

NETSOL TECHNOLOGIES INC  
Form 10QSB  
November 14, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934

For the quarterly period ended September 30, 2006

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-22773

NETSOL TECHNOLOGIES, INC.  
(Exact name of small business issuer as specified in its charter)

NEVADA  
(State or other  
Jurisdiction of  
Incorporation  
or  
Organization)

95-4627685  
(I.R.S.  
Employer  
NO.)

23901 Calabasas Road, Suite 2072, Calabasas, CA 91302  
(Address of principal executive offices) (Zip Code)

(818) 222-9195 / (818) 222-9197  
(Issuer's telephone/facsimile numbers, including area code)

Check whether the issuer: (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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

The issuer had 17,647,396 shares of its \$.001 par value Common Stock issued and outstanding as of November 10, 2006.

Transitional Small Business Disclosure Format (check one)

Yes  No

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NETSOL TECHNOLOGIES, INC.

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## NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET — SEPTEMBER 30, 2006  
(UNAUDITED)

## ASSETS

**Current assets:**

Cash and cash equivalents	\$ 3,822,420
Accounts receivable, net of allowance for doubtful accounts of \$106,090	6,356,012
Revenues in excess of billings	5,103,259
Other current assets	2,666,324
<b>Total current assets</b>	<b>17,948,015</b>

<b>Property and equipment</b> , net of accumulated depreciation	<b>6,411,173</b>
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**Intangibles:**

Product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, net	5,615,521
Customer lists, net	2,948,387
Goodwill	6,092,906
<b>Total intangibles</b>	<b>14,656,814</b>

<b>Total assets</b>	<b>\$ 39,016,002</b>
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## LIABILITIES AND STOCKHOLDERS' EQUITY

**Current liabilities:**

Accounts payable and accrued expenses	\$ 4,422,167
Current portion of notes and obligations under capitalized leases	698,701
Other payables - acquisitions	60,637
Billings in excess of revenues	1,085,816
Due to officers	231,955
Loans payable, bank	988,957
<b>Total current liabilities</b>	<b>7,488,233</b>

<b>Obligations under capitalized leases</b> , less current maturities	<b>164,947</b>
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<b>Convertible notes payable - net</b>	<b>4,203,460</b>
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<b>Total liabilities</b>	<b>11,856,640</b>
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<b>Minority interest</b>	<b>1,874,319</b>
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**Commitments and contingencies**

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**Stockholders' equity:**

Common stock, \$.001 par value; 45,000,000 share authorized; 17,618,289 issued and outstanding	17,618
Additional paid-in-capital	59,517,012
Treasury stock	(10,194)
Accumulated deficit	(32,968,005)
Stock subscription receivable	(1,041,750)
Common stock to be issued	263,512
Other comprehensive loss	(493,150)
<b>Total stockholders' equity</b>	<b>25,285,043</b>

<b>Total liabilities and stockholders' equity</b>	<b>\$ 39,016,002</b>
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See accompanying notes to these unaudited consolidated financial statements.



**NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	For the Three Months Ended September 30,	
	2006	2005
<b>Revenues:</b>		
Licence fees	\$ 1,578,412	\$ 462,478
Maintenance fees	1,294,964	525,915
Services	2,989,184	3,481,592
Total revenues	5,862,560	4,469,985
<b>Cost of revenues:</b>		
Salaries and consultants	1,902,812	1,141,534
Travel and entertainment	339,676	165,599
Communication	42,065	23,804
Depreciation and amortization	162,518	122,668
Other	364,489	213,745
Total cost of sales	2,811,560	1,667,350
<b>Gross profit</b>	<b>3,051,000</b>	<b>2,802,635</b>
<b>Operating expenses:</b>		
Selling and marketing	351,802	318,864
Depreciation and amortization	488,643	552,531
Bad debt expense	65,808	-
Salaries and wages	1,050,106	536,376
Professional services, including non-cash compensation	278,005	139,111
General and administrative	975,843	583,547
Total operating expenses	3,210,207	2,130,429
<b>Income (loss) from operations</b>	<b>(159,207)</b>	<b>672,206</b>
<b>Other income and (expenses)</b>		
Gain (loss) on sale of assets	(12,280)	391
Beneficial conversion feature	-	(6,569)
Fair market value of warrants issued	-	(9,489)
Amortization of debt discount and capitalized cost of debt	(734,659)	-
Gain on forgiveness of debt	-	3,641
Interest expense	(249,790)	(79,023)
Interest income	90,746	84,412
Other income and (expenses)	69,323	(32,503)
Income taxes	(52,824)	(62,108)
Total other expenses	(889,484)	(101,248)
<b>Net income (loss) before minority interest in subsidiary</b>	<b>(1,048,691)</b>	<b>570,958</b>
<b>Minority interest in subsidiary</b>	<b>(247,273)</b>	<b>(367,213)</b>
<b>Net income (loss)</b>	<b>(1,295,964)</b>	<b>203,745</b>
<b>Other comprehensive loss</b>		
Translation adjustment	(73,490)	(120,820)
<b>Comprehensive income (loss)</b>	<b>\$ (1,369,454)</b>	<b>\$ 82,925</b>
<b>Net income (loss) per share</b>		
Basic	\$ (0.08)	\$ 0.01
Diluted	\$ (0.08)	\$ 0.01

Weighted average number of shares outstanding		
Basic	17,046,715	13,897,883
Diluted	17,046,715	14,246,614

See accompanying notes to these unaudited consolidated financial statements.

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

	For the Three Months Ended September 30,	
	2006	2005
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (1,295,964)	\$ 203,745
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	651,161	644,733
Bad debt expense	65,808	-
Gain on settlement of debt	-	(3,641)
(Gain) loss on sale of assets	12,280	(391)
Minority interest in subsidiary	247,273	367,213
Stock issued for services	30,600	60,856
Fair market value of warrants and stock options granted		9,489
Beneficial conversion feature	-	6,569
Amortization of debt discount and capitalized cost of debt	734,659	-
<b>Changes in operating assets and liabilities:</b>		
<b>Increase in assets:</b>		
Accounts receivable	(250,489)	(123,256)
Other current assets	(354,871)	(1,731,193)
<b>Decrease in liabilities:</b>		
Accounts payable and accrued expenses	(520,473)	(540,968)
Other payable - acquisition	(4,025,567)	-
<b>Net cash used in operating activities</b>	<b>(4,705,583)</b>	<b>(1,106,844)</b>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(238,323)	(817,676)
Sales of property and equipment	24,553	91,046
Purchases of certificates of deposit	-	(2,282,097)
Proceeds from sale of certificates of deposit	1,739,851	-
Increase in intangible assets	(585,631)	(211,844)
<b>Net cash provided by (used in) investing activities</b>	<b>940,450</b>	<b>(3,220,571)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from the exercise of stock options	-	288,062
Capital contributed from sale of subsidiary stock	-	4,031,001
Reduction in restricted cash	4,533,555	-
Proceeds from loans from officers	165,000	-
Proceeds from convertible notes payable & interest	167,489	-
Payments on capital lease obligations & loans - net	237,702	91,236
<b>Net cash provided by financing activities</b>	<b>5,103,746</b>	<b>4,410,299</b>
<b>Effect of exchange rate changes in cash</b>	<b>(9,961)</b>	<b>14,543</b>
<b>Net increase in cash and cash equivalents</b>	<b>1,328,652</b>	<b>97,427</b>
Cash and cash equivalents, beginning of period	2,493,768	1,371,727
<b>Cash and cash equivalents, end of period</b>	<b>\$ 3,822,420</b>	<b>\$ 1,469,154</b>



See accompanying notes to the unaudited consolidated financial statements.

## NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
(UNAUDITED)

	For the Three Months Ended September 30,	
	2006	2005
<b>SUPPLEMENTAL DISCLOSURES:</b>		
<b>Cash paid during the period for:</b>		
Interest	\$ 70,013	\$ 57,398
Taxes	\$ -	\$ -
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Stock issued for accrued expenses and payables	\$ 15,000	\$ -
Stock issued for intangible assets	\$ 137,360	\$ -
Common stock issued for conversion of convertible debenture	\$ -	\$ 50,000
Common stock issued for acquisition of subsidiary	\$ 1,582,328	\$ -

See accompanying notes to the unaudited consolidated financial statements.

**NETSOL TECHNOLOGIES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION**

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

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

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

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

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

**NOTE 2 - USE OF ESTIMATES:**

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

**NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS:**

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

derivatives, and amends SFAS No. 140 to eliminate the prohibition on the qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for all financial instruments acquired or issued after the beginning of the Company's first fiscal year that begins after September 15, 2006. SFAS No. 155 is not expected to have a material effect on the consolidated financial position or results of operations of the Company.

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

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

2. Requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable.
3. Permits an entity to choose 'Amortization method' or 'Fair value measurement method' for each class of separately recognized servicing assets and servicing liabilities.
4. At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value.
5. Requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

This Statement is effective as of the beginning of the Company's first fiscal year that begins after September 15, 2006. Management believes that this statement will not have a significant impact on the consolidated financial statements.

In September 2006, FASB issued SFAS 157 'Fair Value Measurements'. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on the consolidated financial statements.

In September 2006, FASB issued SFAS 158 'Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)' This Statement improves financial reporting by requiring an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements:

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

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

**NOTE 4 - EARNINGS/(LOSS) PER SHARE:**

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

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

<b>For the three months ended September 30, 2006</b>	<b>Net Income</b>	<b>Shares</b>	<b>Per Share</b>
Basic earnings (loss) per share:	\$ (1,295,964)	17,046,715	\$ (0.08)
Net income available to common shareholders			
Effect of dilutive securities *			
Stock options			
Warrants			
Diluted earnings per share	\$ (1,295,964)	17,046,715	\$ (0.08)

<b>For the three months ended September 30, 2005</b>	<b>Net Income</b>	<b>Shares</b>	<b>Per Share</b>
Basic earnings per share:	\$ 203,745	13,897,883	\$ 0.01
Net income available to common shareholders			
Effect of dilutive securities			
Stock options		347,064	
Warrants		1,667	
Diluted earnings per share	\$ 203,745	14,246,614	\$ 0.01

\* As there is a loss, these securities are anti-dilutive. The basic and diluted earnings per share is the same for the three months ended September 30, 2006

#### **NOTE 5 - FOREIGN CURRENCY:**

The accounts of NetSol Technologies UK, Ltd., and NetSol-CQ Ltd. use the British Pound; NetSol Technologies, (PVT), Ltd, NetSol Connect PVT, Ltd., NetSol Omni, and NetSol-TiG use Pakistan Rupees; and NetSol Abraxas Australia Pty, Ltd. uses the Australian dollar as the functional currencies. NetSol Technologies, Inc., and subsidiary McCue Systems, Inc., use the U.S. dollar as the functional currency. Assets and liabilities are translated at the exchange rate on the balance sheet date, and operating results are translated at the average exchange rate throughout the period. Accumulated translation losses of \$493,150 at September 30, 2006 are classified as an item of accumulated other comprehensive loss in the stockholders' equity section of the consolidated balance sheet. During the three months ended September 30, 2006 and 2005, comprehensive loss in the consolidated statements of operations included translation loss of \$73,490 and \$120,820, respectively.

#### **NOTE 6 - OTHER CURRENT ASSETS**

Other current assets consist of the following at September 30, 2006:

Prepaid Expenses	\$ 1,392,772
Advance Income Tax	131,196
Employee Advances	105,595
Security Deposits	105,239
Other Receivables	252,231
Other Assets	101,788
Debt issuance costs	577,503
Total	\$ 2,666,324





**NOTE 7 - DEBTS****NOTES PAYABLE**

Notes payable as of September 30, 2006 consist of the following:

Name	Balance at 9/30/06	Current Maturities	Long-Term Maturities
D&O Insurance	\$ 18,892	\$ 18,892	\$ -
Professional Liability Insurance	-	-	-
Noon Group	528,582	528,582	-
Subsidiary Capital Leases	151,227	151,227	-
	\$ 698,701	\$ 698,701	\$ -

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

In January 2006, the Company renewed its directors and officers' liability insurance for which the annual premium is \$185,000. In January 2006, the Company arranged financing with AFCO Credit Corporation with a down payment of \$19,007 with the balance to be paid in nine monthly installments of \$19,007 each. The balance owing as of September 30, 2006 was \$18,892.

In February 2005, the Company received a loan from Noon Group in the amount of \$500,000. The note carries an interest rate of 9.75% per annum and is due in one year. The maturity date of the loan may be extended at the option of the holder for an additional year. In March, 2006, the note was extended for another year. During the quarter ended September 30, 2006, \$12,288 of accrued interest was recorded for this loan. Total accrued interest added to the loan at September 30, 2006 was \$28,582.

In addition, the various subsidiaries had current maturities of capital leases of \$151,227 as of September 30, 2006.

**BANK NOTE**

The Company's Pakistan subsidiary, NetSol Technologies (Private) Ltd., has one loan with a bank, secured by the Company's assets. The note consists of the following as of September 30, 2006:

TYPE OF LOAN	MATURITY DATE	INTEREST RATE	BALANCE USD
Export Refinance	Every 6 months	9%	\$ 988,957
Total			\$ 988,957

**OTHER PAYABLE - ACQUISITION**

CQ System

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

### McCue Systems

On June 30, 2006, the acquisition with McCue Systems, Inc. ("McCue") closed (see Note 14). As a result, the first installment consisting of \$2,117,864 cash and 958,213 shares of the Company's restricted common stock was recorded. The cash portion was shown as "Other Payable - Acquisition" and the stock was shown as "Shares to Be Issued" as of June 30, 2006. During the quarter ended September 30, 2006, \$2,057,227 of the cash portion of was paid to the McCue shareholders leaving a balance to be paid of \$60,637. This represents the few remaining McCue shareholders that have not been located as of this date. In July 2006 the stock was issued.

### **DUE TO OFFICERS**

The officers of the Company from time to time loan funds to the Company. One of the officers has deferred the increase in his wages. During the quarter ended September 30, 2006, \$18,750 of accrued wages was added to the balance due to officers and \$41,102 was remitted to one officer against the amounts owing to him. In addition, one subsidiary had \$33,745 due to an officer of the subsidiary.

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

The balance of due to officers as of September 30, 2006 was \$231,955.

### **NOTE 8 - STOCKHOLDERS' EQUITY:**

#### **EQUITY TRANSACTIONS**

##### **Private Placements**

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

##### **Services**

In October 2005, the Company entered into an agreement with a vendor whereby the Company agreed to issue \$2,500 worth of stock per month as payment for services rendered. The stock is to be issued after the end of each quarter. The Company issued 3,841 shares of its common stock during the quarter ended September 30, 2006 and recorded 4,334 shares of common stock valued at \$7,500 to "Stock to Be Issued" under this agreement as of September 30, 2006.

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

##### **Business Combinations:**

In June 2006, the Company completed the acquisition of McCue Systems, Inc. (see Note 14). As part of this agreement, the Company issued 930,781 shares of its restricted common stock valued at \$1,582,328 to the

shareholders of McCue Systems.

**Options and Warrants Exercised**

During the quarter ended September 30, 2006, the Company issued 470,000 shares of its common stock for the exercise of options valued at \$757,500. Of this, \$742,500 was recorded as "Stock Subscription Receivable" and \$15,000 was a cashless exercise whereby the exercise price was applied against amounts owed by the Company to a Director. In addition, 3,030 shares of the Company's common stock valued at \$5,000 was issued against payments made in the previous quarter and was recorded as a reduction in "Shares to Be Issued."

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**STOCK SUBSCRIPTION RECEIVABLE**

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

During the quarter ended September 30, 2006, issued a total of \$742,500 of new receivables. The balance at September 30, 2006 was \$1,041,750.

**COMMON STOCK PURCHASE WARRANTS AND OPTIONS**

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

Common stock purchase options and warrants consisted of the following as of September 30, 2006:

	# shares	Exercise Price	Aggregated Intrinsic Value
<b>Options:</b>			
Outstanding and exercisable, June 30, 2006	8,585,500	\$ 0.75 to \$5.00	\$ 269,125
Granted	-		
Exercised	(470,000)	\$ 0.75 to \$1.75	
Expired	-		
Outstanding and exercisable, September 30, 2006	8,115,500	\$ 0.75 to \$5.00	\$ 415,775
<b>Warrants:</b>			
Outstanding and exercisable, June 30, 2006	2,598,937	\$ 1.75 to \$5.00	\$ 13,333
Granted	-		
Exercised	-		
Expired	-		
Outstanding and exercisable, September 30, 2006	2,598,937	\$ 1.65 to \$5.00	\$ 50,667

**Options:**

There were no options granted or vested during the quarter ended September 30, 2006.

During the quarter ended September 30, 2005, a total of 320,000 options were granted to employees of the company and are fully vested and expire ten years from the date of grant unless the employee terminates employment, in which case the options expire within 30 days of their termination. The exercise price of the options ranges from \$1.75 to \$2.89. No expense was recorded for these options.

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

The company adopted SFAS No. 123-R effective July 1, 2006 using the modified prospective method. Under this transition method, stock compensation expense recognized in the quarter ended September 30, 2006 includes compensation expense for all stock-based compensation awards vested during the quarter ended September 30, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123-R. As there were no options granted or vested since the implementation of SFAS 123-R, no expense has been recorded during the quarter ended September 30, 2006.

For periods presented prior to the adoption of SFAS No. 123R, pro forma information regarding net income and earnings per share as required by SFAS No. 123R has been determined as if the Company had accounted for its employee stock options under the original provisions of SFAS No. 123. The fair value of these options was estimated using the Black-Scholes option pricing model. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. The pro forma expense to recognize during the quarter ended September 30, 2005 is as follows:

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	2005
Net income (loss) - as reported	\$ 203,745
Stock-based employee compensation expense, included in reported net loss, net of tax	-
Total stock-based employee compensation expense determined under fair-value-based method for all rewards, net of tax	(388,750)
Pro forma net loss	\$ (185,005)
Earnings per share:	
Basic, as reported	0.01
Diluted, as reported	0.01
Basic, pro forma	(0.01)
Diluted, pro forma	(0.01)

Pro forma information using the Black-Scholes method at the date of grant was based on the following assumptions:

Risk-free interest rate	3.25%
Expected life	10 years
Expected volatility	54% - 57%
Dividend yield	0%

Impact of adoption of SFAS No. 123-R in the quarter ended September 30, 2006

There was no stock compensation expense measured in accordance with SFAS No. 123-R since there were no options granted or vested during the quarter ended September 30, 2006.

#### Methods of estimating fair value

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

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

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

#### Warrants:

During the quarter ended September 30, 2005, one debenture holder converted their note into common stock. As part of the conversion, warrants to purchase a total of 13,441 common shares were issued to the note holder. The warrants expire in five years and have an exercise price of \$3.30 per share. The warrants were valued using the fair value

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method at \$9,489 or \$0.71 per share and recorded the expense in the accompanying consolidated financial statements. The Black-Scholes option pricing model used the following assumptions:

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

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**NOTE 9 - INTANGIBLE ASSETS:**

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

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

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

Product licenses and customer lists were comprised of the following as of September 30, 2006:

	Product Licenses	Customer Lists	Total
Intangible asset - June 30, 2006	\$ 10,920,327	\$ 5,438,594	\$ 16,358,921
Additions	691,711	12,500	704,211
Effect of translation adjustment	38,100	-	38,100
Accumulated amortization	(6,034,617)	(2,502,707)	(8,537,324)
Net balance - March 31, 2006	\$ 5,615,521	\$ 2,948,387	\$ 8,563,908

**Amortization expense:**

Quarter ended September 30, 2006	\$ 236,678	\$ 173,661	\$ 410,339
Quarter ended September 30, 2005	\$ 345,754	\$ 157,155	\$ 502,909

The above amortization expense includes amounts in "Cost of Goods Sold" for capitalized software development costs of \$21,454 and \$18,875 for the quarters ended September 30, 2006 and 2005, respectively.

At September 30, 2006 and 2005, product licenses, renewals, enhancements, copyrights, trademarks, and tradenames, included unamortized software development and enhancement costs of \$3,097,446 and \$1,572,675, respectively, as the development and enhancement is yet to be completed. Software development amortization expense was \$60,814 and \$27,755 for the quarters ended September 30, 2006 and 2005, respectively.

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



Asset	FISCAL YEAR ENDING					
	9/30/07	9/30/08	9/30/09	9/30/10	9/30/11	TOTAL
Product Licences	\$ 911,592	\$ 908,217	\$ 781,478	\$ 437,822	\$ 169,500	\$ 3,208,609
Customer Lists	694,644	694,644	694,644	541,008	323,448	2,948,388
	\$ 1,606,236	\$ 1,602,861	\$ 1,476,122	\$ 978,830	\$ 492,948	\$ 6,156,997

There were no impairments of the goodwill asset in the periods ended September 30, 2006 and 2005.

#### NOTE 10 - SEGMENT INFORMATION

The Company has identified three global regions or segments for its products and services. The following table presents a summary of operating information and certain year-end balance sheet information for the three months ended September 30:

	2006	2005
Revenues from unaffiliated customers:		
North America	\$ 1,303,026	\$ -
Europe	1,488,335	1,644,683
Asia - Pacific	3,071,199	2,825,302
Consolidated	\$ 5,862,560	\$ 4,469,985
Operating income (loss):		
North America	\$ (736,509)	\$ (913,708)
Europe	(136,113)	313,066
Asia - Pacific	713,415	1,272,848
Consolidated	\$ (159,207)	\$ 672,206
Identifiable assets:		
North America	\$ 14,363,555	\$ 5,839,916
Europe	5,026,237	3,345,735
Asia - Pacific	19,626,210	16,453,817
Consolidated	\$ 39,016,002	\$ 25,639,468
Depreciation and amortization:		
North America	\$ 384,965	\$ 482,991
Europe	57,691	33,609
Asia - Pacific	208,505	128,133
Consolidated	\$ 651,161	\$ 644,733
Capital expenditures:		
North America	\$ 6,795	\$ -
Europe	31,840	60,634
Asia - Pacific	199,688	757,042
Consolidated	\$ 238,323	\$ 817,676

#### NOTE 11 - MINORITY INTEREST IN SUBSIDIARY

The Company had minority interests in several of its subsidiaries. The balance of the minority interest as of September 30, 2006 was as follows:

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SUBSIDIARY	MIN INT %	MIN INT BALANCE AT 9/30/06
Connect	49.90%	\$ 266,863
NetSol-TiG	49.90%	913,634
PK Tech	28.13%	689,656
Omni	49.90%	4,166
Total		\$ 1,874,319

NetSol Connect:

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

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

For the quarters ended September 30, 2006 and 2005, the subsidiary had net loss of \$68,563 and net income of \$51,538, respectively, of which (\$34,213) and \$25,717 respectively, was recorded against the minority interest. The balance of the minority interest at September 30, 2006 was \$266,863.

NetSol-TiG:

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

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

For the quarters ended September 30, 2006 and 2005, the subsidiary had net income of \$193,563 and \$240,166, of which \$96,588 and \$119,843 was recorded against the minority interest, respectively. The balance of the minority interest at September 30, 2006 was \$913,634.

NetSol Technologies, Limited (“PK Tech”)

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

For the quarters ended September 30, 2006 and 2005, the subsidiary had net income of \$670,781 and \$952,384, of which \$188,691 and \$221,653 was recorded against the minority interest. The balance of the minority interest at September 30, 2006 was \$689,656.

Talk Trainers (Private) Limited (“Talk Trainers”) - NetSol Omni

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

For the quarter ended September 30, 2006, the subsidiary had a net loss of \$7,600, of which (\$3,792) was recorded against the minority interest. The balance of the minority interest at September 30, 2006 was \$4,167.

**NOTE 12 - CONVERTIBLE DEBENTURE**

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

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

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

**NOTE 13 - CONVERTIBLE NOTE PAYABLE**

On June 15, 2006, the Company entered into an agreement with 5 accredited investors whereby the Company issued 5 convertible notes payable for an aggregate principal value of \$5,500,000. These notes bear interest at the rate of 12% per annum and are due in full one year from the issuance date or on June 15, 2007 (the “Financing”). The Convertible Notes may immediately convert into shares of common stock of the Company at the conversion value (initially set at one share per \$1.65 of principal dollar) to the extent that such conversion does not violate Nasdaq Market Place rules. Due to the limitation rule, none of the note is convertible as of September 30, 2006. Upon the approval of the stockholders, to the extent not already converted into common shares, the Convertible Notes Payable will immediately convert into shares of Preferred Stock. On October 18, 2006, the shareholders approved the shares and on October 30, 2006 the notes were converted into 5,500 shares of Preferred Stock. During the quarter ended September 30, 2006, \$167,489 of interest was accrued. As of September 30, 2006, a total of \$194,989 in accrued interest had been recorded on the notes and was added to the principle of the notes.

The common stock shares issued under this financing agreement, including warrants, are to be registered within 120 days after closing. If the Company does not meet the registration requirement, the Company shall pay in cash as liquidated damages for such failure and not as a penalty to each Holder an amount equal to one percent (1%) of such Holder's Purchase Price paid by such Holder pursuant to the Purchase Agreement for each thirty (30) day period until the applicable Event has been cured. To date, no shares of common stock have been issued to the investors in the Financing.

As part of the agreement, the investors received warrants to purchase 1,666,668 shares of the Company's common stock. The warrants have an exercise price of \$2.00 and expire in five years. These warrants were valued using the Black-Scholes model at \$2,108,335 and have been capitalized as a contra-account against the note balance in these consolidated financial statements. These costs are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. During the quarter ended September 30, 2006, \$530,834 of these costs were amortized and recorded as "amortization of debt discount" in the accompanying consolidated financial statements. As of September 30, 2006, the balance was \$1,491,529.



The Black-Scholes pricing model used the following assumptions:

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

The net balance of the notes at September 30, 2006 was \$4,203,460.

In connection with this financing the Company paid \$474,500 in cash for placement agent fees and legal fees. These costs were capitalized and are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. During the quarter ended September 30, 2006, \$118,625 of these costs were amortized and recorded as amortization of capitalized cost of debt in the accompanying consolidated financial statements.

As part of the financing, warrants to purchase 266,666 shares of the Company's common stock were issued to the placement agent as part of their fee. The warrants have an exercise price of \$1.65 and expire in two years. These warrants were valued using the Black-Scholes model at \$340,799 and have been capitalized in these consolidated financial statements. These costs are being amortized over the life of the loan or a pro-rata basis as the loan is converted into common or preferred stock. During the quarter ended September 30, 2006, \$85,200 of these costs were amortized and recorded as amortization of capitalized cost of debt in the accompanying consolidated financial statements.

The Black-Scholes pricing model used the following assumptions:

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

#### **NOTE 14 - ACQUISITION OF McCUE SYSTEMS**

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

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

For the three  
months ended  
Sept. 30, 2005  
(Unaudited)

**Statement of operations:**

Revenues	\$	6,147,069
Cost of sales		2,484,437
Gross profit		3,662,632
Operating expenses		2,718,707
Income from operations		943,925
Other expenses		(90,137)
Income before minority interest		853,788
Minority interest in subsidiary		(367,213)
Net income	\$	486,575
Earnings per share:		
Basic	\$	0.04
Diluted	\$	0.03

**NOTE 15 - SUBSEQUENT EVENTS**

On October 18, 2006, a special meeting of the Company's shareholders was held to approve, amongst other issuances, the shares to be issued to the investors underlying the convertible note and, upon conversion, the preferred shares. On October 30, 2006, the convertible notes payable were converted into 5,500 shares of the Company's Series A 7% Cumulative Convertible Preferred stock. (See note 13). On October 20, 2006, a registration statement on form S-3 was filed to register these shares.

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

The following discussion is intended to assist in an understanding of the Company's financial position and results of operations for the quarter ending September 30, 2006.

### **Forward-Looking Information.**

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

## **INTRODUCTION**

NetSol Technologies, Inc. (F/K/A NetSol International, Inc. "NetSol" or the "Company") is an end-to-end information technology ("IT") and business consulting services provider for the lease and finance, banking and financial services industries. Since it was founded in 1997, the Company has developed enterprise solutions that help clients use IT more efficiently in order to improve their operations and profitability and to achieve business results. The Company's focus has remained the lease and finance, banking and financial services industries. The Company operates on a global basis with locations in China, Europe, East Asia and the U.S. By utilizing its worldwide resources, the Company believes it has been able to deliver high quality, cost-effective IT products and IT services. The Company's subsidiary, NetSol Technologies Ltd. ("NetSol PK") develops the majority of the software for the Company. NetSol PK was the first software company in Pakistan in 1998 to achieve the ISO 9001 accreditation and was again the first software company in Pakistan to obtain Carnegie Mellon's Software Engineering Institute ("SEI") Capable Maturity Model ("CMM") Level 4 assessment in 2004 and CMMI Level 5 now in 2006. The two recent acquisitions, of CQ Systems in the United Kingdom and McCue Systems, in the United States, add an onshore development capacity. The capacity and capability of these locations provide the Company with contingency development centers in the event of any unforeseen crises at the Lahore facility. Currently about 30% of the Company's software development takes place in these locations while 70% takes place at the Lahore technology campus.

NetSol offers a broad spectrum of IT products and IT services which management believes deliver a high return on investment for its customers. NetSol has nearly perfected its delivery capabilities by continuously investing in maturing its software development and Quality Assurance ("QA") processes. NetSol believes its key competitive advantage is its ability to build high quality enterprise applications using its offshore development facility in Lahore, Pakistan while also utilizing our facility in Beijing, China. A major portion of NetSol's revenues are derived from exports in general and LeaseSoft in particular. The use of the facility in Pakistan as the basis for software development, configuration and professional services represents a cost-effective and economical cost arbitrage model that is based on the globally acclaimed advantages of outsourcing and offshore development. In the areas of professional services, the Company is now changing its focus from just being a custom development facility to offering high end services like systems integration and technology consulting services. NetSol management believes

that the use of this model will only further benefit the Company in its penetration of US, European, developed and developing country markets.

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

The Company is divided into two groups, the Global Product Group and the Global Services Group; and three regions: North America, Europe and Asia Pacific. The North American Region is headed by John McCue, Chief Executive Officer of the Company's newly acquired subsidiary, McCue Systems, Inc. based in Burlingame, California. McCue has 35 years of experience in developing business solutions for the equipment and vehicle leasing industry as a provider of lease/loan portfolio management software for banks, leasing companies and manufacturers. Its flagship product, LeasePak, simplifies lease/loan administration and asset management by accurately tracking leases, loans and equipment from origination through end-of-term and disposition. The LeasePak brand is recognized in the US and Canadian marketplace and is configured to handle the unique tax and regulation requirements of North America. LeasePak is complementary to NetSol's LeaseSoft offering and its geographic specificity complements LeaseSoft in regions in which LeaseSoft does not currently have coverage or domain support knowledge.

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

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

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

NetSol has already initiated an active plan to gradually move some of the software production activities at NetSol-CQ to its offshore development center in Lahore. This phase of the transition plan has been completed whereby a dedicated team of software engineers and testers have been trained on the NetSol-CQ product suite and most of the quality assurance, documentation and some of the NetSol-CQ products core software development activities have been transitioned to Lahore. While it is expected that a gradual reduction in costs on a like for like basis at NetSol-CQ will occur, the expected growth in Netsol-CQ Systems business over the next eighteen months, would result in higher level of cost efficiencies for using the Lahore offshore facility for software development and quality assurance.

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

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

Finally, the Asia Pacific Region is headed by former President of NetSol and current Chief Executive Officer of NetSol Technologies, Ltd. (the Company's Pakistan subsidiary), Salim Ghauri. The Asian continent, Australia and New Zealand, from the perspective of LeaseSoft marketing, are targeted by NetSol Technologies from its Lahore subsidiary and its offices in Beijing, China. NetSol (Pvt) Ltd. has continued to grow its service contracts within the local Pakistani public and defense sectors. An important aspect of these contracts is that not all of them focused solely on software development and engineering. This year, NetSol has gone a step further by providing both consultancy services to organizations so as to improve their quality of operations and services and, winning strategically important

assignments with the E-Governance domains for organizations of national significance in Pakistan including, but not limited to, the Prime Minister's office and the lower and upper houses of Parliament. These clients include private as well as public sector enterprises. In response, NetSol Pakistan has created a new division known as NDD - NetSol Defense Division in Islamabad. This division is headed by a retired IT focused Brigadier General and designed to create new contracts from Pakistan Ministry of Defense. There is a sizable budget allocated by the government of Pakistan to automate and use new technologies and systems. NetSol is in a sound position to win these high ticketed projects. This department includes 12 key personnel who have made some major progress in building new alliances and collaborations. They expect to see the results of these efforts in the next few quarters.

**PLAN OF OPERATIONS**

The change of senior management on Oct 1, 2006 resulted in the creation of three new geographic regions. The division of the Company into regions is designed for better accountability, ownership and results. The regions are comprised of North America, Europe and Asia Pacific.