

**Report of Wipfli LLP,
Report of Independent Registered Public Accounting Firm**

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

We have audited the accompanying consolidated balance sheets of ARI Network Services, Inc. and Subsidiaries (the Company) as of July 31, 2010 and 2009 and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Wipfli LLP
Milwaukee, Wisconsin
October 29, 2010

Consolidated Financial Statements

ARI Network Services, Inc.
Years ended July 31, 2010 and 2009

ARI Network Services, Inc.
Consolidated Balance Sheet
(Dollars in Thousands, Except per Share Data)

	July 31 2010	July 31 2009
Current assets:		
Cash and cash equivalents	\$ 938	\$ 650
Trade receivables, less allowance for doubtful accounts of \$565 and \$410 at July 31, 2010 and 2009, respectively	1,359	1,352
Work in process	133	156
Prepaid expenses and other	481	321
Deferred income taxes	2,600	2,544
<i>Total current assets</i>	5,511	5,023
Equipment and leasehold improvements:		
Computer equipment	1,883	1,827
Leasehold improvements	506	463
Furniture and equipment	1,970	2,479
	4,359	4,769
Less accumulated depreciation and amortization	2,433	2,827
<i>Net equipment and leasehold improvements</i>	1,926	1,942
Capitalized software product costs:		
Amounts capitalized for software product costs	15,919	14,886
Less accumulated amortization	13,524	12,489
<i>Net capitalized software product costs</i>	2,395	2,397
Deferred income taxes	1,616	110
Other long term assets	63	59
Other intangible assets	2,827	3,637
Goodwill	5,439	5,439
Total assets	\$ 19,777	\$ 18,607

See accompanying notes

ARI Network Services, Inc.
Consolidated Balance Sheet
(Dollars in Thousands, Except per Share Data)

	<u>July 31 2010</u>	<u>July 31 2009</u>
Current liabilities:		
Current borrowings on line of credit	\$ 1,025	\$ 500
Current portion of notes payable	-	117
Accounts payable	490	788
Deferred revenue	5,270	5,523
Accrued payroll and related liabilities	1,322	1,421
Accrued taxes	60	82
Other accrued liabilities	844	729
Current portion of capital lease obligations	192	109
<i>Total current liabilities</i>	<u>9,203</u>	<u>9,269</u>
Non-current liabilities:		
Notes payable	5,000	5,000
Long-term portion of accrued compensation	17	36
Capital lease obligations	338	115
<i>Total non-current liabilities</i>	<u>5,355</u>	<u>5,151</u>
Total liabilities	14,558	14,420
Shareholders' equity:		
Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at July 31, 2010 and 2009, respectively	-	-
Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at July 31, 2010 and 2009, respectively	-	-
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 7,768,921 and 7,693,510 shares issued and outstanding at July 31, 2010 and 2009, respectively	8	8
Common stock warrants and options	983	816
Additional paid-in-capital	95,748	95,681
Accumulated deficit	(91,507)	(92,284)
Other accumulated comprehensive loss	(13)	(34)
Total shareholders' equity	<u>5,219</u>	<u>4,187</u>
Total liabilities and shareholders' equity	<u>\$ 19,777</u>	<u>\$ 18,607</u>

See accompanying notes

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

	<u>2010</u>	<u>2009</u>
Net revenue	\$ 21,484	\$ 17,560
Cost of revenue	<u>4,353</u>	<u>3,400</u>
Gross profit	17,131	14,160
Operating expenses:		
Sales and marketing	4,786	3,419
Customer operations and support	3,469	2,785
Software development and technical support (net of capitalized software product costs)	1,415	1,534
General and administrative	4,879	4,212
Restructuring	437	-
Depreciation and amortization (exclusive of amortization of software product costs included in cost of revenue)	<u>1,640</u>	<u>1,101</u>
Net operating expenses	<u>16,626</u>	<u>13,051</u>
Operating income	505	1,109
Other income (expense):		
Interest expense	(649)	(214)
Other, net	<u>19</u>	<u>(7)</u>
Total other income (expense)	<u>(630)</u>	<u>(221)</u>
Income (loss) from continuing operations before provision for income tax	(125)	888
Income tax benefit (expense)	<u>1,294</u>	<u>(123)</u>
Income from continuing operations	1,169	765
Discontinued operations, net of tax	<u>(392)</u>	<u>(341)</u>
Net income	<u>\$ 777</u>	<u>\$ 424</u>
Income from continuing operations per common share:		
Basic	<u>\$ 0.15</u>	<u>\$ 0.11</u>
Diluted	<u>\$ 0.15</u>	<u>\$ 0.11</u>
Net income per common share:		
Basic	<u>\$0.10</u>	<u>\$0.06</u>
Diluted	<u>\$0.10</u>	<u>\$0.06</u>

See accompanying notes

ARI Network Services, Inc.
Consolidated Statements of Shareholders' Equity
(Dollars in Thousands)

	Common Stock			Paid in Capital	Accumulated Deficit	Other Accumulated Comprehensive Loss	Total Shareholders' Equity
	Shares Issued and Outstanding	Par Value	Warrants & Options				
Balance July 31, 2008	6,971,927	\$ 7	\$ 501	\$ 95,148	\$ (92,708)	\$ (52)	\$ 2,896
Stock-based compensation	-	-	315	-	-	-	315
Issuance of common stock under company 401(k) plan	32,955	-	-	45	-	-	45
Issuance of common stock under executive bonus plan	8,642	-	-	8	-	-	8
Issuance of common stock from exercise of stock options	60,242	-	-	16	-	-	16
Issuance of common stock under stock purchase plan	4,359	-	-	4	-	-	4
Issuance of common stock related to acquisitions	615,385	1	-	460	-	-	461
Net Income	-	-	-	-	424	-	424
Foreign currency translation adjustments	-	-	-	-	-	18	18
Comprehensive income	-	-	-	-	424	18	442
Balance July 31, 2009	7,693,510	\$ 8	\$ 816	\$ 95,681	\$ (92,284)	\$ (34)	\$ 4,187
Stock-based compensation	-	-	167	-	-	-	167
Issuance of common stock under company 401(k) plan	58,332	-	-	52	-	-	52
Issuance of common stock under executive bonus plan	10,495	-	-	10	-	-	10
Issuance of common stock under stock purchase plan	6,584	-	-	5	-	-	5
Net Income	-	-	-	-	777	-	777
Foreign currency translation adjustments	-	-	-	-	-	21	21
Comprehensive income	-	-	-	-	777	21	798
Balance July 31, 2010	7,768,921	\$ 8	\$ 983	\$ 95,748	\$ (91,507)	\$ (13)	\$ 5,219

Shareholders' Equity Includes cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding for all periods presented.

Shareholders' Equity includes junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding for all periods presented.

See accompanying notes

ARI Network Services, Inc.
Consolidated Statements of Cash Flows
(Dollars in Thousands)

	2010	2009
Operating activities		
Net income	\$ 777	\$ 424
Adjustments to reconcile net income to net cash provided by operating		
Amortization of software products	1,054	876
Impairment of software products	189	-
Amortization of deferred financing costs, debt discount and excess carrying value over face amount of notes payable	-	8
Depreciation and other amortization	1,640	1,054
Loss on disposal of equipment	10	47
Allowance for investment in Bank Note	-	127
Loss on disposal of discontinued operations	1	-
Provision for bad debt allowance	287	111
Deferred income taxes	(1,562)	88
Stock based compensation related to stock options	167	315
Stock issued as contribution to 401(k) plan	52	45
Net change in assets and liabilities:		
Trade receivables	(301)	124
Work in process	10	108
Prepaid expenses and other	(160)	89
Other long term assets	(4)	(5)
Accounts payable	(288)	137
Deferred revenue	(253)	(859)
Accrued payroll and related liabilities	(87)	352
Accrued taxes	(22)	2
Accrued vendor specific liabilities	-	-
Other accrued liabilities	114	(298)
<i>Net cash provided by operating activities</i>	1,624	2,745
Investing activities		
Purchase of equipment, software and leasehold improvements	(541)	(636)
Cash paid for goodwill and intangible assets related to acquisitions	-	(645)
Cash surrendered in disposal of discontinued operations	(10)	-
Cash paid for other net assets related to acquisitions	-	(123)
Software developed for internal use	(99)	(56)
Software development costs capitalized	(1,241)	(759)
<i>Net cash used in investing activities</i>	(1,891)	(2,219)
Financing activities		
Borrowings (repayments) under line of credit	525	(200)
Payments under notes payable	(117)	(684)
Proceeds from capital lease obligations incurred	300	-
Payments of capital lease obligations	(163)	(104)
Proceeds from issuance of common stock	5	20
<i>Net cash provided by (used in) financing activities</i>	550	(968)
Effect of foreign currency exchange rate changes on cash	5	6
Net change in cash and cash equivalents	288	(436)
Cash and cash equivalents at beginning of period	650	1,086
Cash and cash equivalents at end of period	\$ 938	\$ 650
Cash paid for interest	\$ 474	\$ 211
Cash paid for income taxes	\$ 89	\$ 28
Noncash investing and financing activities		
Capital lease obligations incurred for computer equipment	\$ 170	\$ -
Accrued liabilities related to purchase of computer equipment	-	86
Issuance of common stock in connection with acquisitions	-	461
Debt issued in connection with acquisitions	-	5,000
Accrued liabilities assumed in connection with acquisitions	-	1,691
Net current assets and liabilities surrendered in sale of discontinued operations	9	-
Issuance of common stock related to payment of executive compensation	10	8

See accompanying notes

ARI Network Services, Inc.

Notes to Consolidated Financial Statements

1. Description of the Business and Significant Accounting Policies

Description of the Business

ARI Network Services, Inc. ("ARI") provides technology-enabled services that help dealers, distributors and manufacturers worldwide enhance revenue and reduce costs. Our technology-enabled services allow customers in a service or distribution network to: (i) conveniently reference parts, service bulletins and other technical information; (ii) manage and nurture customers and prospects; (iii) efficiently market to their customers and prospects; and (iv) increase revenues by selling products online. We deliver our services to companies of all sizes across a dozen vertical markets, with a core emphasis on the outdoor power, power sports, marine, RV, and appliance sectors. Approximately 18,000 equipment dealers, 125 manufacturers, and 150 distributors worldwide leverage our technology to drive revenue, gain efficiencies and increase customer satisfaction. We also develop and offer electronic catalog content for approximately 125 leading equipment manufacturers.

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.

Basis of Presentation

These consolidated financial statements include the financial statements of ARI and its wholly owned subsidiaries. We have eliminated all significant intercompany balances and transactions in consolidation. Certain reclassifications were made to amounts previously reported in our financial statements, including interim reports on Form 10-Q, in order to conform to the current presentation. These reclassifications include: (i) shifting the results of our discontinued operation out of income from continuing operations; (ii) reclassifying product management and design costs from sales and marketing to software development and technical support; and (iii) reclassifying certain components of deferred tax assets from long term to short term.

In fiscal 2009 ARI acquired Channel Blade Technologies, Inc. ("Channel Blade"). We have included the results of operations for Channel Blade in our consolidated results of operations from the date of acquisition. In fiscal 2009, ARI F&I Services, LLC ("AFIS"), a wholly-owned subsidiary of ARI, acquired Powersports Outsourcing Group ("PSOG"). AFIS was subsequently sold on July 27, 2010. The results of AFIS have been reported as a discontinued operation.

Fiscal Year

Our fiscal year ends on July 31. References to fiscal 2010, for example, refer to the fiscal year ending July 31, 2010, and references to fiscal 2009 refer to the fiscal year ending July 31, 2009.

Foreign Currency Translation

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

Use of Estimates

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

Changes in Accounting Estimates

During fiscal 2010 and fiscal 2009, the Company had a change in its estimated valuation allowance related to deferred tax assets due to ongoing revisions and evaluations of the estimated future expected results of operations. The difference between the amounts previously recorded as a valuation allowance and the amount currently recorded was charged to income tax expense, as more fully discussed in Note 11. The amount of this change in accounting estimate was income of \$1,402,000, or \$0.18 per basic and diluted common share in fiscal 2010, and expense of approximately \$88,000, or \$0.01 per basic and diluted common share, in fiscal 2009.

Concentrations

We currently maintain cash deposits in bank accounts in excess of amounts insured by the Federal Deposit Insurance Corporation ("FDIC"). The Company had cash deposits in excess of the FDIC insurance coverage of \$800,000 and \$400,000 as of July 31, 2010 and 2009, respectively. These cash deposits are exposed to loss in the event of nonperformance by the financial institution.

No single customer accounted for 10% or more of ARI's revenue in fiscal 2010 or fiscal 2009.

Revenue Recognition

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

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

Revenue from software licenses, which is included in multiple element arrangements, is recognized ratably over the contractual term of the arrangement. ARI considers all arrangements with payment terms extending beyond twelve months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential to software license arrangements include customizing complex features and functionality in a product's base software code or developing complex interfaces within a customer's environment. When professional services are considered essential to software license arrangements, 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. Professional services revenue for set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of this type of arrangement, is amortized over the term of the contract. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined.

Revenue for variable transaction fees, primarily for use of the shopping cart feature of our websites, is recognized as it is earned.

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

In conjunction with our acquisition of Channel Blade, we incurred a deferred revenue liability of approximately \$1,310,000 related to setup fees charged for hosted websites. The deferred revenue liability is being amortized over the terms of the customer contracts, of which approximately \$48,000 is remaining as of July 31, 2010. Approximately \$800,000 and \$462,000 of the Channel Blade deferred revenue was recognized during fiscal 2010 and fiscal 2009, respectively.

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

Cash and Cash Equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

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

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within 30 days from the invoice date. Payments of trade receivables are allocated to the specific invoices identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of trade receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews all receivable balances that exceed 60 days from the invoice date and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. The allowance for potential credit losses is reflected as an offset to trade receivables in the accompanying balance sheets.

Work in Process

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

Equipment and Leasehold Improvements

Equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed under the straight-line method for financial reporting purposes and accelerated methods for income tax purposes. Depreciation and amortization have been provided over the estimated useful lives of the assets as follows:

Computer equipment	3 – 7 years
Leasehold improvements	2 – 7 years
Furniture and equipment	3 – 5 years

Leasehold improvements are amortized over the useful lives of the assets or the term of the related lease agreement, whichever is shorter. During fiscal 2010 and fiscal 2009, the Company disposed of equipment and leasehold improvements with a cost basis of \$1,220,000 and \$5,309,000, respectively and recorded a loss on disposal of \$10,000 and \$47,000, respectively.

Capitalized and Purchased Software Product Costs

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

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

Capitalized Interest Costs

Capitalized interest costs were immaterial as a whole to the financial statements in fiscal 2010 and 2009.

Insurance Premiums Receivable

The Company is the beneficiary of the total premiums it paid on a split-dollar life insurance policy at the death of the policy holder. Insurance premiums receivable are recorded at present value based on the average life expectancy of the policy holder and are included in other long term assets. Insurance premiums receivable consisted of \$63,000 and \$59,000 at July 31, 2010 and 2009, respectively, which is the present value of future life insurance premiums receivable of approximately \$237,000 discounted at an average rate of 9% and averaged over 14 to 17 years.

Impairment of Long-Lived Assets

In accordance with GAAP, capitalized software product costs are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve judgment. We evaluated the ongoing value of our long-lived assets as of July 31, 2010 and 2009. In fiscal 2010 we incurred an impairment charge of \$48,000 on capitalized software, with a cost basis of \$208,000, which was disposed of, and an additional impairment charge of \$141,000 on assets that are still in use. These impairment charges are included in restructuring costs on the statement of operations. We did not incur any software impairment charges in fiscal 2009.

Fair Value Measurements

GAAP has established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions. The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

We have a limited number of financial instruments which are measured at fair value on a recurring basis. Unrealized gains and losses on items for which the fair value option has been elected are recognized in earnings. In fiscal 2009, we incurred a loss of \$127,000 related to a note receivable as a result of a fair market valuation as follows (in thousands):

	<u>2010</u>	<u>2009</u>
Fair value measurements using:		
Level 1 inputs: quoted prices in active markets for identical assets	\$ -	\$ -
Level 2 inputs: significant other observable inputs	-	-
Level 3 inputs: significant unobservable inputs	-	-
Total fair value	<u>\$ -</u>	<u>\$ -</u>
Total loss recognized	<u>\$ -</u>	<u>\$ 127</u>

ARI also measures non-financial instruments at fair value on a non-recurring basis as required by GAAP. Gains and losses on items which were measured at fair market value on a non-recurring basis were recognized in earnings. In fiscal 2010, we incurred a loss of \$189,000 related to impairment of certain software products as follows (in thousands):

	<u>2010</u>
Fair value measurements using:	
Level 1 inputs: quoted prices in active markets for identical assets	\$ -
Level 2 inputs: significant other observable inputs	-
Level 3 inputs: significant unobservable inputs	<u>2,395</u>
Total fair value	<u>\$ 2,395</u>
Total loss recognized	<u>\$ 189</u>

Goodwill and Other Intangible Assets

GAAP requires that we assess goodwill for impairment annually, or more frequently if circumstances warrant a review. Certain triggering events that may warrant a more frequent impairment test include a significant change in the business climate, legal factors, a decline in operating performance, competition, sale or disposition of a significant portion of the business, or other factors. We tested for goodwill impairment at July 31, 2010 and 2009.

We test goodwill for impairment using a two-step process, as prescribed by GAAP. The first step of the test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

We determined that there is a single reporting unit for the purpose of goodwill impairment tests. We estimate the fair value of the reporting unit using various valuation techniques, with the primary technique being a discounted cash flow analysis. There are many estimates and assumptions involved in preparing a discounted cash flow analysis, including most significantly the weighted average cost of capital ("WACC") used to discount future cash flows, anticipated long-term growth rates, and future profit margins. Management uses its best efforts to reasonably estimate all of these and other inputs in the cash flow models utilized. We estimated future cash flows using two forecast scenarios and management used its best judgment to assign a weighting to each scenario. Step 1 of the goodwill impairment test indicated that goodwill was not impaired in fiscal 2010 or fiscal 2009. As a result, step 2 of the test was not performed.

Impairment tests are also performed for those intangible assets with estimable useful lives when circumstances warrant testing for impairment. Intangible assets with estimable useful lives consist primarily of customer relationships and trade names, which are amortized over their estimated useful lives of 4-8 years, and employee non-compete agreements, which are amortized over their estimated useful lives of two years. There were no impairments to intangible assets with estimable useful lives in fiscal 2010 or fiscal 2009.

Deferred Income Taxes

The tax effect of the temporary differences between the book and tax bases of assets and liabilities and the estimated tax benefit from tax net operating losses is reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed semi-annually or when events or changes in circumstances indicate that there may be a change in the valuation allowance. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as valuation allowance is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the income statement.

Stock-Based Compensation

ARI uses the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. As stock-based compensation expense recognized in our results of operations is based on awards ultimately expected to vest, the amount has been reduced for estimated forfeitures, which were estimated based on our historical experience.

Advertising Costs

Advertising costs are expensed as incurred. Total advertising costs were \$132,000 and \$74,000 in fiscal 2010 and fiscal 2009, respectively.

Comprehensive Income (Loss)

Comprehensive income is a more inclusive financial reporting method that includes disclosure of financial information that historically has not been recognized in the calculation of net income. We reported comprehensive income, which includes net income and foreign currency translation adjustments, in the Consolidated Statements of Shareholders' Equity for fiscal 2010 and fiscal 2009.

Legal Provisions

ARI is periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable, in accordance with GAAP. We had no legal provisions in fiscal 2010 or fiscal 2009.

Recently Adopted Accounting Standards

In February 2010 the Financial Accounting Standards Board ("FASB") amended ASC Topic 855, Subsequent Events. The amendment does not change the definition of a subsequent event (i.e. an event or transaction that occurs after the balance sheet date but before the financial statements are issued) but requires SEC filers to evaluate subsequent events through the date that its financial statements are issued. The new standard was effective immediately and we adopted these new requirements in fiscal 2010.

In December 2009 the FASB amended guidance related to fair value measurements and disclosures, which was effective beginning with the fiscal quarter ended April 30, 2010. These amendments prescribe new disclosures and clarify certain existing disclosure requirements related to fair value measurements. The objective of the amendments was to improve these disclosures and, thus, increase the transparency in financial reporting. The adoption of these amendments did not have a material impact on our consolidated financial statements.

In June 2009 the FASB issued ASC 105, Generally Accepted Accounting Principles, effective for interim and annual reporting periods ending after September 15, 2009. This statement established the Accounting Standards Codification (the "Codification") as the single official source of authoritative accounting principles used in the preparation of financial statements in conformity with GAAP. The Codification does not replace or affect guidance issued by the SEC or its staff. The Company adopted ASC 105 on beginning with its fiscal quarter ended October 31, 2009. Since ASC 105 does not change GAAP, adoption of ASC 105 did not impact the results of operations, financial position or cash flows of the Company. Rather, the references to authoritative accounting pronouncements included herein now refer to the Codification topic section rather than a specific accounting rule, as was past practice.

In December 2007, the FASB issued ASC 805, Business Combinations. This standard became effective for ARI business combinations on, or after, the beginning of the first annual reporting period beginning on August 1, 2009. This standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This standard was adopted on August 1, 2009. The adoption did not have a material impact on our consolidated financial statements for fiscal 2010.

New Accounting Pronouncements

In October 2009, the FASB amended guidance related to revenue recognition for software with multiple elements that will become effective for the Company beginning August 1, 2010. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB amended guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. We are evaluating the potential impact of adopting these standards on the consolidated financial statements for fiscal 2011 and beyond.

Other recently issued accounting pronouncements are not believed by management to have a material impact on our present or future financial statements.

2. Basic and Diluted Net Income per Common Share

Basic net income per common share is computed by dividing net income by the basic weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and reflects the potential dilution that could occur if all of ARI's outstanding stock options and warrants that are in the money were exercised (calculated using the treasury stock method).

The following table is a reconciliation of basic and diluted net income per common share for fiscal 2010 and fiscal 2009 (in thousands, except per share data):

	<u>2010</u>	<u>2009</u>
Income from continuing operations	\$ 1,169	\$ 765
Loss from discontinued operations	<u>(392)</u>	<u>(341)</u>
Net income	<u>\$ 777</u>	<u>\$ 424</u>
Weighted-average common shares outstanding	7,751	7,203
Effect of dilutive stock options and warrants	<u>15</u>	<u>25</u>
Diluted weighted-average common shares outstanding	<u>7,766</u>	<u>7,228</u>
Earnings per share - basic:		
Income from continuing operations	\$ 0.15	\$ 0.11
Loss from discontinued operations	<u>(0.05)</u>	<u>(0.05)</u>
Net income	<u>\$ 0.10</u>	<u>\$ 0.06</u>
Earnings per share - diluted:		
Income from continuing operations	\$ 0.15	\$ 0.11
Loss from discontinued operations	<u>(0.05)</u>	<u>(0.05)</u>
Net income	<u>\$ 0.10</u>	<u>\$ 0.06</u>
Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive	<u>1,504</u>	<u>1,394</u>

3. Capitalized and Purchased Software Product Costs

The balance of capitalized and purchased software product costs consisted of the following (in thousands):

	Software Product Costs	Accumulated Amortization	Net Value
Balance 7/31/08	\$ 13,209	\$ (11,613)	\$ 1,596
Capitalized costs	759		759
Acquisitions	918		918
Amortization expense		(876)	(876)
Balance 7/31/09	\$ 14,886	\$ (12,489)	\$ 2,397
Capitalized costs	1,241		1,241
Disposals	(208)	208	-
Impairments		(189)	(189)
Amortization expense		(1,054)	(1,054)
Balance 7/31/10	\$ 15,919	\$ (13,524)	\$ 2,395

The estimated aggregate amortization expense for each of the five succeeding fiscal years related to capitalized and purchased software product costs consist of the following at July 31, 2010 (in thousands):

2011	\$ 961
2012	787
2013	513
2014	90
2015	44
	<u>\$ 2,395</u>

4. Notes Payable

Notes payable consisted of the following at July 31, 2010 and 2009 (in thousands):

	2010	2009
Notes payable	\$ 5,000	\$ 5,117
Less current maturities	-	117
Notes payable - non-current	\$ 5,000	\$ 5,000

We issued a \$5,000,000 secured promissory note in connection with the April 27, 2009 acquisition of Channel Blade. The annual interest rate on the note was 10% for the first year and 14% thereafter. If we had pre-paid a minimum principal amount of \$3,000,000 on or before April 27, 2010, the interest rate would have remained at 10% for the remainder of the note's term. Accrued interest only is due quarterly commencing July 31, 2009 through April 30, 2011. Twenty equal quarterly payments, which will include principal and interest, will then be due, commencing August 1, 2011.

Principal payments due on the Channel Blade note payable are as follows (in thousands):

2011	\$ -
2012	948
2013	885
2014	1,016
2015	1,165
2016	986
	<u>\$ 5,000</u>

We issued \$700,000 of notes and \$400,000 of future non-interest bearing contingent payments in connection with the January 26, 2007 acquisition of OC-Net, Inc. As of July 31, 2010, all outstanding amounts due on the note and all contingent payments have been made.

5. Acquisitions

On April 17, 2009, AFIS acquired the assets of PSOG, valued at approximately \$85,000, in partial satisfaction of its debt to ARI of approximately \$185,000. This debt consisted of a note with a face value of \$149,000, which was purchased from Keybank National Association on April 16, 2009 for \$125,000 and an additional loan from ARI of \$36,000. PSOG, located in Schenectady, NY and then led by Mark L. Taylor, had been offering outsourced F&I services to power sports, marine and RV customers in the Northeast United States since 1998.

We allocated the acquisition of the PSOG assets as follows (in thousands):

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

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

On July 27, 2010 we sold AFIS to F&I Smart LLC in a membership interest sale agreement (the "Subject Interests"). The sales price of the Subject Interests is a contingent amount based on dealer revenue beginning July 28, 2010 and ending on August 28, 2013. We have not accrued for any future contingent proceeds as we are not able to estimate the amounts at this time. We recognized a \$1,000 loss on the sale of AFIS in the fourth quarter of fiscal 2010. Refer to Note 14 for further discussion of our discontinued operation.

On April 27, 2009, we acquired substantially all of the assets of Channel Blade, the leading provider of websites, lead management and marketing automation solutions in the marine and RV markets. The acquisition makes ARI a marine industry leader with enhanced opportunities for growth. Consideration for the acquisition included approximately \$500,000 in cash, 615,385 shares of common stock at a market price of \$0.75 per share, \$765,000 of assumed net liabilities and a \$5,000,000 note payable.

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

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

Other intangible assets include trade names, customer relationships and employee non-compete agreements, which are amortized over 5, 8 and 2 years, respectively. Capitalized software product costs are amortized over 4.1 years. The goodwill recognized as part of the accounting for the acquisition relates to Channel Blade's knowledge of and penetration into the marine and RV vertical markets.

In connection with the acquisition, we entered into one year employment agreements with Jon Lintvet and Charles Lewis to serve as Director of New Business Development and Director of Strategic Accounts - Marine and RV, respectively. The employment agreements expired and both Mr. Lintvet and Mr. Lewis remain employees of the Company.

The following table shows the unaudited pro forma results of operations for fiscal 2009, which assumes the Channel Blade acquisition occurred as of August 1, 2008 (in thousands, except per share data):

	Unaudited 2009
Revenues	\$ 20,998
Cost of revenues	<u>4,084</u>
Gross profit	16,914
Net operating expenses	<u>16,838</u>
Operating income	76
Interest expense	(739)
Other expense, net	<u>(7)</u>
Loss from continuing operations	
before provision for income taxes	(670)
Income tax benefit (provision)	<u>(123)</u>
Loss from continuing operations	(793)
Discontinued operations	<u>(341)</u>
Net loss	<u><u>\$ (1,134)</u></u>
Average common shares outstanding:	
Basic	7,780
Diluted	7,780
Loss from continuing operations per common share:	
Basic	<u>\$ (0.10)</u>
Diluted	<u>\$ (0.10)</u>
Net loss per share:	
Basic	<u>\$ (0.15)</u>
Diluted	<u>\$ (0.15)</u>

This pro forma information does not purport to be indicative of the results that actually would have been obtained if the combined operations had been conducted during the periods presented and is not intended to be a projection of future results. We have not disclosed separately Channel Blade's revenue and earnings included within the consolidated financial statements. Disclosure of these amounts was deemed impractical as we have fully integrated into our operations the accounting for the revenues and earnings of Channel Blade.

6. Other Intangible Assets

Amortizable intangible assets include customer relationships, trade names and employee non-compete agreements. Amortizable intangible assets are composed of the following at July 31, 2010 and 2009 (in thousands):

	Customer Relationships	Trade Names	Non-Compete Agreements	Total
Net value 7/31/08	\$ 1,396	\$ -	\$ -	\$ 1,396
Additions	2,274	252	186	2,712
Amortization	<u>(435)</u>	<u>(13)</u>	<u>(23)</u>	<u>(471)</u>
Net value 7/31/09	3,235	239	163	3,637
Additions	-	-	-	-
Amortization	<u>(667)</u>	<u>(50)</u>	<u>(93)</u>	<u>(810)</u>
Net value 7/31/10	<u>\$ 2,568</u>	<u>\$ 189</u>	<u>\$ 70</u>	<u>\$ 2,827</u>
<i>Weighted average remaining useful life</i>	5.48	3.75	0.75	5.25

The estimated amortization expense related to intangible assets for the years subsequent to July 31, 2010 is as follows (in thousands):

2011	\$ 787
2012	602
2013	335
2014	322
2015	284
2016	284
2017	<u>213</u>
	<u>\$ 2,827</u>

7. Capital and Operating Leases

The Company leases office space and certain office equipment under operating lease arrangements expiring through 2021. The Company is generally liable for its share of increases in the landlord's direct operating expenses and real estate taxes related to these leases. Total rental expense for the operating leases was \$738,000 in fiscal 2010 and \$554,000 in fiscal 2009, respectively. An additional \$131,000 of rent costs were incurred in fiscal 2009 but were accrued in fiscal 2008 related to our fiscal 2008 restructuring.

Where applicable, rent expense for leased offices is recognized on a straight-line basis over the lease terms, which differ from the pattern of payments required by the leases. Other accrued liabilities included \$233,000 and \$0 of deferred rent at July 31, 2010 and 2009, respectively. As more fully discussed in Note 13, we recorded a restructuring liability for estimated net future lease costs associated with closed offices. The remaining balance of this restructuring liability was \$80,000 and \$93,000 as of July 31, 2010 and 2009, respectively, which were included in the future minimum lease schedules.

ARI leases approximately 16,300 square feet of office space located at 10850 West Park Place, Milwaukee, Wisconsin 53224. Commencement of the lease occurred on July 17, 2009 and the lease expires July 17, 2021. Over the twelve year lease agreement, annual base rent of \$149,000 increases approximately 2.9% per year. Rent abatement was negotiated for the first fifteen months, and saved us approximately \$187,000. Annual projected operating costs and taxes, which are subject to change, are currently \$8.52 per square foot.

We have certain equipment and leasehold improvements with capital lease obligations of (in thousands):

Fiscal Year Ending July 31:	2010	2009
Equipment and leasehold improvements	\$ 803	\$ 335
Less: accumulated depreciation (1)	271	103
Total cost of equipment and leasehold improvements with outstanding capital lease obligations	\$ 532	\$ 232

(1) amortization of leased equipment and leasehold improvements is included in depreciation and amortization expense

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

Fiscal Year Ending July 31:	Capital Leases	Operating Leases
2011	\$ 237	\$ 666
2012	165	375
2013	161	361
2014	60	363
2015	-	353
Thereafter	-	1,982
Total minimum lease payments	623	4,100
Less amounts related to interest	93	-
Net minimum lease payments	\$ 530	\$ 4,100

8. Line of Credit

On July 9, 2004, we entered into a line of credit agreement with JPMorgan Chase, N.A. which, as amended, permits us to borrow an amount equal to 80% of the book value of all eligible accounts receivable plus 45% of the value of all eligible open renewal orders (provided the renewal rate is at least 85%) minus \$75,000, up to \$2,000,000. Eligible accounts include certain non-foreign accounts receivable which are outstanding for fewer than 90 days from the invoice date.

The agreement bears interest at 1% per annum above the prime rate (effective rate of 4.25% as of July 31, 2010) plus an additional 3%, at the bank's option, upon the occurrence of any default under the note. The interest rate is subject to a floor equal to the sum of (i) 2.5%; plus (ii) the quotient of: (a) the one month LIBOR rate divided by (b) one minus the maximum aggregate reserve requirement imposed under Regulation D of the Board of Governors of the Federal Reserve System (effective floor of 2.8% as of July 31, 2010). The agreement includes a non-usage fee of 0.25% per annum on any unused portion of the line of credit. The line of credit terminates June 30, 2012 and is secured by substantially all of the Company's assets. The line of credit limits repurchases of common stock, the payment of dividends, liens on assets and new indebtedness. It also contains a financial covenant requiring us to maintain a minimum debt service coverage ratio of 1.2 to 1.0, with which we were in compliance at July 31, 2010. There was \$1,025,000 and \$500,000 principal outstanding on the line of credit at July 31, 2010 and July 31, 2009, respectively. There was \$975,000 remaining and eligible per the terms of the agreement on the line of credit at July 31, 2010.

9. Shareholder Rights Plan

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

10. Stock-based Compensation Plans

Total stock compensation expense in fiscal 2010 and fiscal 2009 was approximately \$167,000 and \$315,000, respectively. As of July 31, 2010 and 2009, there was approximately \$134,000 and \$224,000, respectively, of total unrecognized compensation cost related to non-vested options granted under the plans.

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

	2010	2009
Expected life (years)	10 years	10 years
Risk-free interest rate	3.6%	3.5%
Expected volatility	93.5%	77.2%
Expected forfeiture rate	16.0%	13.2%
Expected dividend yield	0.0%	0.0%

Employee Stock Purchase Plans

ARI's 2000 Employee Stock Purchase Plan has 175,000 shares of common stock reserved for issuance, and 165,265 of the shares have been issued as of July 31, 2010. All employees of the Company, other than executive officers, with nine months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.

1991 Stock Option Plan

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

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

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

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

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding and exercisable at 7/31/08	93,186	\$ 2.27	1.23	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(57,686)	2.18	n/a	n/a
Outstanding and exercisable at 7/31/09	35,500	\$ 2.43	\$ 1.09	\$ -
Outstanding and exercisable at 7/31/09	35,500	\$ 2.43	1.09	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(500)	9.06	n/a	n/a
Outstanding and exercisable at 7/31/10	35,000	\$ 2.33	0.10	\$ -

The range of exercise prices for options outstanding at July 31, 2010 was \$2.06 to \$2.44 and at July 31, 2009 was \$2.06 to \$9.06.

1993 Director Stock Option Plan

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

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

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding and exercisable at 7/31/08	1,313	\$ 2.65	1.97	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	-	n/a	n/a	n/a
Outstanding and exercisable at 7/31/09	1,313	\$ 2.65	0.97	\$ -
Outstanding and exercisable at 7/31/09	1,313	\$ 2.65	0.97	\$ -
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(563)	3.46	n/a	n/a
Outstanding and exercisable at 7/31/10	750	\$ 2.05	0.08	\$ -

The range of exercise prices for options outstanding was \$2.00 to \$2.13 at July 31, 2010 and \$2.00 to \$3.56 at July 31, 2009.

2000 Stock Option Plan

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

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

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

Stock-based compensation expense is recognized in our results of operations over the vesting period, which is typically four years for nonqualified stock options.

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

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/08	1,380,538	\$ 1.51	7.36	\$ 150,967
Granted	150,250	1.06	n/a	n/a
Exercised	(60,242)	0.26	n/a	n/a
Forfeited	(257,144)	1.52	n/a	n/a
Outstanding at 7/31/09	1,213,402	\$ 1.51	7.08	\$ 21,337
Exercisable at 7/31/09	871,626	\$ 1.55	6.35	\$ 21,328
Outstanding at 7/31/09	1,213,402	\$ 1.51	7.08	\$ 21,337
Granted	210,250	0.82	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(153,671)	1.35	n/a	n/a
Outstanding at 7/31/10	1,269,981	\$ 1.41	6.48	\$ 13,319
Exercisable at 7/31/10	987,453	\$ 1.51	5.82	\$ 13,117

The range of exercise prices for options outstanding at July 31, 2010 and 2009 was \$0.15 to \$2.74

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

	Number of Options	Wtd. Avg. Exercise Price
Non-vested at 7/31/08	443,335	\$ 1.76
Granted	150,250	1.06
Vested	(195,622)	1.47
Forfeited	(56,187)	1.54
Non-vested at 7/31/09	<u>341,776</u>	<u>\$ 1.40</u>
Non-vested at 7/31/09	341,776	\$ 1.40
Granted	210,250	0.82
Vested	(196,812)	1.27
Forfeited	(72,686)	1.23
Non-vested at 7/31/10	<u>282,528</u>	<u>\$ 1.09</u>

The weighted average remaining vesting period was 2.19 years at July 31, 2010

Stock Warrants

On April 24, 2003, in exchange for previously outstanding securities, we issued to a group of investors warrants for 250,000 common shares, exercisable at \$1.00 per share that expire on December 21, 2010.

11. Income Taxes

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

	<u>2010</u>	<u>2009</u>
Current:		
Federal	\$ -	\$ 6
State	6	29
Change in the beginning deferred tax asset valuation allowance	(1,402)	(502)
Deferred, net	<u>102</u>	<u>590</u>
Income tax (benefit) expense from continuing operations	<u>\$ (1,294)</u>	<u>\$ 123</u>
Income tax benefit from discontinued operations	<u>\$ (262)</u>	<u>\$ -</u>

Provision for income taxes is based on taxes payable under currently enacted tax laws and an analysis of temporary differences between the book and tax bases of our assets and liabilities, including various accruals, allowances, depreciation and amortization. The tax effect of these temporary differences and the estimated tax benefit from tax net operating losses are reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed. To the extent that management believes it is more likely than not that some portion, or all, of the deferred tax asset will not be realized, a valuation allowance is established. This assessment is based on all available evidence, both positive and negative, in evaluating the likelihood of realizability. Issues considered in the assessment include future reversals of existing taxable temporary differences, estimates of future taxable income (exclusive of reversing temporary differences and carryforwards) and prudent tax planning strategies available in future periods. Because ultimately the realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as valuation allowances is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the tax provision in the statement of operations.

In fiscal 2010 we had a change in our estimated valuation allowance. This change resulted from an extension of the number of years used in the forecast to determine net operating loss utilization. Historically, in determining the amount of net operating loss carryforwards that would be utilized, we projected our taxable income for twelve quarters, with the assumption that any forecast beyond three years was not meaningful. In fiscal 2010 we determined that we were in a position to forecast taxable income for the remaining life of our current net operating loss carryforwards for the following reasons:

- We have experienced six consecutive profitable years of operations, while at the same time integrating four acquisitions. Although we incurred a taxable loss in fiscal 2010, these losses were primarily due to the results of our discontinued operation as well as one-time restructuring costs that are not expected to continue.
- We continued to grow both organically and through acquisitions and is now at a stage where our operating structure and costs are more sustainable.
- We established a strategic plan to focus on our core offerings: electronic catalogs, websites and lead management services. This plan encompassed the discontinuation of several products and the sale of a non-strategic and underperforming subsidiary, thereby reducing our cost structure. This strategic plan is expected to provide more stability going forward.

The Company had a change in its estimated valuation allowance in fiscal 2009 primarily due to a change in its projections of taxable income for the next twelve quarters. We will continue to evaluate the realizability of deferred tax assets on a semi-annual basis.

Significant components of our deferred tax liabilities and assets as of July 31 were as follows (in thousands):

	<u>2010</u>	<u>2009</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 6,808	\$ 8,235
Alternative minimum tax credit carryforwards	85	96
Deferred revenue	1,918	2,032
Software product costs	214	378
Intangible assets	233	81
Other	<u>1,074</u>	<u>837</u>
Total deferred tax assets	10,332	11,659
Valuation allowance for deferred tax assets	<u>(5,657)</u>	<u>(8,747)</u>
Net deferred tax assets	4,675	2,912
Deferred tax liabilities:		
Software product costs and other	(297)	(208)
Goodwill	<u>(162)</u>	<u>(50)</u>
Net deferred taxes	<u>\$ 4,216</u>	<u>\$ 2,654</u>

As of July 31, 2010, we had unused net operating loss carryforwards for federal income tax purposes of \$17,852,000 expiring in 2011 through 2030. Of these unused federal net operating loss carryforwards, \$2,038,000 expire between 2012 and 2014 and are limited to \$116,000 annually that can be utilized to offset taxable income. Use of these net operating loss carryforwards is restricted under Section 382 of the Code because of changes in ownership in 1997.

In addition, we have net operating loss carryforwards for state income tax purposes totaling approximately \$12,310,000 expiring in 2011 through 2025.

A reconciliation between income tax expense and income taxes computed by applying the statutory federal income tax rate of 34% and the state rate of approximately 6% to U.S. based income before income taxes is as follows (in thousands):

	2010	2009
Computed income taxes at 40%	\$ 14	\$ 395
Permanent items	91	93
Change in the beginning deferred tax asset valuation allowance	(1,402)	(502)
Effective rate adjustments and other	3	137
Income tax expense (benefit) from continuing operations	<u>\$ (1,294)</u>	<u>\$ 123</u>
Income tax benefit from discontinued operations	<u>\$ (262)</u>	<u>\$ -</u>

During fiscal 2010 and fiscal 2009, \$4,231,000 and \$6,047,000, respectively, of federal net operating loss carryforwards expired. These expired net operating loss carryforwards have been included in the calculation of the change in valuation allowance.

We perform an evaluation of uncertain tax positions as a component of income tax expense on an annual basis. We determined that ARI did not have any significant risk related to income tax expense and therefore no amounts were reserved for uncertain tax positions as of July 31, 2010 and 2009. We will accrue and recognize interest and penalties related to uncertain tax positions as a component of income tax expense if it becomes necessary. Fiscal years subsequent to 2006 remain open and subject to examination by state tax jurisdictions and the United States federal tax authorities.

12. Employee Benefit Plan

ARI has a qualified retirement savings plan (the "401(k) Plan") covering its employees. Each employee may elect to reduce his or her current compensation by up to 50%, up to a maximum of \$16,500 (\$22,000 over age 50) in calendar 2010 (subject to adjustment in future years) and have the amount of the reduction contributed to the 401(k) Plan. Company contributions to the 401(k) Plan are at the discretion of the Board of Directors. During fiscal 2010 and fiscal 2009, we issued 58,332 and 32,955 shares of common stock, respectively, as a discretionary contribution to the 401(k) Plan. The amounts charged to expense for the 401(k) contributions, net of forfeitures, were \$62,000 during fiscal 2010 and \$45,000 during fiscal 2009.

13. Restructuring

In July 2008 ARI announced a restructuring that consolidated our data conversion operations in Virginia into our Wisconsin location and consolidated our software development operations in Colorado into our California location. Adjustments were made to the restructuring reserve during fiscal 2010 to reflect changes to our assumptions regarding our ability to sublet the vacant office space in Colorado and the present value of the net future lease costs through March 2011. The following represents changes to the restructuring reserve, which is included in other accrued liabilities on the balance sheet (in thousands):

	Severance and related benefits	Net future lease costs	Software and equipment impairments	Total
Balance at 7/31/08	\$ 292	\$ 204	\$ 33	\$ 529
Payments	(292)	(111)	-	(403)
Disposals	-	-	(33)	(33)
Balance at 7/31/09	\$ -	\$ 93	\$ -	\$ 93
Payments	-	(114)	-	(114)
Adjustments to restructuring charges	-	101	-	101
Balance at 7/31/10	\$ -	\$ 80	\$ -	\$ 80

In July 2010, in an effort to focus on our core business, which includes electronic catalogs, websites, and lead management services, we undertook a workforce reduction and business improvement initiative, which included the divestiture of AFIS and the write off of certain components of capitalized software related to products no longer in use or with limited future cash flows that are no longer considered a part of our core operation.

The following represents restructuring charges incurred in fiscal 2010 from continuing operations (in thousands):

Severance and related benefits	\$ 147
Software impairments	<u>189</u>
Total restructuring costs	<u>\$ 336</u>

The following represents the restructuring charges incurred in fiscal 2010 with respect to the AFIS divestiture, which were included in discontinued operations (in thousands):

Severance and related benefits	\$ 27
Other accrued liabilities	<u>83</u>
Total restructuring costs	<u>\$ 110</u>

The accrued severance and related restructuring reserve from continuing operations, which is included in accrued payroll and related liabilities on the balance sheet, is \$147,000 as of July 31, 2010 and will be fully paid during fiscal 2011. The accrued restructuring from discontinued operations, which is included in other accrued liabilities on the balance sheet, is \$110,000 as of July 31, 2010 and will have payments continuing through fiscal 2013.

14. Discontinued Operations

On July 27, 2010, we divested AFIS, which offered dealer F&I services. The divestiture resulted in a loss from discontinued operations of \$1,000. The results of operations of AFIS have been reflected as a discontinued operation in our consolidated financial statements for all periods presented. The results of operations of AFIS were previously reported within the United States business segment.

	<u>2010</u>	<u>2009</u>
Revenues	\$ 136	\$ 77
Cost of sales	13	12
Operating expenses	<u>776</u>	<u>406</u>
Operating loss	(653)	(341)
Loss on sale	(1)	-
Income tax benefit (1)	<u>262</u>	<u>-</u>
Net loss	<u>\$ (392)</u>	<u>\$ (341)</u>

(1) Net of recorded deferred income tax asset valuation allowance

15. Business Segments

Our business segments are internally organized primarily by geographic location of the operating facilities. In accordance with GAAP regarding disclosures about business segments, we have segregated the Netherlands operation and the United States operations into separate reportable segments. Segment revenue for the Netherlands operation includes only revenue generated out of the Netherlands subsidiary and does not include rest of world revenue sold by the United States operation. We evaluate the performance of and allocate resources to each of the segments based on their operating results.

Information concerning our operating business segments for fiscal 2010 and fiscal 2009 is as follows (in thousands):

	<u>2010</u>	<u>2009</u>
Revenue from continuing operations:		
Netherlands	\$ 689	\$ 652
United States	20,795	16,908
Consolidated	<u>\$ 21,484</u>	<u>\$ 17,560</u>
Net income (loss) from continuing operations:	<u>2010</u>	<u>2009</u>
Netherlands	\$ (159)	\$ (100)
United States	1,328	865
Consolidated	<u>\$ 1,169</u>	<u>\$ 765</u>
Total Assets	<u>July 31</u> <u>2010</u>	<u>July 31</u> <u>2009</u>
Netherlands	\$ 328	\$ 227
United States	19,449	18,380
Consolidated	<u>\$ 19,777</u>	<u>\$ 18,607</u>

16. Related Party

Briggs & Stratton Corporation ("Briggs") is one of our customers and owns approximately 11% of ARI stock. Briggs has entered into customer contracts with us and has provided vendor services to us in the ordinary course of business. Generally, the customer contracts are for one to three years and renew annually thereafter unless either party elects otherwise. We invoiced Briggs approximately \$371,000 and \$416,000 for products and services provided during fiscal 2010 and fiscal 2009, respectively. Briggs had unpaid net trade receivables of \$15,000, or 1%, and \$201,000, or 15%, of total trade receivables outstanding as of July 31, 2010 and 2009, respectively, \$0 of which was over 90 days at July 31, 2010 or 2009.

The vendor services provided by Briggs are for printing of materials which are generally resold to customers and included in cost of sales. Briggs invoiced us approximately \$55,000 and \$105,000 for printing services during fiscal 2010 and fiscal 2009, respectively, \$2,000 of which were unpaid as of July 31, 2010 and 2009.

Gordon J. Bridge serves on our board of directors. He was assigned by the board to be the lead Director for AFIS, for which he was paid \$57,050 in fiscal 2010. We had accrued but unpaid expenses of \$17,050 at July 31, 2009. There were no unpaid expenses at July 31, 2010.

17. Litigation

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

18. Subsequent Events

We evaluated whether any events or transactions occurred after the balance sheet date that would require recognition or disclosure in our financial statements in accordance with GAAP, and determined that there were no events that occurred after July 31, 2010, but prior to October 29, 2010 that would affect the financial statements for the period ending July 31, 2010.