ARI NETWORK SERVICES INC /WI
Form 10-Q
June 14, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended April 30, 2002

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 000-19608

ARI Network Services, Inc.
(Exact name of registrant as specified in its charter.)

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

330 E. Kilbourn Avenue, Milwaukee, Wisconsin 53202
(Address of principal executive office)

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

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 twelve 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 ninety days.

YES X NO

As of June 12, 2002 there were 6,223,342 shares of the registrant's shares outstanding.

ARI NETWORK SERVICES, INC.

FORM 10-Q

FOR THE THREE MONTHS ENDED APRIL 30, 2002

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ARI NETWORK SERVICES, INC.
BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

ASSETS	APRIL 30	JULY 31

	2002	2001
Current assets:		
Cash	$ 1,343	$ 313
Trade receivables, less allowance for doubtful accounts of $502 at April 30, 2002 and $757 at July 31, 2001	1,358	2,084
Prepaid expenses and other	45	140
Total current assets	2,746	2,537
Equipment and leasehold improvements:		
Computer equipment	4,394	4,394
Leasehold improvements	239	239
Furniture and equipment	1,024	1,000
	5,657	5,633
Less accumulated depreciation and amortization	5,445	5,293
Net equipment and leasehold improvements	212	340
Goodwill, less accumulated amortization of $64 at April 30, 2002 and $54 at July 31,2001	5	15
Deferred financing costs, less accumulated amortization of $298 at April 30, 2002 and $203 at July 31, 2001	112	207
Capitalized software development	24,116	23,533
Less accumulated amortization	20,777	19,572
Net capitalized software development	3,339	3,961
TOTAL ASSETS	$ 6,414	$ 7,060

ARI NETWORK SERVICES, INC.
BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

LIABILITIES AND SHAREHOLDERS' DEFICIT	APRIL 30 2002	
Current liabilities:		
Current portion of notes payable to shareholder	$ 152	$
Current portion of notes payable	3,312	
Current portion of line of credit to shareholder	-	
RFC financed receivables facility	660	
Accounts payable	353	

Deferred revenue	4,668
Accrued payroll and related liabilities	1,355
Other accrued liabilities	1,102
Current portion of capital lease obligations	175
Total current liabilities	11,777
Long term liabilities:	
Notes payable to shareholder	-
Notes payable	8
Capital lease obligations	47
Accrued restructuring costs	303
Total long term liabilities	358
Shareholders' deficit:	
Cumulative preferred stock, par value $.001 per share, 1,000,000 shares authorized; 20,350 shares issued and outstanding at April 30, 2002 and July 31, 2001	-
Common stock, par value $.001 per share, 25,000,000 shares authorized; 6,223,342 and 6,184,281 shares issued and outstanding at April 30, 2002 and July 31, 2001, respectively	6
Common stock warrants and options	2,459
Additional paid-in-capital	91,811
Accumulated deficit	(99,997)
Total shareholders' deficit	(5,721)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT	$ 6,414

See notes to unaudited condensed financial statements.

Note: The balance sheet at July 31, 2001 has been derived from the audited balance sheet at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

ARI NETWORK SERVICES, INC.
STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

THREE MONTHS ENDED APRIL 30		NINE M... A...
2002	2001	2002

Net revenues:			
Subscriptions, support and other services fees	$ 2,106	$ 2,515	$ 6,78
Software licenses and renewals	637	823	2,12
Professional services	665	538	1,62
	3,408	3,876	10,54
Operating expenses:			
Cost of products and services sold:			
Subscriptions, support and other services fees	30	579	18
Software licenses and renewals *	435	529	1,25
Professional services	266	269	62
	731	1,377	2,06
Depreciation and amortization (exclusive of amortization of software products included in cost of products and services sold)	55	382	16
Customer operations and support	308	423	90
Selling, general and administrative	1,657	2,407	5,17
Software development and technical support	457	955	1,64
Operating expenses before amounts capitalized	3,208	5,544	9,94
Less capitalized portion	(153)	(556)	(58
Net operating expenses	3,055	4,988	9,36
Operating income (loss)	353	(1,112)	1,18
Other expense:			
Interest expense	(342)	(366)	(1,08
Other, net	7	(24)	1
Total other expense	(335)	(390)	(1,07
Net income (loss)	$ 18	$ (1,502)	$ 11
Average common shares outstanding	6,223	6,184	6,20
Basic and diluted net income (loss) per share	$ 0.00	($ 0.24)	$ 0.0

See notes to unaudited condensed financial statements.

* Includes amortization of software products of $410, $764, $1,205 and $2,436 and excludes other depreciation and amortization shown separately.

ARI NETWORK SERVICES, INC.
STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	NINE MONTHS ENDED APRIL 30 2002	NINE MONTHS ENDED APRIL 30 2001
OPERATING ACTIVITIES		
Net income (loss)	$ 115	$(4,240)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of network platform	-	428
Amortization of software products	1,205	2,436
Amortization of goodwill	10	493
Amortization of deferred financing costs and debt discount	710	713
Depreciation and other amortization	152	231
Net change in receivables, prepaid expenses and other current assets	821	757
Net change in accounts payable, deferred revenue, accrued liabilities and RFC financed receivables facility	(610)	1,129
Net cash provided by operating activities	2,403	1,947
INVESTING ACTIVITIES		
Purchase of equipment and leasehold improvements	-	(33)
Software product costs capitalized	(583)	(1,496)
Net cash used in investing activities	(583)	(1,529)
FINANCING ACTIVITIES		
Repayments under line of credit	(200)	-
Payments under notes payable	(471)	(628)
Payments of capital lease obligations	(133)	(112)
Debt issuance costs incurred	-	(39)
Proceeds from issuance of common stock	14	14
Net cash used in financing activities	(790)	(765)
Net increase (decrease) in cash	1,030	(347)
Cash at beginning of period	313	563
Cash at end of period	$ 1,343	$ 216
Cash paid for interest	$ 372	$ 420
NONCASH INVESTING AND FINANCING ACTIVITIES		
Capital lease obligations incurred for:		
Computer equipment	$ 24	$ 154

See notes to unaudited condensed financial statements.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)
APRIL 30, 2002

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared and reviewed in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended April 30, 2002 are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2002. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended July 31, 2001.

2. BASIC AND DILUTED NET INCOME (LOSS) PER SHARE

The weighted average number of shares outstanding used to calculate basic and diluted earnings per share result in the same earnings per share amount.

3. PREFERRED STOCK

The Series A preferred stock accrues dividends on a quarterly basis, cumulatively, at a rate per annum equal to the product of the stated value thereof and 2% above the prime rate (minimum dividend rate of 10% and maximum of 14%). All Series A preferred stock must be redeemed at $100 per share plus accrued and unpaid dividends prior to any payment of dividends on, or repurchases by the Company of, the Company's common stock. Prior to August 1, 2002, dividends, if declared by the Board of Directors, can be paid in either cash or additional shares of Series A preferred stock. The total amount of dividends in arrears on the Series A preferred stock is $1,226,000 at April 30, 2002.

4. NOTES PAYABLE

The convertible debentures, issued on April 27, 2000, and accrued interest thereon are convertible into common stock at a rate of $4 per share, subject to certain adjustments. Concurrent with the issuance of the debentures, the Company issued the investors 600,000 common stock purchase warrants expiring April 27, 2005 and 800,000 investment options which expired October 27, 2001. Each of the warrants are exercisable for one share of common stock at a price of $6 per share. The warrants and options, which were originally estimated to have a value of $2,354,000, less accumulated amortization, reduce the carrying amount of the debt.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Total revenue for the quarter ended April 30, 2002 decreased $468,000 or 12% compared to the same period last year, primarily due to the expected decline in non-Equipment Industry revenue and a decrease in new customers in the Equipment Industry. Earnings improved 101% from a net loss of $1,502,000, or $0.24 per share for the quarter ended April 30, 2001 to net income of $18,000 or $0.00 per share for the quarter ended April 30, 2002. Management believes that, due to the restructuring in the fourth quarter of fiscal 2001 which focused the Company on our core catalog business and reduced both cash and non-cash expenses to bring them in line with our revenues, we will continue to generate enough cash from operations to fund investment and debt, although we may incur net losses for the remainder of fiscal 2002. See "Forward Looking Statements."

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

General

The Company's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to customer contracts, bad debts, intangible assets, financing instruments, restructuring and other accrued revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its financial statements.

Revenue Recognition

Revenue for use of the network and for information services is recognized in the period such services are utilized. Revenue from annual or periodic maintenance fees, license and license renewal fees and catalog subscription fees is recognized ratably over the period the service is provided. Arrangements that include acceptance terms beyond the Company's standard terms are not recognized until acceptance has occurred. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When professional services are considered essential, revenue under the arrangement is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made. Revenue on arrangements with customers who are not the ultimate users (resellers) is deferred if there is any contingency on the ability and intent of the reseller to sell such software to a third party.

Bad Debt

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company currently reserves for most amounts due over 90 days, unless there is reasonable assurance of collectability. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Use of Estimates

The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about accrued expenses, including royalties and other contingent expenses that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Debt Instruments

The Company valued a debt discount for Common Stock Warrants and Options granted in consideration for the RGC Debenture and the WITECH Facility using the Black Scholes valuation method. Non-cash interest expense is recorded for the amortization of the debt discount over the term of the debt.

Impairment of Long-Lived Assets

Equipment and leasehold improvements, capitalized software development costs and goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets.

REVENUES

The Company is a leading provider of electronic catalog technology-enabled business solutions for sales, service and life cycle product support in the manufactured equipment market. The Company currently serves approximately 100 lines of manufactured equipment and 25,000 dealers in more than 100 countries in 12 segments of the worldwide manufactured equipment market including outdoor power, recreation vehicles, auto and truck parts aftermarket, marine, construction, power sports, floor maintenance and others. The Company supplies three types of software and services: robust Web and CD-ROM electronic parts catalogs, transaction services and template-based website services. The Company's primary business is electronic cataloging; the others are complementary businesses that leverage our catalog position.

The Company also has a supplemental business that provides e-Commerce services to certain non-equipment industries including agribusiness and, until February 28,2002, publishing. As the Company focuses on its core businesses in the Equipment industry, revenues in the non-equipment industry are expected to continue to decline during fiscal 2002.

Management reviews the Company's recurring vs. non-recurring revenue in the aggregate and within the North American Equipment, Non-North American Equipment and non-Equipment markets.

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

REVENUE BY INDUSTRY SECTOR
(IN THOUSANDS)

INDUSTRY SECTOR	THREE MONTHS ENDED APRIL 30 2002	THREE MONTHS ENDED APRIL 30 2001	PERCENT CHANGE	NINE MONTHS ENDED APRIL 30 2002	NINE MONTHS ENDED APRIL 30 2001	PERCENT CHANGE
EQUIPMENT INDUSTRY						
North American						
Recurring	$ 1,994	$ 1,835	9%	$ 5,877	$ 5,616	5%
Non-recurring	681	1,002	(32%)	1,841	2,576	(29%)
Subtotal	2,675	2,837	(6%)	7,718	8,192	(6%)
Non-North American						
Recurring	202	248	(19%)	680	795	(14%)
Non-recurring	103	48	115%	226	255	(11%)
Subtotal	305	296	3%	906	1,050	(14%)
Total Equipment Industry						
Recurring	2,196	2,083	5%	6,557	6,411	2%
Non-recurring	784	1,050	(25%)	2,067	2,831	(27%)
Subtotal	2,980	3,133	(5%)	8,624	9,242	(7%)
NON-EQUIPMENT INDUSTRY						
Recurring	428	743	(42%)	1,914	2,815	(32%)
Non-recurring	-	-	-	8	47	(83%)
Subtotal	428	743	(42%)	1,922	2,862	(33%)
TOTAL REVENUE						
Recurring	2,624	2,826	(7%)	8,471	9,226	(8%)
Non-recurring	784	1,050	(25%)	2,075	2,878	(28%)
Grand Total	$ 3,408	$ 3,876	(12%)	$10,546	$12,104	(13%)

Recurring revenues are derived from catalog subscription fees, software maintenance and support fees, software license renewals, network traffic and support fees and other miscellaneous subscription fees. Non-recurring revenues are derived from initial software licenses and professional services fees. Recurring revenue, as a percentage of total revenue, was 80% for the nine months ended April 30, 2002 compared to 76% for the same period last year. Management believes that the relationship of approximately three quarters recurring revenue to one quarter non-recurring revenue establishes an appropriate level of base revenue while the Company continues to add new sales to drive future increases in recurring revenue. If the manufacturing sector of the economy improves in the future, the percentage of recurring revenue may be slightly lower, indicating a higher amount of new business. This ratio is expected to fluctuate from quarter to quarter and year to year, depending on the size and timing of new business. Management expects the Equipment Industry revenues to increase and non-Equipment Industry revenues to decrease resulting in decreased total revenues for the remainder of fiscal 2002 compared to last year.

Equipment Industry

The Equipment Industry comprises several vertical markets including outdoor power, recreation vehicles, motorcycles, auto and truck parts after-market, farm equipment, marine, construction, power sports, floor maintenance and others primarily in the U.S., Canada, Europe and Australia. Management's strategy is to expand the Company's electronic parts catalog software and services business with manufacturers and distributors and their dealers in the existing vertical markets, add supplemental products for existing customers, and then expand to other similar markets in the future. Revenues in the Equipment Industry increased, as a percentage of total revenues, from 76% for the nine months ended April 30, 2001 to 82% for the nine months ended April 30, 2002. Management expects revenues in the Equipment Industry to increase for the remainder of fiscal 2002, as management continues to focus attention and resources in this industry, but not at a rate sufficient to offset the year over year decline in non-Equipment Industry revenues.

North American

Recurring revenues in the North American Equipment Industry increased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the increase in the base revenue from the Company's catalog products. Non-recurring revenues in the North American Equipment Industry decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, due to fewer new customer contracts because of the decline in the manufacturing sector of the economy.

Non-North American

Recurring revenues in the Non-North American Equipment Industry decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the loss of a major customer in the agricultural equipment market. Non-recurring revenues in the Non-North American Equipment Industry increased for the three month period ended April 30, 2002, compared to the same period last year, primarily due to an increase in new customer contracts.

Non-Equipment Industry

The Company's business outside of the Equipment Industry includes sales of database management services and electronic communications services to the agricultural inputs industry, the on-line provision of information for republication to the non-daily newspaper publishing industry until February 28, 2002 and until December 31, 2000, database management services to the railroad industry. Revenues in the non-Equipment Industry decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, due to the Company's focus in the Equipment Industry and the non-renewal of the railroad industry and newspaper publishing businesses. Management expects revenues in the non-Equipment Industry will decline significantly for the remainder of fiscal 2002. The Company's five-year contract with the Associated Press, on which its business in the non-daily newspaper publishing industry depended and which represented approximately $1.5 million in revenue on an annual basis, expired on February 28, 2002.

COST OF PRODUCTS AND SERVICES SOLD

The following table sets forth, for the periods indicated, certain revenue and cost of products and services sold information derived from the Company's unaudited financial statements.

COST OF PRODUCTS AND SERVICES SOLD AS A PERCENT OF REVENUE BY REVENUE TYPE
(IN THOUSANDS)

	THREE MONTHS ENDED APRIL 30 2002	THREE MONTHS ENDED APRIL 30 2001	PERCENT CHANGE
Subscriptions, support and other services fees			
Revenue	$ 2,106	$ 2,515	(16%)
Cost of revenue	30	579	(95%)
Cost of revenue as a percent of revenue	1%	23%	
Software licenses and renewals			
Revenue	637	823	(23%)
Cost of revenue	435	529	(18%)
Cost of revenue as a percent of revenue	68%	64%	
Professional services			
Revenue	665	538	24%
Cost of revenue	266	269	(1%)
Cost of revenue as a percent of revenue	40%	50%	
Total			

Revenue	$ 3,408	$ 3,876	(12%)
Cost of revenue	731	1,377	(47%)
Cost of revenue as a percent of revenue	21%	36%	

Cost of subscriptions, support and other services fees consists primarily of telecommunications and catalog replication and distribution costs and royalties on revenues in the publishing industry. Cost of subscriptions, support and other services fees as a percentage of revenue decreased significantly for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the reduction of an accrual for royalties related to the settlement of a contract in the publishing industry. Management expects gross margins, as a percent of revenue from subscriptions, support and other services fees, to be relatively consistent from quarter to quarter, once the royalties from revenues in the publishing industry are no longer being incurred.

Cost of software licenses and renewals consists primarily of amortization of software products, royalties and software distribution costs. Cost of software license and renewals decreased for the three and nine month periods ending April 30, 2002, compared to the same periods last year, primarily due to lower software amortization costs as a result of the restructuring in the fourth quarter of fiscal 2001. Cost of software licenses and renewals as a percentage of revenue increased slightly for the three month period ended April 30, 2002, compared to the same period last year, and decreased for the nine month period ended April 30, 2002, compared to the same period last year. Gross margins from software licenses and renewals will fluctuate from quarter to quarter based on the level of revenue, while costs remain relatively the same as amortization of software is not related to the level of revenue generated from software license and renewals.

Cost of professional services consists of customization and catalog production labor. Cost of professional services as a percentage of revenue decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to a decrease in communication software customization, which has a lower margin. Management expects cost of professional services to fluctuate from quarter to quarter depending on the mix of services sold and on the Company's performance towards the contracted amount for customization projects.

OPERATING EXPENSES

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

OPERATING EXPENSES
(IN THOUSANDS)

	THREE MONTHS ENDED	NINE MONTHS ENDED

	APRIL 30 2002	APRIL 30 2001	PERCENT CHANGE	APRIL 30 2002	APRIL 30 2001
Cost of products and services sold	$ 731	$ 1,377	(47%)	$ 2,061	$ 4,845
Customer operations and support	308	423	(27%)	902	1,236
Selling, general and administrative	1,657	2,407	(31%)	5,174	6,840
Software development and technical support	457	955	(52%)	1,644	2,630
Less capitalized portion	(153)	(556)	(72%)	(583)	(1,496)
Depreciation and amortization	55	382	(86%)	162	1,152
Net operating expenses	$ 3,055	$ 4,988	(39%)	$ 9,360	$ 15,207

Customer operations and support consists primarily of data center operations, software maintenance agreements for the Company's core network and customer support costs. Customer operations and support costs decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the cost reductions associated with the Company's restructuring. Management expects customer operations and support costs to continue to be lower than last year for the remainder of fiscal 2002 due to the cost containment efforts instituted by the restructuring.

Selling, general and administrative expenses ("SG&A") decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the cost reductions associated with the Company's restructuring. SG&A, as a percentage of revenue, decreased from 57% for the nine month period ended April 30, 2001 to 49% for the nine month period ended April 30, 2002. Management expects costs in SG&A to continue to be lower than last year for the remainder of fiscal 2002 due to the cost containment efforts instituted by the restructuring.

The Company's technical staff (in-house and contracted) performs both software development and technical support and software customization and data conversion services for customer applications. Therefore, management expects fluctuations between software customization and data conversion services and development and technical support expenses quarter to quarter, as the mix of development and customization activities will change based on customer requirements. Software development and technical support costs decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to the reduction of resources as a result of the restructuring. Management expects software development and technical support costs to continue to be lower than the previous year for the remainder of fiscal 2002 due to the cost containment efforts instituted by the restructuring.

Capitalized software product costs represented 35% of software development and technical support for the nine month period ended April 30, 2002, compared to 57% for the same period last year. Management expects capitalized software product costs to fluctuate from quarter to quarter depending on the deployment of the Company's resources between early stage research, software development available for capitalization, data conversion, customer customizations and maintenance and technical support.

Depreciation and amortization expense decreased significantly for the three and nine month periods ended April 30, 2002, compared to the same periods last year. Management expects depreciation and amortization to continue to be significantly lower than the previous year for the remainder of fiscal 2002 due to the write-off of long-lived assets related to the Company's network platform at the end of fiscal 2001.

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OTHER ITEMS

Earnings improved from a loss of $4,240,000 for the nine month period ended April 30, 2001, to net income of $115,000 for the nine month period ended April 30, 2002. The substantial improvement in earnings is attributable to the restructuring, which focused the Company on its core catalog business and reduced both cash and non-cash expenses to bring them in line with our revenues.

Interest paid or accrued for payment decreased for the nine month period ended April 30, 2002, compared to the same period last year because the Company paid off $806,000 of debt and capital lease obligations since April 30, 2001. Non-cash interest expense of approximately $615,000 was incurred for each of the nine month periods ended April 30, 2001 and 2002 due to debt discount amortization for the Debenture sold to RGC in April 2000.

Since December 1995, the Company has had a formal and aggressive business development program aimed at identifying, evaluating and closing acquisitions that augment and strengthen the Company's market position, product offerings, and personnel resources. Since the program's inception, four acquisitions have been completed, all of which were fully integrated into the Company's operations prior to fiscal year 2000. The business development program is still an important component of the Company's growth strategy.

LIQUIDITY AND CAPITAL RESOURCES

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

CASH FLOW INFORMATION
(IN THOUSANDS)

	THREE MONTHS ENDED APRIL 30		PERCENT	NINE MONTHS ENDED APRIL 30	
	2002	2001	CHANGE	2002	2001
Net cash provided by operating activities before changes in working capital	$ 720	$ (119)	705%	$ 2,192	$ 61
Net cash used in investing activities	(153)	(579)	74%	(583)	(1,529)
Subtotal	567	(698)	181%	1,609	(1,468)
Effect of net changes in working capital	399	343	16%	211	1,886
Net cash provided by operating and investing activities	$ 966	$ (355)	372%	$ 1,820	$ 418

Net cash provided by operating activities before changes in working capital increased significantly for the three and nine month periods ended April 30, 2002, compared to the same periods last year, due to the reduction in cash expenses related to the Company's restructuring. Net cash used in investing activities decreased for the three and nine month periods ended April 30, 2002, compared to the same periods last year, primarily due to decreased costs attributable to the Company's restructuring. The effect of net changes in working capital is dependent on the timing of payroll and other cash disbursements, accruals and the timing of invoices and may vary significantly from quarter to quarter. Management expects the summation of cash provided by operating activities and used in investing activities to continue to be positive for the remainder of the fiscal year ended July 31, 2002 and beyond, however, there can be no assurance that this result will be ultimately achieved.

At April 30, 2002, the Company had cash of approximately $1,343,000 compared to approximately $313,000 at July 31, 2001.

The following table sets forth, for the periods indicated, certain information related to the Company's debt derived from the Company's unaudited financial statements.

DEBT SCHEDULE
(IN THOUSANDS)

	APRIL 30 2002 (UNAUDITED)	JULY 31 2001 (AUDITED)	NET CHANGE
Debt to Shareholder:			
Current portion of line of credit	$ -	$ 200	$ (200)
Current portion of notes payable	167	333	(166)
Long-term portion of notes payable	-	56	(56)
Debt discount (common stock warrants)	(15)	(41)	26
Total Debt to Shareholder	152	548	(396)
Subordinated Debenture:			
Notes payable *	4,000	4,000	-
Debt discount (common stock warrants and options)	(784)	(1,373)	589
Total Subordinated Debenture	3,216	2,627	589
Other Debt:			
Current portion of notes payable other	96	275	(179)
Long-term notes payable other	8	78	(70)
Total Other Debt	104	353	(249)
Total Debt	$ 3,472	$ 3,528	$ (56)

* The debenture includes a condition which was in default due to the Company's delisting from Nasdaq, which gives RGC the right to call the debenture, although they have not actually done so.

On April 27, 2000, the Company issued and sold pursuant to a Securities Purchase Agreement, dated as of April 25, 2000, by and among the Company and RGC International Investors, LDC (the "Investor"), (i) a convertible subordinated debenture in the amount of $4,000,000 due on April 27, 2003 (the "Debenture"), and convertible into shares of the Company's common stock, (ii) warrants to purchase 600,000 shares of Common Stock (the "Warrants"), and (iii) an investment option to purchase 800,000 shares of Common Stock (the "Investment Option"). The Investment Option expired on October 27, 2001 and the Warrants expire on April 27, 2005. The Debenture is convertible into Common Stock at $4 per share and the Warrants are exercisable at $6 per share. The Company is required to maintain listing of its common stock on the Nasdaq National Market, the Nasdaq Small Cap Market, the New York Stock Exchange or the American Stock Exchange; failure to meet this requirement results in the Debenture becoming fully due at 130% of principal and accrued interest, as well as an increase in the interest rate from 7% to 17%. At any time after October 27, 2000, the Company can require the Investor to convert the amount owed under the Debenture into Common Stock at $4.00 per share provided that: (i) the closing bid price of the Common Stock has been greater than $6.60 for twenty (20) consecutive trading days and (ii) the Company's resale registration statement has been effective for at least three (3) months. As long as $500,000 or more principal amount of the Debenture is outstanding, the Company agreed not to: (i) pay any dividends or make any other distribution on our common stock, other than stock dividends and stock splits; (ii) repurchase or redeem any shares of our capital stock, except in exchange for common stock or preferred stock; (iii) incur or assume any liability for borrowed money, except our existing debt, debt from a bona fide financial lending institution, indebtedness to trade creditors, borrowings used to repay the debenture, indebtedness assumed or incurred in connection with the acquisition of a business, product, license or other asset, refinancing of any of the above, and indebtedness that is subordinate to the debenture; (iv) sell or otherwise dispose of assets outside the normal course of business, except the sale of a business, product, license or other asset that our board of directors determines is in the best interests of us and our shareholders, and sales of assets with a value not exceeding $500,000 in any 12-month period following the issuance of the debenture; (v) lend money or make advances to any person not in the ordinary course of business, except loans to subsidiaries or joint ventures approved by a majority of our independent directors, guarantee another person's liabilities, except, among other things, guarantees made in connection with the acquisition of a business, product, license or other asset.

The Company was delisted on July 7, 2001 from the NASDAQ National Market System but is currently listed on the NASDAQ Bulletin Board Market. The delisting resulted in a default condition on the RGC debenture, which gives RGC the right to accelerate the Debenture, although they have not actually done so. If the Company is unable to negotiate a new debenture or obtain waivers from the Investor, shareholders could be materially and adversely affected.

ARI has a term loan with WITECH for an original principal amount of $1.0 million payable in equal monthly principal installments over three years, commencing November 1, 1999 and which bears interest at prime plus 4.0%. As of June 12, 2002 there was $111,000 outstanding under the WITECH term loan. The only financial covenant was that ARI maintained a net worth (calculated in accordance with accounting principles generally accepted in the United States) of at least $1 million. This net worth covenant was waived as of July 31, 2001 and for the fiscal year ended July 31, 2002.

On September 28, 1999, ARI and RFC Capital Corporation ("RFC") executed a Receivables Sales Agreement (the "Sale Agreement") establishing a $3.0 million working capital facility (the "RFC Facility"). The three-year Sale Agreement allows RFC to purchase up to $3.0 million (the "Purchase Commitment") of ARI's accounts receivable. The Purchase Commitment may be increased in increments of $1.0 million upon mutual agreement and a payment by ARI of $10,000 for each $1.0

million increase. Under the Sale Agreement, RFC purchases 90% of eligible receivables. In connection with the Sale Agreement ARI was required to pay a Commitment Fee of $45,000 on September 28, 1999, $30,000 on September 28, 2000, and $15,000 on September 28, 2001. In addition, ARI is obligated to pay a monthly program fee equal to the greater of (a) $3,000 or (b) the amount of the purchased but uncollected receivables times the prime rate plus 2%. ARI may terminate the Sale Agreement prior to three-year term by paying 2.0% of the Purchase Commitment during the second year, and 1.0% of the Purchase Commitment during the third year. The RFC Facility expires on September 28, 2002. RFC has indicated to the Company that the Facility can be extended, although there can be no assurance that this will occur. As of June 7, 2002, the balance of the RFC Facility was $156,000.

Management believes that funds generated from operations and the RFC Facility will be adequate to fund the Company's operations, investments and debt payments through fiscal 2003 if the Debenture is successfully renegotiated or the necessary waiver is obtained from RGC. If management is unable to renegotiate the Debenture or obtain the necessary waiver, the Company will remain in default and could owe in excess of $5 million, which would have a material adverse effect on the Company. The Company does not expect to be in a position to pay back the Debenture if it is accelerated or at the scheduled maturity date. Management has restructured the Company to reduce cash overhead by over $2 million in fiscal 2002. Management is also continually analyzing its anticipated cash flows under a variety of growth scenarios ranging from modest contraction to modest growth. Management believes that, provided the defaults can be cured, either (i) sufficient cash can be generated from the business to fund operations and a modest level of investment or (ii) that the cash profile of the business can be further restructured to be self-funding, although there can be no assurance that these efforts will be successful.

The Company believes that earnings before interest, taxes, depreciation and amortization ("EBITDA") is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA increased from $481,000 for the nine month period ended April 30, 2001 to $2,564,000 for the nine month period ended April 30,2002 primarily due to reductions in cash expenses as a result of the restructuring. Management believes that EBITDA will continue to be positive for the remainder of fiscal 2002 and beyond, although there can be no assurance that this will occur.

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

FORWARD LOOKING STATEMENTS

Certain statements contained in this Form 10-Q are forward looking statements including projected revenue growth, future cash flows and cash generation and sources of liquidity. Expressions such as "believes," "anticipates," "expects," and similar expressions are intended to identify such forward looking statements. Several important factors can cause actual results to materially differ from those stated or implied in the forward looking statements. Such factors include, but are not limited to the factors listed on exhibit 99.1 of the Company's annual report on Form 10-K for the year ended July 31, 2001.

PART II - OTHER INFORMATION

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

(a) See Part I, Item 2 Management's discussion and analysis of financial condition and results of operation under liquidity with respect to information of the Company's violation of requirements of its debenture with RGC International Investors, LDC.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARI Network Services, Inc.
(Registrant)

Date: June 14, 2002

/s/ Brian E. Dearing

Brian E. Dearing, Chairman of the Board

/s/ Timothy Sherlock

Timothy Sherlock, Chief Financial Officer