Net Element International, Inc.
Form 10-Q
May 15, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from __________ to __________

Commission file number: **001-34887**

Net Element International, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**98-0668024**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1450 S. Miami Avenue

Miami, Florida	**33130**
(Address of principal executive offices)	(Zip Code)

(305) 507-8808

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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 (Do not check if a smaller reporting company) ¨ Smaller reporting company x

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

The number of outstanding shares of common stock, $.0001 par value, of the registrant as of May 14, 2013 was 28,136,439.

Defined Terms

Net Element International, Inc. is a corporation organized under the laws of the State of Delaware. As used in this Quarterly Report on Form 10-Q (this "Report"), unless the context otherwise requires, the terms "Company," "we," "us" and "our" refer to Net Element International, Inc. and, as applicable, its majority-owned and consolidated subsidiaries.

All amounts of shares and consideration for shares (including, without limitation, purchase prices, exercise prices and conversion prices) described in this Report for periods prior to October 2, 2012 (which was the closing date of the Company's merger with Net Element, Inc.) have been adjusted to give effect to the conversion ratio for shares of Net Element, Inc. common stock that were cancelled and converted into shares of the Company's common stock pursuant to the Merger Agreement. Pursuant to the terms of the Merger Agreement, upon completion of the Merger, each share of then-issued and outstanding common stock of Net Element, Inc. was automatically cancelled and converted into the right to receive one-fortieth (1/40) of a share of the Company's common stock. For additional information regarding the Merger, see Note 4 of the accompanying notes to unaudited condensed consolidated financial statements.

Forward-Looking Statements

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements contained in this Report that are not statements of historical fact may be deemed forward-looking statements. Forward-looking statements generally are identified by the words "expects," "anticipates," "believes," "intends," "estimates," "aims," "plans," " "will," "continue," "seeks," "should," "believe," "potential" or the negative of such terms and similar expressions. Forward-loo statements are based on current plans, estimates and projections, and therefore you should not place too much reliance on them. Forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update any forward-looking statement in light of new information or future events, except as expressly required by law. Forward-looking statements involve inherent risks and uncertainties, most of which are difficult to predict and are generally beyond the Company's control. The Company cautions you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in, or implied by, the forward-looking statements. These factors include, among other factors: the Company's ability (or inability) to continue as a going concern, the willingness of the Company's majority stockholder, Mike Zoi (including entities directly or indirectly controlled by Mr. Zoi), and/or other affiliates of the Company, to continue investing in the Company's business to fund working capital requirements, the Company's ability (or inability) to obtain additional financing in sufficient amounts or on acceptable terms when needed, the Company's ability (or inability) to adequately address the material weaknesses in its internal control over financial reporting, development or acquisition of additional businesses, attracting and retaining competent management and other personnel, successful implementation of the Company's business strategy, continued development and market acceptance of the Company's technologies and products and services, protection of the Company's intellectual property, and successful integration and promotion of any business developed or acquired by the Company. If these or other risks and uncertainties (including those described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the U.S. Securities and Exchange Commission (the "Commission") and the Company's subsequent filings with the Commission) materialize, or if the assumptions underlying any of these statements prove incorrect, the Company's actual results may be materially different from those expressed or implied by such statements.

World Wide Web addresses contained in this report are for explanatory purposes only and they (and the content contained therein) do not form a part of and are not incorporated by reference into this Report.

Net Element International, Inc.

Form 10-Q

For the Quarter Ended March 31, 2013

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.

NET ELEMENT INTERNATIONAL, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash	$2,029,588	$3,579,737
Restricted cash	-	2,056,821
Notes receivable (net)	557,372	6,088,934
Accounts receivable	11,905,562	10,863,577
Advances to aggregators (net)	8,128,762	4,777,033
Prepaid expenses and other assets	220,232	508,650
Total current assets	22,841,516	27,874,752
Property and equipment (net)	245,593	291,017
Intangible assets, net	211,856	212,865
Advances to Unified Payments	454,814	-
Other assets	49,030	-
Total assets	$23,802,809	$28,378,634
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$666,421	$569,900
Accrued expenses	934,140	925,966
Short term loans	8,513,311	9,400,164
Due to related parties (current portion)	323,993	338,374
Total current liabilities	10,437,865	11,234,404
Due to related parties (non-current portion)	60,693	135,693
Total liabilities	10,498,558	11,370,097
STOCKHOLDERS' EQUITY		
Preferred stock ($.01 par value, 1,000,000 shares authorized and no shares issued and outstanding)	-	-
Common stock ($.0001 par value, 100,000,000 shares authorized and 28,136,439 and 28,303,659 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively)	2,813	2,830

Paid in capital	86,979,381	87,452,060
Accumulated other comprehensive income	250,260	276,333
Accumulated deficit	(73,450,286)	(70,216,456)
Noncontrolling interest	(477,917)	(506,230)
Total stockholders' equity	13,304,251	17,008,537
Total liabilities and stockholders' equity	$23,802,809	$28,378,634

See accompanying notes to unaudited condensed consolidated financial statements.

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NET ELEMENT INTERNATIONAL, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Quarter ended March 31,	
	2013	2012 (As Restated)
Net revenues	$874,515	$74,810
Costs and expenses:		
Cost of revenues	275,466	100,585
General and administrative (includes $0 and $2,661,772 of non cash compensation for quarters ended March 31, 2013 and 2012, respectively	3,068,325	4,017,747
Provision for loan losses	406,585	-
Depreciation and amortization	43,075	68,663
Total costs and operating expenses	3,793,451	4,186,995
Loss from operations	(2,918,936)	(4,112,185)
Interest expense	(250,570)	(72,674)
Other expense	(80,541)	(411,225)
Loss before income tax provision	(3,250,047)	(4,596,084)
Income tax provision	-	-
Net loss from operations	(3,250,047)	(4,596,084)
Net loss attributable to the noncontrolling interest	16,216	72,088
Net loss	(3,233,831)	(4,523,996)
Foreign currency translation (loss) income	(26,073)	100
Comprehensive loss	$(3,259,904)	$(4,523,896)
Net loss per share - basic and diluted	$(0.11)	$(0.24)
Weighted average number of common shares outstanding - basic and diluted	28,224,893	18,819,814

See accompanying notes to unaudited condensed consolidated financial statements.

NET ELEMENT INTERNATIONAL, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Quarter ended March 31,	
	2013	2012 (As Restated)
Cash flows from operating activities:		
Net loss	$(3,233,831)	$(4,523,996)
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash compensation	-	2,661,772
Non cash interest expense	-	2,859
Depreciation and amortization	43,075	68,663
Provision for loan losses	406,585	-
Non controlling interest	(16,216)	(72,088)
Loss attributable to investment in subsidiary	83,823	411,225
Changes in assets and liabilities, net of acquisitions and the effect of consolidation of equity affiliates		
Accounts receivable	(1,041,985)	346
Advances to aggregators	(3,758,314)	-
Prepaid expenses and other assets	200,096	(8,994)
Accounts payable	96,522	160,278
Accrued expenses	8,173	23,923
Total adjustments	(3,978,241)	3,247,984
Net cash used in operating activities	(7,212,072)	(1,276,012)
Cash flows from investing activities:		
Collections from notes receivable	5,531,562	-
Cash Advanced to Unified Payments	(454,814)	-
Capitalized web development and patent costs	-	(168,738)
Change in fixed assets	3,357	(21,886)
Net cash used in investing activities	5,080,105	(190,624)
Cash flows from financing activities:		
Repayments of short term loans	(886,854)	-
Change in restricted cash	2,056,821	-
Cash paid for share repurchases	(472,695)	-
Due to related parties	(14,381)	(46,492)
Contributed capital from non-controlling shareholders	-	2,140,000
Repayments to related parties	(75,000)	(75,000)
Net cash provided by financing activities	607,891	2,018,508
Effect of exchange rate changes on cash	(26,073)	100
Net (decrease) increase in cash	(1,550,149)	551,972
Cash at beginning of period	3,579,737	83,173
Cash at end of period	$2,029,588	$635,145
Supplemental disclosure of cash flow information		
Cash paid during the period for:		

Interest	$146,711	$-
Taxes	$196,425	$-
Non-cash investing and financing activities:		
Contributed capital from JV partner	$-	$28,972

See accompanying notes to unaudited condensed consolidated financial statements.

NET ELEMENT INTERNATIONAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

Net Element International, Inc. (the "Company") was incorporated on April 20, 2010 as a Cayman Islands exempted company with limited liability under the name Cazador Acquisition Corporation Ltd. ("Cazador"). Cazador was a blank check company incorporated for the purpose of effecting a merger, share capital exchange, asset acquisition, share purchase, reorganization or similar business combination with one or more operating businesses or assets.

On October 2, 2012, the Company completed a merger (the "Merger") with Net Element, Inc., a Delaware corporation ("Net Element"), which was a company with businesses in the online media and mobile commerce payment processing markets. Immediately prior to the effectiveness of the Merger, the Company (then known as Cazador Acquisition Corporation Ltd.) changed its jurisdiction of incorporation by discontinuing as an exempted company in the Cayman Islands and continuing and domesticating as a corporation incorporated under the laws of the State of Delaware. Effective upon consummation of the Merger, (i) Net Element was merged with and into the Company, resulting in Net Element ceasing to exist and the Company continuing as the surviving company in the Merger, and (ii) the Company changed its name to Net Element International, Inc. Pursuant to the Merger, the Company issued 24,543,826 shares of its common stock to the former stockholders of Net Element, which shares amount to approximately 86.7% of the post-Merger issued and outstanding shares of common stock of the Company. Following the Merger, the Company's business consists of the former business of Net Element. For financial reporting purposes, the Merger was accounted for as a recapitalization of Net Element and the financial statements reflect the historical financial information of Net Element. The assets and liabilities of the Company were recognized and measured in accordance with ASC Topic 805, Business Combinations. Therefore, for accounting purposes, the shares recorded as issued in the Merger are the 3,793,355 shares owned by Cazador shareholders prior to Merger. See Note 4 for additional information regarding the Merger.

The Company is a technology driven Internet group that focuses in two business lines: (i) mobile commerce and payment processing for electronic commerce, and (ii) entertainment and culture Internet destinations.

During the third quarter of 2012, the Company's subsidiary, OOO TOT Money (a Russian limited liability company) ("TOT Money"), launched operations as a mobile commerce payment processing business in Russia. Since then, TOT Money has continued seeking to expand its payment processing business primarily in the Commonwealth of

Independent States (CIS) countries (comprised of participating states of the former Soviet Union) and other emerging markets. During the second half of 2012, TOT Money entered into contracts with the three largest mobile phone operators in Russia, Mobile TeleSystems OJSC, MegaFon OJSC and OJSC VimpelCom, to facilitate payments using SMS and MMS for their mobile phone subscribers in Russia.

On April 16, 2013, the Company entered into a Contribution Agreement with Unified Payments, LLC, a Delaware limited liability company ("Unified Payments"), TOT Group, Inc., a Delaware corporation (formerly known as TOT, Inc.), which is a direct subsidiary of the Company ("TOT Group"), Oleg Firer, individually, and Georgia Notes 18 LLC, a Florida limited liability company. Pursuant to the Contribution Agreement, on April 16, 2013, certain subsidiaries of TOT Group, which were formed for the purpose of effectuating the transactions contemplated by the Contribution Agreement, acquired substantially all of the business assets of Unified Payments. Unified Payments provides comprehensive turnkey, payment-processing solutions to small and medium size business owners (merchants) and independent sales organizations across the United States. For additional information, see Note 18.

In addition to developing its mobile commerce payment processing operations, since April 1, 2010, the Company has pursued a strategy to develop and acquire technology and applications for use in the online media industry. The Company currently owns controlling interests in several companies that develop and operate online media products (websites and mobile applications) in the peer-to-peer application, music, motorsport and film markets. The Company intends to explore additional acquisitions of, as well as developing internally, other Internet based properties, services and companies with similar goals of connecting people in various vertical markets, such as the medical, music, film, sports and legal markets.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Commission for reporting on Form 10-Q. Accordingly, certain information and footnotes required for complete financial statements are not included herein. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. These results have been determined on the basis of generally accepted accounting principles and practices applied consistently with those used in the preparation of the Company's financial statements for the year ended December 31, 2012. Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results that may be reported for any particular quarterly period or the year ending December 31, 2013. It is recommended that the accompanying unaudited condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2012 included in the Company's Annual Report on Form 10-K filed with the Commission.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of expenses for the period presented. Actual results could differ from those estimates.

Cash

We maintain our U.S. Dollar-denominated cash in several non-interest bearing bank deposit accounts. All non-interest bearing transaction accounts are fully insured at all FDIC insured institutions up to $250,000. Our bank balances did not exceed FDIC limits at March 31, 2013 and December 31, 2012.

The Company had approximately $1.8 million and $315,000 in un-insured Russian bank accounts as of March 31, 2013 and December 31, 2012, respectively.

Fixed Assets

The Company depreciates its furniture, servers, data center software and equipment over a term of three to five years. Computers and client software are depreciated over terms between two and five years. Leasehold improvements are depreciated over the shorter of the economic life or terms of each lease. All of our assets are depreciated on a straight-line basis for financial statement purposes.

Intangible Assets

The Company capitalizes the costs that are directly related to website development. These costs include platform services, engineering, Internet hosting, Internet streaming, content delivery network fees and general and administrative expenses to directly support engineering services from the point of start to the point the application, service or website is publicly launched.

Website development costs include projects that are significant in terms of functional value added to the site, product or service. A capitalized project would be closer to a full product launch than an incremental or point release update. Costs for updates are expensed as incurred. Capitalized costs are amortized to depreciation and amortization expense over 24 months on a straight-line basis based on the estimated useful life of the asset.

The Company also capitalizes start-up projects from the point of start to the point the application, service or website is publicly launched. These assets are amortized on a straight-line basis over 24 months and charged to depreciation and amortization expense. Intangible assets are assessed for impairment on a quarterly basis to ensure only viable active project costs are capitalized.

The Company also capitalizes direct expenses associated with filing of patents and patent applications and amortizes the capitalized intellectual property costs over five years beginning when the patent is approved.

Additionally, the Company capitalizes the fair value of intangible assets acquired in business combinations. The Company performs valuations of assets acquired and liabilities assumed on each acquisition accounted for as a business combination and allocates the purchase price of each acquired business to its respective net tangible and intangible assets. Acquired intangible assets include: trade names, non-compete agreements, owned website names, customer relationships, technology, media content and content publisher relationships.

Foreign Currency Transactions

The Company is subject to exchange rate risk in its foreign operations in Ukraine and Russia where the Company generates service fee revenues and interest income and incurs in product development, engineering, website development, expense, and general and administrative costs. The Ukrainian and Russian engineering operations pay a majority of their operating expenses in their local currencies, exposing the Company to exchange rate risk. Ukrainian salaries and consulting fees are negotiated and paid in U.S. dollars. The majority of Russian salaries are negotiated and paid in U.S. dollars.

The Company does not engage in any currency hedging activities.

Revenue Recognition

The Company recognizes revenue when the following four basic criteria have been met: (1) persuasive evidence of a sales arrangement exists; (2) performance of services has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. The Company considers persuasive evidence of a sales arrangement to be the receipt of a billable transaction from aggregators, signed contract or website advertising insertion order. Collectability is assessed based on a number of factors, including transaction history with the customer and the credit worthiness of the customer. If it is determined that the collection is not reasonably assured, revenue is not recognized until collection becomes reasonably assured, which is generally upon receipt of cash. The Company records cash received in advance of revenue recognition as deferred revenue.

The Company periodically engages in transactions involving the exchange of certain advertising services for various goods and services from third parties (barter transactions). These transactions are recorded at the estimated fair value of the goods or services received. Revenue from trade transactions is recognized when the related advertisements are broadcast. Expense is recognized when services or merchandise received are used.

Our revenues for the quarters ended March 31, 2013 and 2012 are principally derived from the following sources:

Service Fees. Service fees are generated primarily from TOT Money’s payment processing and from A&R Music Live, LLC where emerging artists pay industry professionals to review, critique and suggest improvements of music submitted on-line for evaluation. A&R Music Live, LLC operations were discontinued on January 31, 2013 and management believes these operations are not significant to the financial statements. Accordingly, the Company did not present these results as discontinued operations for the quarter ended March 31, 2013.

Revenues from TOT Money are recognized as a percentage of amounts billed to mobile operators. Revenue is recognized when TOT Money billing system is able to create a billable transaction for a mobile operator. Billable transactions are created and submitted to TOT Money by content aggregators.

Each month, mobile operators provide TOT Money with detail supporting the transactions received by the mobile operator. TOT Money reconciles the data provided by the mobile operator to its internal billing system. Pursuant to the mobile operator agreements, any total billing difference under 5% is considered immaterial and TOT Money accepts the mobile operator data as accurate. Any differences from content providors that exceed 5% of the amount billed are researched, reconciled and addressed with the mobile operator.

Funds received by TOT Money from mobile operators include amounts due to aggregators for supplying billable transactions from content providers. Revenues are presented net of aggregator payments on the financial statements of TOT Money as the payments are considered to be agency fees. TOT Money serves as agent to the mobile operators performing a service for a fee.

Interest Income. Interest income is generated from lending arrangements made by the Company and through one of the Russian subsidiaries, TOT Money.

License Fees. License fees are generated from customers who utilize Launchpad to operate and manage on-line contests.

Advertising Revenue. Advertising revenue is generated by performance-based Internet advertising, such as cost-per-click, or CPC, in which an advertiser pays only when a user clicks on its advertisement that is displayed on the Company's owned and operated websites; fees generated by users viewing third-party website banners and text-link advertisements; fees generated by enabling customer leads or registrations for aggregators; and fees from referring users to, or from users making purchases on, sponsors' websites. In determining whether an arrangement exists, the Company ensures that a binding arrangement is in place, such as a standard insertion order or a fully executed customer-specific agreement. Obligations pursuant to the advertising revenue arrangements typically include a minimum number of impressions or the satisfaction of the other performance criteria. Revenue from performance-based arrangements, including referral revenues, is recognized as the related performance criteria are met.

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In certain cases, the Company records revenue based on available and preliminary information from third parties. Amounts collected on the related receivables may vary from reported information based upon third party refinement of estimated and reported amounts owing that occurs typically within 30 days of the period end.

Subscription Services and Social Media Services. Subscription services revenue is generated through the sale of memberships to access content available on certain owned and operated websites and to be eligible to enter our contests. The majority of Openfilm's memberships have a one month term and renew automatically at the end of each month, if not previously cancelled. Membership revenue is recognized as billed.

Net Loss Per Share

Basic net loss per common share is computed by dividing net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares issuable upon exercise of common stock options or warrants. In periods when losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents because their inclusion would have an anti-dilutive effect. At March 31,2013 and December 31, 2012, the Company had 8,938,900 warrants issued and outstanding that are anti-dilutive in effect.

Fair Value of Financial Instruments

The Company's financial instruments consist mainly of cash deposits, accounts receivable, notes receivable, advances to aggregators, short-term payables and short-term loans. The Company believes that the carrying amounts of these financial instruments approximate fair value, due to their short-term maturities. The Company evaluates the collectability of accounts receivable, notes receivable and advances to aggregators based on the credit worthiness of borrower, payment history, forecasts and other indicators to establish any necessary provisions for loss reserves. The Company maintains a general provision for possible losses on advances to aggregators at 10% of the outstanding balance of these advances.

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes indicate that the carrying amount of an asset or group of assets may not be recoverable. No impairment losses were recorded during the quarters ended March 31, 2013 or 2012.

Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We recognize net deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If we determine that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, we would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

The Company accounts for uncertainty in income taxes using a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. The Company classifies the liability for unrecognized tax benefits as current to the extent that the Company anticipates payment (or receipt) of cash within one year. Interest and penalties related to uncertain tax positions are recognized and recorded as necessary in the provision for income taxes. There were no uncertain tax positions at March 31, 2013 and December 31, 2012. The Company's evaluation of uncertain tax positions was performed for the tax years ended December 31, 2008 and forward, the tax years which remain subject to examination as of March 31, 2013.

Reclassification

Certain balances for the quarter ended March 31, 2012 have been reclassified to conform to the March 31, 2013 presentation.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2013-02, *Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"). ASU 2013-02 requires an entity to present, either on the face of the statement where net income is presented or in the notes to the financial statements, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This guidance was effective on a prospective basis for the annual and interim reporting periods for the Company beginning January 1, 2013. The Company's adoption of this standard did not have a significant impact on its consolidated financial statements.

NOTE 2. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The following condensed balance sheet as of December 31, 2012, which has been derived from audited financial statements, and unaudited interim condensed financial statements of the Company have been prepared in accordance with U.S. GAAP. These consolidated financial statements include two reportable segments, as disclosed in Note 16.

Following the consolidation principles promulgated by U.S. GAAP, the consolidated financial statements of the Company include the assets, liabilities, results of operations, and cash flows of the following subsidiaries: (1) Openfilm, LLC ("Openfilm"), a wholly owned subsidiary formed in Florida; (2) Netlab Systems, LLC ("Netlab"), a wholly owned subsidiary formed in Florida; (3) NetLab Systems IP, LLC, a wholly owned subsidiary formed in Florida; (4) LegalGuru LLC, a partially owned subsidiary formed in Florida (5) Yapik LLC, a partially owned subsidiary formed in Florida; (6) Splinex, LLC ("Splinex"), a partially owned subsidiary formed in Florida; (7) IT Solutions LTD, a wholly owned subsidiary formed in the Cayman Islands; (8) Music1, LLC ("Music1"), a wholly owned subsidiary formed in Florida; (9) Motorsport, LLC ("Motorsport"), a wholly owned subsidiary formed in Florida; and (10) OOO Net Element Russia ("Net Element Russia"), a wholly owned subsidiary formed in Russia.

The subsidiaries listed above are the parent companies of several other subsidiaries, which hold the Company's underlying investments or operating entities.

- Openfilm is the parent company of Openfilm, Inc., Openfilm Studios, LLC and Zivos, LLC (Ukraine)
- Netlab is the parent company of Tech Solutions LTD
- Splinex is the parent company of IT Solutions LTD
- Music1 is the parent company of A&R Music Live, LLC ("A&R Music Live")(Operations discontinued January 31, 2013)
- Motorsport is the parent company of Motorsport.com, Inc.
- Net Element Russia is the parent company of OOO TOT Money ("TOT Money"), OOO TOT Group, OOO Music1, and Ya-Talant.

The amounts of shares and consideration for shares (including purchase prices, exercise prices and conversion prices) described in the Notes to Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2012, which is the period prior to October 2, 2012 (which was the closing date of the Company's merger with Net Element), have been adjusted to give effect to the conversion ratio for shares of Net Element common stock that were cancelled and converted into shares of the Company's common stock pursuant to the Merger Agreement. Pursuant to the terms of the Merger Agreement, upon completion of the Merger, each share of then-issued and outstanding common stock of Net Element was automatically cancelled and converted into the right to receive one-fortieth (1/40) of a share of the Company's common stock. See Note 4 for additional information regarding the Merger.

All material intercompany accounts and transactions have been eliminated in this consolidation.

NOTE 3. GOING CONCERN CONSIDERATIONS

The Company's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The Company had negative cash flows from operating activities of $7.2 million for the quarter ended March 31, 2013, an accumulated deficit of $73.4 million at March 31, 2013 and working capital of $12.4 million at March 31, 2013. The Company's current assets at March 31, 2013 included $20.6 million of receivables (consisting of $0.6 million of net notes receivable, $11.9 million of accounts receivable and $8.1 million of receivables from advances to aggregators). These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company plans to increasingly generate most of its revenues from the payment processing operations of its subsidiary TOT Group. Failure to successfully continue developing the Company's payment processing operations and maintain contracts with merchants, mobile phone carriers and content providers to use TOT Group's services, or failure to expand the Company's base of advertisers or generate and maintain high quality content on its websites, could harm the Company's revenue prospects. The Company faces all of the risks inherent in a new business, including management's potential underestimation of initial and ongoing costs, and potential delays and other problems in connection with developing its technologies, Internet websites and operations.

The Company is continuing with its plan to further grow and expand its payment processing operations and leverage its existing entertainment and culture assets in emerging markets, particularly in Russia and surrounding countries. Management believes that its current operating strategy will provide the opportunity for the Company to continue as a going concern as long as we are able to obtain additional financing; however, there is no assurance this will occur. The accompanying consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

The independent auditors' report on the Company's consolidated financial statements for the year ended December 31, 2012 contains an explanatory paragraph expressing substantial doubt as to the Company's ability to continue as a going concern.

NOTE 4. MERGER TRANSACTION

On October 2, 2012, the Company completed its Merger with Net Element, Inc. and the various transactions contemplated by the Merger Agreement dated June 12, 2012. Immediately prior to the effectiveness of the Merger, the Company (then known as Cazador Acquisition Corporation Ltd.) changed its jurisdiction of incorporation by discontinuing as an exempted company in the Cayman Islands and continuing and domesticating as a corporation incorporated under the laws of the State of Delaware. Effective upon consummation of the Merger, (i) Net Element was merged with and into the Company, resulting in Net Element ceasing to exist and the Company continuing as the surviving company in the Merger, and (ii) the Company changed its name to Net Element International, Inc. Pursuant to the terms of the Merger Agreement, upon completion of the Merger, each share of then-issued and outstanding common stock of Net Element was automatically cancelled and converted into the right to receive one-fortieth (1/40) of a share of the Company's common stock. All shares of common stock and stock options in the 2012 and 2011 financial statements as of March 31, 2013 and December 31, 2012 and for the quarters ended March 31, 2013 and 2012 have been converted based on the 1/40 ratio.The Merger was structured to qualify as a tax-free reorganization.

To the extent a holder of Net Element common stock would have received fewer than 100 shares of common stock of the Company in the Merger, such holder was issued an additional number of shares of common stock of the Company to bring such holder's aggregate equity holdings in the Company to 100 shares of common stock. No fractional shares were issued in the Merger; instead, the Company issued one share of common stock to the holder of any shares of Net Element common stock that would have otherwise been entitled to receive a fraction of a share of common stock of the Company.

Immediately prior to the effective time of the Merger, all outstanding shares of unvested restricted stock of Net Element accelerated and became fully vested and, at the effective time of the Merger, such shares were cancelled and converted into the right to receive shares of common stock of the Company on the same basis as other issued and outstanding shares of Net Element common stock as described above. Immediately prior to the effective time of the Merger, all outstanding convertible debt instruments of Net Element were converted into shares of Net Element common stock pursuant to the terms of such instruments and, at the effective time of the Merger, such shares were cancelled and converted into the right to receive shares of common stock of the Company on the same basis as other issued and outstanding shares of Net Element common stock as described above. Immediately prior to the effective time of the Merger, all outstanding Net Element stock options and warrants (collectively, “Convertible Securities”) accelerated and became fully vested and exercisable to the extent that they were unvested. If the Convertible Securities were “in-the-money” (meaning that the exercise price was lower than the product obtained by multiplying the price of a Cazador ordinary share as of the close of The NASDAQ Capital Market on the day immediately prior to the closing date by 0.025, which product equaled $0.25 (the “Cashless Share Price”)), then, immediately prior to the effective time of the Merger, they were terminated and exercised into the number of shares of Net Element common stock that would have been issuable if the Convertible Securities were exercised on a cashless basis based on the Cashless Share Price, and, at the effective time of the Merger, such shares of Net Element common stock were cancelled and converted into the right to receive shares of common stock of the Company on the same basis as other issued and outstanding shares of Net Element common stock as described above. Any Convertible Securities that were “out-of-the-money” (meaning that the exercise price was equal to or higher than the Cashless Share Price) were cancelled at the effective time of the Merger and no consideration was delivered in exchange therefor; provided that, with respect to “out-of-the-money” Net Element stock options that were granted to employees under Net Element’s 2011 Equity Incentive Plan in lieu of cash compensation in connection with compensation reductions previously implemented by Net Element, employees had the right to be paid the amount of cash compensation that was previously foregone in connection with the compensation reductions. With respect to “in-the-money” Net Element stock options that were granted to employees under Net Element’s 2011 Equity Incentive Plan in lieu of cash compensation in connection with compensation reductions previously implemented by Net Element, employees of Net Element were given a choice to, immediately prior to the effective time of the Merger, either (i) exercise such stock options on a cashless basis as described above or (ii) cancel all of such stock options and be paid the amount of cash compensation that was previously foregone in connection with the compensation reductions.

NOTE 5. NOTES RECEIVABLE

As of March 31, 2013 and December 31, 2012, the Company had net notes receivable of $557,372 and $6,088,934 as follows:

	March 31, 2013	December 31, 2012
RM Invest	$257,372	$5,188,934
Infratont Equities, Inc.	1,191,475	1,791,475
Less: Allowance for loan losses	(891,475)	(891,475)
Total note receivable, net	$557,372	$6,088,934

On July 12, 2012, the Company's Russian subsidiary, TOT Money, entered into a loan agreement pursuant to which it agreed to loan RM Invest up to a maximum of 200 million Russian rubles (approximately $7.0 million in U.S. dollars). The interest rate on the loan is 10% from the date of advance to the date of scheduled repayment on October 31, 2012. TOT Money would earn interest income on this loan at approximately a 40% annual rate if the loan was repaid timely given interest earned was 10% of the outstanding balance with a term of approximately three months. On August 16, 2012, the loan was increased to 300 million Russian rubles (approximately $9.8 million in U.S. dollars). As of March 31, 2013, the outstanding principal loan balance and accrued interest was 8.0 million rubles (approximately $257,372 in U.S. dollars) and the loan balance was fully satisfied in April 2013. The original stated maturity date of the loan was October 31, 2012 and on February 25, 2013 the Company renegotiated the loan with RM Invest and extended the maturity date until October 1, 2013 with no further interest to be charged. RM Invest is a payment processing business operating in Russia whose payment processing systems are currently being used by TOT Money. RM Invest is 20% owned by TOT Money's general director, Tcahai Hairullaevich Katcaev.

The purpose of this loan was to facilitate uninterrupted business operations by funding one cycle of payments by RM Invest to aggregators while certain mobile operator contracts were being assigned to TOT Money. One cycle of payment processing is approximately 45 days. Aggregators are businesses that contract for content from content providers and provide aggregated processing volume to TOT Money. The assignment and new contract process took until September 22, 2012 to complete and RM Invest continued to require the working capital provided by the loan to operate. Management evaluated the financial statements of RM Invest and considered the repayment history of the loan and determined that no loss provision was necessary.

On November 26, 2012, the Company entered into a loan agreement with Infratont Equities, Inc. ("Infratont"), pursuant to which the Company loaned $1,791,475 to Infratont for the purpose of providing the borrower with working capital and funding of business development in general. The loan matures on November 15, 2013 and accrues interest at a rate of 1.75% per month, payable quarterly commencing in March 2013. Infratont Equities has a relationship with Anatoly Polyanovskiy. The effect of the loan was to defer a repayment obligation of Tcahai Hairullaevich Katcaev to Mr. Polyanovskiy pursuant to an unrelated loan not involving the Company. Mr. Katcaev is general director of the

Company's subsidiary, TOT Money, and he owns a 20% interest in RM Invest, a payment processing business in Russia whose payment processing systems are currently used by TOT Money. The Company has had discussions with Messrs. Polyanovskiy and Katcaev about possibly issuing a 10% equity interest in TOT Money to Mr. Polyanovskiy and a 20% equity interest in TOT Money to Mr. Katcaev, although no binding agreement has been entered into to issue any amount of interest in TOT Money to either Mr. Polyanovskiy or Mr. Katcaev.

As of March 31, 2013, the Company has a reserve for loan losses of approximately $900,000 relating to the Infratont loan and a corresponding charge to the provision for loan losses. The Company was not able to review the financial information or the collateral value of the borrower and, as a result, the Company decided to reserve the majority of the outstanding balance of the loan.

NOTE 6. ACCOUNTS RECEIVABLE AND ADVANCES TO AGGREGATORS

Accounts receivable consist of amounts due from Russian mobile operators. The cycle of business begins with TOT Money advancing funds to aggregators based on projected processing volumes. Aggregators then provide transactions to TOT Money for processing and billing to the mobile operators TOT Money has contracts with. The mobile operator contracts and associated receivables are with the three largest mobile telecommunications companies in Russia, Mobile TeleSystems OJSC, MegaFon OJSC and OJSC VimpelCom. The Company does not reserve for these accounts receivable given our payment history with each mobile operator and the size of each mobile operator company. The collection cycle with mobile operators is approximately 45 days. Advances to aggregators are repaid with new business and TOT Money then re-advances to aggregators of content providers for expected new business. In this way, advances are continually rolling over and the outstanding balance per aggregator should approximate, at any point in time, one month of business volume that TOT Money expects the aggregator will provide going forward.

As of March 31, 2013, the Company had accounts receivables and advances to aggregators of approximately $11.9 million and $8.1 million (net of reserve of approximately $1 million), respectively. The Company subsequently collected the majority of amounts due from mobile operators. Due to limited experience with advances to aggregators, a loan loss provision of approximately 10% of the outstanding balance is maintained against advances to aggregators, since the Company was unable to obtain financial information from the aggregators to perform a full credit review. A loan loss provision charge of $406,585 was recorded for the quarter ended March 31, 2013 to maintain the 10% loss reserve. The total loss provision for advances to aggregators at March 31, 2013 is $956,585.

As of December 31, 2012, the Company had accounts receivables and advances to aggregators of approximately $10.9 million and $4.8 million (net of reserve of approximately $550,000), respectively.

NOTE 7. FIXED ASSETS

Fixed assets are stated at cost less accumulated depreciation and amortization as follows:

	Useful life (in years)	March 31, 2013	December 31, 2012
Furniture and equipment	3 - 5	$315,192	$325,522
Computers	2 - 5	312,771	312,771
Leasehold improvements*		19,956	19,956
Total		647,919	658,249
Less: Accumulated depreciation and amortization		(402,326)	(367,232)
Total fixed assets, net		$245,593	$291,017

* Leasehold improvements are amortized over the shorter of the economic useful life or the lease term.

Depreciation and amortization expense was $43,075 and $68,663 for the quarters ended March 31, 2013 and 2012, respectively.

NOTE 8. INTANGIBLE ASSETS

The Company capitalizes certain costs for website development projects. Specifically, the Company capitalizes projects that are significant in terms of functional value added to the site. A capitalized project would be closer to a full product launch than an incremental or point release update. Costs for updates are expensed as incurred. Capitalized costs are amortized to depreciation and amortization expense over 24 months on a straight-line basis. The Company also capitalizes start-up projects from the point of start to the point the application, service or website is publicly launched. Amortization is straight-line over 24 months and charged to depreciation and amortization. Impairment is reviewed quarterly to ensure only viable active project costs are capitalized. Capitalized website development costs are included in other assets.

At March 31, 2013 and December 31, 2012, the Company had $211,856 and $212,865 in capitalized web development costs and intangible assets, respectively. The following table presents the components and activity for capitalized web development costs and intangible assets at March 31, 2013:

	Domain Name	Capitalized Patent Cost	Other	Total
Balance at January 1, 2013	$173,750	$ 37,920	$1,195	$212,865
Amortization	-	(1,009)	-	(1,009)
Balance at March 31, 2013	$173,750	$ 36,911	$1,195	$211,856

At December 31, 2012, the Company had $212,865 in capitalized web development costs and intangible assets. This amount was primarily comprised of $173,750 in capitalized domain names and $37,920 in capitalized patent applications/trademarks. For the three months ended March 31, 2012, the Company amortized $1,009 in patent/trademark costs, $12,500 in customer list, $2,500 in content and $26,510 in capitalized website development.

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The following table presents the estimated aggregate amortization expense of other intangible assets for the next five years:

2013	$4,219
2014	4,032
2015	4,032
2016	4,032
2017	4,032
Total	$20,347

NOTE 9. SHORT TERM LOANS

As of March 31, 2013, the Company had approximately $8.5 million in short term loans under a short term factoring agreement with Alfa-Bank that was entered by the Company’s Russian subsidiary, TOT Money, on September 28, 2012. As of December 31, 2012, the Company had approximately $9.4 million in short term loans which consists of: (i) $7.6 million under a factoring agreement with Alfa-Bank that was entered by the Company’s Russian subsidiary, TOT Money, on September 28, 2012 and (ii) $1.8 million under a credit agreement with Alfa-Bank that was entered by the Company’s Russian subsidiary TOT Money on August 17, 2012.

As stated above, on September 28, 2012, the Company’s Russian subsidiary, TOT Money, entered into a factoring agreement with Alfa-Bank. Pursuant to the agreement, as amended, TOT Money has assigned to Alfa-Bank its accounts receivable as security for financing in an aggregate amount of up to 400 million Russian rubles (approximately $12.9 million in U.S. dollars) provided by Alfa-Bank to TOT Money. The amount loaned by Alfa-Bank pursuant to the agreement with respect to any particular account receivable is limited to 80% of the amount of the account receivable assigned to Alfa-Bank. Pursuant to the agreement, Alfa-Bank is required to track the status of TOT Money’s accounts receivable, monitor timeliness of payment of such accounts receivable and provide related services. The term of the agreement is from September 28, 2012 until December 5, 2013. Alfa-Bank’s compensation pursuant to the agreement for providing services for the administrative management of accounts receivable ranges from 10 Russian rubles (approximately $0.33 in U.S. dollars) to 100 Russian rubles (approximately $3.28 in U.S. dollars) per account receivable, depending upon whether financing was provided related to the particular account receivable and the form of the documentation related to the particular account receivable. Alfa-Bank’s compensation pursuant to the agreement for providing financing to TOT Money is calculated as a financing rate that ranges from 9.70% to 11.95% annually of the amounts borrowed, depending upon the amount borrowed and the number of days in the period from the date financing is provided until the date the applicable account receivable is paid; however, Alfa-Bank has the unilateral right to change such financing rates in the event of changes in certain market rates or in Alfa-Bank’s reasonable discretion. TOT Money’s obligations under the Agreement also are secured by a guarantee given by AO SAT & Company. AO SAT & Company is an affiliate of Kenges Rakishev, who is Chairman of the Board of Directors of the Company.

In addition, on August 17, 2012, the Company's Russian subsidiary, TOT Money, entered into a Credit Agreement with Alfa-Bank. Pursuant to the Credit Agreement, Alfa-Bank agreed to provide a line of credit to TOT Money with the credit line limit set at 300 million Russian rubles (approximately $9.8 million in U.S. dollars). The interest rate varies based on the amount borrowed. Any amount borrowed is secured 100% by restricted cash of the Company. Alfa-Bank has the unilateral right to change the interest rate on amounts borrowed under the Credit Agreement from time to time in the event of changes in certain market rates or in Alfa-Bank's reasonable discretion, provided that the interest rate may not exceed 14% per annum. Interest must be repaid on a monthly basis on the 25th of each month. Amounts borrowed under the Credit Agreement must be repaid within six months of the date borrowed. The duration of the line of credit is set from August 17, 2012 through May 21, 2014. TOT Money's obligations under the Credit Agreement are secured by a pledge of TOT Money's deposits in its deposit account with Alfa-Bank and by a guarantee given by AO SAT & Company. AO SAT & Company is an affiliate of Kenges Rakishev.

On February 13, 2013, the Alfa Bank Credit Agreement had a loan balance of 53,900,000 rubles (approximately $1.8 million in U.S. dollars) secured by 55,000,000 rubles (approximately $1.8 million in U.S. dollars) in restricted cash. The Company paid off this credit facility on February 14, 2013 in order to eliminate interest expense under the credit line and free up the restricted cash. The balance of this loan was $0 and $1.8 million at March 31, 2013 and December 31, 2012, respectively.

NOTE 10. ACCRUED EXPENSES

At March 31, 2013 and December 31, 2012, accrued expenses amounted to $934,140 and $925,966, respectively. Accrued expenses represent expenses that are owed at the end of the period and have not been billed by the provider or are estimates of services provided. The following table details the items comprising the balances outstanding as of March 31, 2013 and December 31, 2012.

	March 31, 2013	December 31, 2012
Accrued professional fees	$534,273	$470,382
Promotional expense	49,922	221,311
Accrued interest	38,606	39,421
Accrued payroll	163,364	52,760
Other accrued expenses	147,975	142,092
	$934,140	$925,966

NOTE 11. COMMITMENTS AND CONTINGENCIES

On February 1, 2013, the Company entered into its second sponsorship agreement with Ferrari North America, Inc. (“FNA”). Consideration is $50,000 in cash and $200,000 in advertising services. Additionally, unused advertising services from the previous agreement of March 8, 2012 will be available to FNA until January 1, 2014. The Company, through its motorsport.com brand, will receive sponsor recognition on all FNA Ferrari Challenge communications, promotions and advertising. FNA is required to include motorsport.com in all its Ferrari Challenge advertisements, communications and promotional materials, including but not limited to, press releases, winner’s podium display and reference to motorsport.com and the Company’s sponsorship in all correspondence. Parties may, at their election, issue joint press releases, subject to approval by FNA. Additionally, motorsport.com signage and decals are required to be displayed on all FNA cars, including during practice and race sessions.

We lease approximately 6,500 square feet of office space in Miami, Florida at annual rent of $201,695. Beginning in January 2013, Enerfund, LLC, which is wholly-owned by our director and majority stockholder, Mike Zoi, uses part of this office space and pays a pro-rata amount of the rent in an amount equal to $8,500 per month (or $102,000 per year). The current lease term expires May 31, 2013. Our corporate headquarters and the operations of our online media products (websites and mobile applications) are conducted at this location. The Company is planning to relocate to Unified Payments’ office upon the expiration of this lease.

The Company also leases office space in Russia and the Ukraine. Total rent expense for these leases was $73,730 and $22,260 for the quarter ended March 31, 2013 and 2012, respectively. Future minimum lease payments are $95,697 for 2013 and $28,000 for 2014, respectively.

On January 2, 2013, the Company entered into an employment agreement with Timothy Greenfield whereby Mr. Greenfield is employed as President – Mobile Commerce & Payment Processing. Mr. Greenfield’s annual salary is $235,000 and he received a $25,000 signing bonus. Mr. Greenfield is entitled to other benefits including a discretionary bonus, vacation/personal days and participation in the Company’s benefit plan for health insurance. Mr. Greenfield is entitled to a one-time payment of $100,000 if his at-will employment is terminated for other than cause.

From time to time, in the ordinary course of business, the Company is subject to legal and/or tax proceedings or inquiries. While it is impossible to determine the ultimate outcome of any such proceedings or inquiries, management believes that the resolution of any pending matters will not have a material adverse effect on the consolidated financial position, cash flows or results of operations of the Company.

NOTE 12. RELATED PARTY TRANSACTIONS

As of March 31, 2013, the Company had $384,686 due to related parties, consisting primarily of $264,802 of which is due to Green Venture Group, LLC, an entity controlled by Mike Zoi, who owns a majority of the Company's outstanding stock, and approximately $120,000 due to former minority owner of A&R Music Live, LLC.

Pursuant to an agreement dated January 31, 2013, the Company ceased all operations of A&R Music Live, LLC and terminated the employment of Stephen Strother (the founder and former President of Music1, LLC) as of January 31, 2013, with agreement to pay him $150,000 over the next twelve months and to transfer and assign to him the Company's 97% interest in A&R Music Live, LLC, the internet domain name www.arlive.com and related intellectual property rights (which transfers and assignments were completed on February 8, 2013). As of February 8, 2013, Mr. Strother owned a 100% interest in and operates A&R Music Live, LLC. The Company retained ownership of and rights to www.music1.com and www.music1.ru. The Company recorded a charge of approximately $84,000 to reflect the loss on disposition of business during the quarter ended March 31, 2013, which is reflected in other expense in the accompanying statements of operations.

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NOTE 13. STOCKHOLDERS' EQUITY

Subscription Agreements

On February 2, 2012, Net Element entered into a Subscription Agreement with one of its directors, Felix Vulis, pursuant to which Mr. Vulis purchased from the Company for $100,000: (i) 16,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 16,667 shares of common stock of the Company with an exercise price of $10 per share; (iii) a three-year warrant to purchase up to an additional 16,667 shares of common stock of the Company with an exercise price of $20 per share; and (iv) a three-year warrant to purchase up to an additional 16,667 shares of common stock of the Company with an exercise price of $40 per share. These warrants were cancelled on October 2, 2012 pursuant to the Merger Agreement with Net Element. The price of the Company's stock was $13.60 on the date of grant and the Company recorded a corresponding compensation charge of $806,667.

On February 23, 2012, Net Element entered into a Subscription Agreement pursuant to which it sold 333,333 newly issued shares of common stock of the Company to Kenges Rakishev for an aggregate purchase price of $2,000,000, or $6.00 per share. In connection with this Subscription Agreement, the Company reco