ARI NETWORK SERVICES INC /WI
Form 10-K
October 29, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended July 31, 2014

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

For the transition period from   to

Commission File Number 000-19608

ARI Network Services, Inc.

(Exact name of registrant as specified in its charter)

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

10850 West Park Place, Suite 1200,

Milwaukee, Wisconsin	53224
(Address of principal executive office)	(Zip Code)

(414) 973-4300

Registrant's telephone number, including area code

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

Name of each exchange

Title of each class   on which registered

Common Stock, par value

$0.001 per share   NASDAQ Capital Market

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

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

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

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.   Yes   No

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

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

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

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price of the registrant's common stock on January 31, 2014 as reported on the NASDAQ Capital Market, was $21,000,000.

As of October 20, 2014, there were 14,197,438 shares of the registrant's shares outstanding.

2

ARI Network Services, Inc.

FORM 10-K

FOR THE FISCAL YEAR ENDED JULY 31, 2014

INDEX

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

PART I

Item 1. Business

Overview

ARI Network Services, Inc. offers an award-winning suite of data-driven software tools and marketing services to help dealers, equipment manufacturers and distributors in selected vertical markets Sell More Stuff!™ – online and in-store. Our innovative products are powered by a proprietary data repository of enriched original equipment and aftermarket electronic content spanning more than 10.5 million active part and accessory SKUs, 469,000 models and $1.7 billion in retail product value. Business is complicated, but we believe our customers' technology tools don't have to be. We remove the complexity of selling and servicing new and used vehicle inventory, parts, garments and accessories ("PG&A") for customers in the automotive tire and wheel aftermarket("ATW"), powersports, outdoor power equipment ("OPE"), marine, home medical equipment ("HME"), recreational vehicles ("RV") and appliance industries. More than 22,000 equipment dealers, 195 distributors and 1,500 manufacturers worldwide leverage our web and eCatalog platforms to Sell More Stuff!™

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

Our Solutions

Our software as a service ("SaaS") and data as a service ("DaaS") solutions include: (i) eCommerce-enabled websites, which provide a web presence for dealers and serve as a platform for driving leads and eCommerce sales; (ii) eCatalog content, which drives sales of inventory and PG&A both online and within the dealership; and (iii) lead management software designed to increase sales for dealers through more efficient management and improved closure of leads. Our solutions also improve our customers' overall customer satisfaction through a highly efficient and accurate data lookup experience at the parts counter and a quicker response time to online inquiries, both of which serve to significantly improve a customer's overall experience with the dealer.

Our SaaS and DaaS solutions are sold through our internal sales force and are composed primarily of recurring license and eCatalog subscriptions. Customers typically sign annual, auto-renewing contracts. Today, more than 90% of our revenues are recurring.

In addition to our award-winning SaaS and DaaS solutions, ARI offers a suite of complementary products and services designed to supplement our three primary offerings in order to help our customers Sell More Stuff!™

Web Platform Solutions

Our eCommerce-enabled website solutions provide consumers with information about a dealership and its product lines through our extensive library of electronic catalog content and allow consumers to obtain information on whole goods and purchase PG&A via the dealers' website 24 hours a day, 7 days a week. Our website solutions are tailored to each of the vertical markets we serve and tightly integrated with our electronic library of inventory and PG&A content. We also offer a mobile solution that allows dealers' websites to be fully functional on smart mobile phones.

4

Websites are sold through our inside sales teams, which are aligned by vertical market. The sales process will typically include a live demo of the site and may even include a free trial period (we refer to these as "test drives"). We typically charge a nominal, one-time set-up fee to develop a new dealer website, monthly recurring subscription fees and variable transaction fees. Our website solutions are typically sold under one year, renewable contracts with monthly payment terms. We estimate that as of July 31, 2014, we host and maintain more than 6,100 websites for dealers in all of our vertical markets. Websites have become ARI's largest source of revenue and accounted for 51% of total revenue during fiscal 2014.

eCatalog Platform Solutions

Our eCatalog solutions, which encompass our PartSmart®, PartSmart Web™, PartStream™ and AccessorySmartTM products, leverage our industry-leading library of electronic whole goods and PG&A content to allow distributors and dealers to view and interact with this information to efficiently support the sales and service of equipment. We believe that our eCatalog solution is the fastest and most efficient in the market, as it allows multi-line dealers to quickly access data for any of the brands serviced from within the same software, allowing the dealer's parts and service operations to more quickly identify, locate and sell products and services to their customers. Our eCatalog solutions include:

PartSmart®, our CD-based electronic parts catalog, is used by dealers worldwide in the OPE, powersports, marine, appliance and agricultural equipment industries to increase productivity by significantly reducing parts lookup time. Our PartSmart® software is designed to allow multi-line dealers to look up parts and service information for all manufacturer product lines that the dealer carries, and integrates with more than 90 of the leading dealer business management systems.

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

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

AccessorySmartTM, a SaaS solution, is the only aftermarket PG&A lookup product of its kind, providing access to more than 500,000 SKUs from more than 1,400 powersports aftermarket manufacturers. AccessorySmart provides parts and service counter personnel a one-stop resource to look up products, cost and availability for all of the leading aftermarket PG&A distributors. AccessorySmart significantly decreases the time it takes to look up PG&A information and availability, allowing dealers to service and sell more stuff to customers on a given day.

Our eCatalog products are sold through our dedicated internal sales team and accounted for approximately 43% of our total revenue during fiscal 2014. Fees charged for the use of our eCatalog products include a recurring license fee, subscription fees for subscribed catalogs, and in some cases, page view fees.

Lead Management Product

Our award-winning SaaS solution, Footsteps™, is designed to efficiently manage and nurture generated leads, increasing conversion rates and ultimately revenues for our customers. Footsteps™ connects equipment manufacturers with their dealer channel through lead consolidation and distribution, and allows the dealers to handle leads more efficiently and professionally through marketing automation and business management system integration. The product is used as a complete database of customers and prospects, and manages the dealer-to-customer relationship, from generating email campaigns and automated responses, to providing sales teams with a daily follow-up calendar and reminder notices.   We derived approximately 3% of our revenues from Footsteps™ during fiscal 2014.

Digital Marketing

Our digital marketing solutions provide lead generation tools through search engine optimization, social media marketing and website enhancements, which serve to increase traffic to our eCommerce platform and at the dealership, in addition to increasing on-line sales and leads. We derived approximately 1% of our revenues from digital marketing services during fiscal 2014. Digital marketing services is a relatively new service offering by ARI and in the third quarter of fiscal 2014, we went to market with a more robust offering in the space as a result of our continued integration of the DUO Web Solutions business ("DUO") we acquired in November 2013.

5

Other Solutions

We also offer a suite of complementary solutions, which include software, website customization, professional services and hosting services. On a combined basis, these other services accounted for approximately 2% of revenue during fiscal 2014.

Our Growth Strategy

ARI's goal is to become the leading provider of SaaS and DaaS solutions that help our customers, efficiently and effectively sell more major units, replacement parts, accessories, and service – in other words, to Sell More Stuff!™   Our continued goal is to grow revenues at a double-digit rate and to grow earnings through scalability. We will accomplish this goal by deploying our solutions to dealers, distributors, manufacturers, service providers, and consumers in selected vertical markets where the finished goods are complex equipment requiring service that are primarily sold and serviced through an independent dealer channel. We believe this strategy will drive increased value to our shareholders, employees, and customers.

We also believe the execution of the following strategic pillars will enable us to achieve the growth and profitability needed to drive long-term sustainable value for our shareholders. These strategic foundations are primarily centered on enhancing the value proposition to our customers, which will lead to additional revenues through pricing actions, product and feature upsells, reduced customer churn rates, and expansion by leveraging our core competencies in new complimentary markets. Each of these strategic pillars is a long-term foundation for growth; within each we have established near-term goals, as discussed below.

Drive organic growth through innovative new solutions, differentiated content, entering new markets and expanding geographically.

As a subscription-based, recurring revenue ("RR") business, the most important drivers of future growth are nurturing and defending our customer base, developing and selling additional products to our existing customer base, and acquiring new customers. We define RR as revenue from products and services which are subscription-based and renewable, including software access fees, data content fees, maintenance and support fees and hosting fees, and we define churn as the percentage of RR that does not renew. In fiscal 2014, our RR increased 14.4% over last year and the percentage of our total revenues that were RR were over 90% in fiscal 2014 and 2013.

· Develop and deploy innovative new solutions. We have resources assigned to each of our core products that continue to research and develop new value-added features and functionality for our existing products. The introduction of new solutions, upgrades to existing products, and new feature sets are all designed to grow our average revenue per dealer ("ARPD"), an important measure for a subscription-based business, and the increase in our

customer base serves to quickly compound the benefits of an increased ARPD. In fiscal 2014, we released a number of new features, upgrades and products including the following:

Web Platform

o We released a completely redesigned website administration panel that is tablet-friendly, presents retailers with a clear view of the most important website value metrics, and introduces a wide array of updated tools to reduce the time and effort required to update inventory and website content.
o We also worked with an independent national Search Engine Optimization ("SEO") firm to develop and implement enhanced strategies to further optimize our entire website platform, utilizing new emerging technologies, ensuring our web platform delivers the best out of the box organic search performance.
o We developed new supplier integrations to enable retailers to present expanded real-time pricing to website shoppers, as well as seamlessly forward orders to suppliers for drop-shipment.
o We integrated an all new search technology that significantly reduces the time to return shopping search results, while also introducing new search capabilities to enable customers to easily filter available products by key attributes.
o We designed and released Wheel Studio, a website visualizer that enables consumers to view available wheels on their unique vehicle in a highly dynamic and cohesive presentation on desktop, tablet, and mobile.

eCatalog

o We developed and released a new DaaS API suite that empowers customers to build proprietary websites and applications directly on top of our market-leading PG & A catalog information. The API suite includes robust fitment search capabilities, image edge caching, and more, across all major power sports PG & A manufacturers.

6

o We launched a new version of PartSmart Data Manager, which includes automatic diagram hotspotting that finds and links diagram callouts to associated items in the parts list; enhanced part, assembly and attachment search utilities; as well as enhanced data import features.

o We released an update for PartSmart, which expands the scalability and international localization capabilities, as well as introduces the ability to automatically receive parts catalog pricing updates via the internet.

o We released a number of updates to our AccessorySmart product, introducing the ability to brand customer pick lists, view key unit technical specifications, integrate with ADP Lightspeed's EVO business management system, and more.

o We released updated tools for our AccessoryStream product including a new SEO control designed to optimize product presentation for search engines, as well as a new pricing import utility.

· Differentiate our content. We believe we have the largest library of replacement part, major unit, and PG&A content in the vertical markets we serve. During fiscal 2014, we added 25 new accessory and 6 OEM parts catalogs to our library. However, simply offering the largest content library in the markets we serve is not sufficient to drive the long-term revenue growth we desire.   We strive to deliver more value to our customers through enrichment of our content. Content enrichment can take several forms, including the incorporation of user reviews and feedback into our existing content, further enhancing content provided to us by our OEM customers, and creating new forms of content that further our customers' ability to efficiently service and sell more whole goods and PG&A. During fiscal 2014, our enrichment activities included the introduction of color parts photography to certain OEM catalogs, as well as the introduction of key unit specifications, including fluid type and capacity requirements, to our PG&A content. We have also continued integrating analytic tools into several of our products, offering value-added feedback to our customers and channel partners to help them "Sell More Stuff!"

· Enter new markets. ARI currently maintains a significant share of the OPE and appliances markets. Accordingly, we anticipate low single-digit growth in these markets.

o Our acquisition of the Retail Services Division of Fifty Below Sales and Marketing, Inc. ("50 Below") more than doubled our website business, providing ARI entrance into two new potentially high-growth markets – Automotive Tire & Wheel ("ATW") and Home Medical Equipment ("HME"). The acquisition also catapulted the Company into one of the leaders in the power sports industry. As we continue to increase our share in our current markets, leveraging our technology in new and underserved markets will be important to maintaining substantial organic growth rates. ARI currently has more than 2,000 dealer websites in the ATW market. We estimate that the total market approximates 18,000 dealers and further, the broader automotive aftermarket comprises nearly 80,000 dealers, more than all of our other markets combined. We intend to continue to invest heavily in this market, including seeking opportunities to leverage our products and services in the broader automotive aftermarket. 50 Below was one of the first website providers to service the HME market. We estimate that this market comprises nearly 25,000 dealers, and believe the market to be in its infancy with respect to eCommerce. We recently invested in dedicated resources designed to expedite our growth in this market.

o Ready2Ride, Incorporated ("Ready2Ride"), which we acquired in August 2012, was the first to market with electronic aftermarket fitment data for the power sports industry. We estimate that the availability of this data almost doubles the size of our addressable market in the power sports industry. In February 2013, we launched our new AccessorySmartTM product. AccessorySmart is the only aftermarket PG&A lookup solution of its kind, providing access to more than 500,000 SKUs from more than 1,400 aftermarket manufacturers. AccessorySmart provides parts and service counter personnel a one-stop resource to look up products, cost and availability for all of the leading aftermarket PG&A distributors. AccessorySmart significantly decreases the time it takes to look up PG&A information and availability, allowing dealers to service and sell more customers on a given day. We plan to leverage our aftermarket publishing experience and product capabilities in our other vertical markets where the market will support it.

· Expand geographically. Although we maintain relationships with dealers throughout the world, we have low penetration into international markets. Growing our international business will require us to secure and publish electronic content from OEMs outside the U.S. and make changes to our existing products that will allow us to rapidly deploy these products in a scalable and efficient manner and without the need to have "boots on the ground" in

those countries.   To this end we have a business development resource solely dedicated to obtaining new international content and to date, we have added 10 new catalog content offerings in the international OPE market and begun to establish relationships with OEMs in China and Europe. Also, we have upgraded our product roadmaps to allow us to rapidly deploy our products in these markets as discussed above.

7

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

In order to achieve sustained double-digit organic growth, we not only need to execute the new growth strategies described above, we must also retain our existing customers. In a SaaS business, the cost to retain an existing customer is much less than the cost to acquire a new customer. Accordingly, customer churn is one of the most important metrics we track and manage. We experienced marked improvements in our churn rates the past several years as a result of strategic actions taken by the Company, all of which are designed to enhance the "stickiness" of our product within our customers' operations. We have reduced the rate of customer churn in each of the last four fiscal years. In fiscal 2014, customer churn improved to 12.6% from 12.8% in fiscal 2013. We will continue to leverage our relationships with existing customers and closely monitor and manage the level of customer churn.

Lead the market with open integration to related platforms.

One of our strategic advantages is our focus on integrating our solutions with dealer business management systems ("DMS") in order to pass key information, including customer and transactional data, between our solutions and the DMS, saving our customers valuable time and eliminating redundant data entry. In fiscal 2014 we furthered this goal by introducing a new integration with the ADP Lightspeed EVO DMS. We currently have integration capabilities with over 90 DMSs (we refer to these relationships as "Compass Partners") and we continue to seek other strategic alliances that can be integrated with our product and service offerings.

During fiscal 2014, we also completed new supplier integrations that drive the display of real-time pricing from suppliers directly to website customers, as well as introduced new functionality to support order forwarding to suppliers for drop shipment to customers. To further enhance our forward open integration capabilities, we also developed a new universal API for adding and maintaining unit inventory on our website platform, which will enable us to quickly connect third party systems and software to automate changes in unit inventory disposition.

Successfully execute acquisitions that align with our core strategy

Since 1995 we have had a formal corporate development program aimed at identifying, evaluating and closing acquisitions that align with our strategy. Since the program's inception until the end of fiscal 2014, we closed thirteen acquisitions, and we completed an additional acquisition on September 30, 2014. A summary of some of our most recent acquisitions is as follows: