customers renew the service, we consider SES revenue to be non-recurring. SES revenue increased 18.0% or $198,000 during fiscal 2012, compared to the same period last year, from the addition of several new customers.

Other Revenue

Other revenue primarily consists of professional services related to software customization, website hosting fees, and revenue generated from ancillary products. Approximately $275,000 of revenue from the divested AgChem EDI business was included within this category in fiscal 2011 prior to its sale, creating the 30.9% decrease in other revenues in fiscal 2012. Management anticipates that other revenue will fluctuate based on the timing of professional fees related to software customization.

Cost of Revenue

We classify as cost of revenue those costs directly attributable to the provision of services. These costs include (i) software amortization, which represents the periodic amortization of costs for internally developed or purchased software sold to customers; (ii) direct labor for the provision of catalog production, product implementations and professional services revenue; and (iii) other direct costs, which represent amounts paid to third party vendors directly attributable to the services we provide our customers.

The table below breaks out cost of revenue into each of these three categories (in thousands):

	2012	Percent of Revenue	2011	Percent of Revenue
Net revenues	$ 22,494		$ 21,334	
Cost of revenues:				
Amortization of capitalized software costs	1,420	6.3 %	1,127	5.3 %
Direct labor	1,560	6.9 %	1,352	6.3 %
Other direct costs	2,286	10.2 %	2,008	9.4 %
Total cost of revenues	5,266	23.4 %	4,487	21.0 %
Gross profit	$ 17,228	76.6 %	$ 16,847	79.0 %

Gross profit was $17,228,000 or 76.6% of revenue for the twelve months ended July 31, 2012, compared to $16,847,000 or 79.0% of revenue for the same period last year. The decline in gross profit margin was primarily attributed to: (i) an increase in SES revenue, which has a lower margin than our other core products; (ii) an increase in website and lead management software amortization; and (iii) an increase in website labor costs, as we delivered more new sites and updates to current customer sites than last year. We expect fluctuations in gross margin based on the mix of products sold, but expect our gross margins to improve over time as we focus our sales and development efforts on higher margin, recurring revenue products.

Gross Margins

The following table summarizes our gross profit and gross margin percentage by major product category (in thousands):

	2012	2011	Percent Change
Catalog			
Revenue	$ 13,449	$ 12,649	6.3 %
Cost of revenue	1,901	1,733	9.7 %
Gross profit	11,548	10,916	5.8 %
Gross margin percentage	85.9 %	86.3 %	
Website			
Revenue	5,577	5,025	11.0 %
Cost of revenue	1,332	1,120	18.9 %
Gross profit	4,245	3,905	8.7 %
Gross margin percentage	76.1 %	77.7 %	
Lead management			
Revenue	1,013	884	14.6 %
Cost of revenue	546	308	77.3 %
Gross profit	467	576	(18.9)%
Gross margin percentage	46.1 %	65.2 %	
Lead generation			
Revenue	1,296	1,098	18.0 %
Cost of revenue	1,213	850	42.7 %
Gross profit	83	248	(66.5)%
Gross margin percentage	6.4 %	22.6 %	
Other			
Revenue	1,159	1,678	(30.9)%
Cost of revenue	274	476	(42.4)%
Gross profit	885	1,202	(26.4)%
Gross margin percentage	76.4 %	71.6 %	
Total			
Revenue	22,494	21,334	5.4 %
Cost of revenue	5,266	4,487	17.4 %
Gross profit	$ 17,228	$ 16,847	2.3 %
Gross margin percentage	76.6 %	79.0 %	

Overall gross margin was 76.6% of revenue in fiscal 2012 or $17,228,000, a 2.3 percent decrease from fiscal 2011. The decrease was attributed to reduced margins on our lead generation and lead management products. Gross margin on our core catalog and website products remained relatively stable at 83.0% in fiscal 2012 versus 83.9% in fiscal 2011.

The decline in lead generation gross margin in fiscal 2012 was due to price discounts on larger sales contracts. The decline in lead management gross margin was due to an increase in software amortization, as we continue to invest in product development of our Footsteps™ technology in an effort to drive significant growth in this area.

Operating Expenses

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

	2012	Percent of Revenue	2011	Percent of Revenue	Percent Change
Sales and marketing	$ 4,249	18.9 %	$ 4,272		