

Net Element, Inc.
Form 10-Q
November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(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, 2016

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, Inc.

(Exact name of registrant as specified in its charter)

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Delaware

90-1025599

(State or other jurisdiction of incorporation (I.R.S. Employer
or organization) Identification No.)

3363 NE 163rd Street, Suite 705

North Miami Beach, Florida 33160

(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

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 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

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

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The number of outstanding shares of common stock, \$.0001 par value, of the registrant as of November 8, 2016 was 15,292,225.

Defined Terms

Net Element, 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, Inc. and, as applicable, its majority-owned and consolidated subsidiaries. References in this Report to “PayOnline” refer, collectively, to PayOnline System LLC, Innovative Payment Technologies LLC, Polimore Capital Limited and Brosword Holding.

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-looking 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 impact of any new or changed laws, regulations, card network rules or other industry standards affecting our business including the U.S. government decision to impose sanctions or other legal restrictions that may restrict our ability to do business in Russia;
- the impact of any significant chargeback liability and liability for merchant or customer fraud, which we may not be able to accurately anticipate and/or collect;
- our ability to secure or successfully migrate merchant portfolios to new bank sponsors if current sponsorships are terminated;
- our and our bank sponsors’ ability to adhere to the standards of the Visa® and MasterCard® payment card associations;
- our reliance on third-party processors and service providers;
- our dependence on independent sales groups (“ISGs”) that do not serve us exclusively to introduce us to new merchant accounts;
- our ability to pass along increases in interchange costs and other costs to our merchants;
- our ability to protect against unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems or otherwise;

the effect of the loss of key personnel on our relationships with ISGs, card associations, bank sponsors and our other service providers;

- the effects of increased competition, which could adversely impact our financial performance;
- the impact of any increase in attrition due to an increase in closed merchant accounts and/or a decrease in merchant charge volume that we cannot anticipate or offset with new accounts;
- the effect of adverse business conditions on our merchants;
- our ability to adopt technology to meet changing industry and customer needs or trends;
- the impact of any decline in the use of credit cards as a payment mechanism for consumers or adverse developments with respect to the credit card industry in general;
- the impact of any adverse conditions in industries in which we obtain a substantial amount of our bankcard processing volume;
- the impact of seasonality on our operating results;
- the impact of any failure in our systems due to factors beyond our control;
- the impact of any material breaches in the security of third-party processing systems we use;
- the impact of any new and potential governmental regulations designed to protect or limit access to consumer information;
- the impact on our profitability if we are required to pay federal, state or local taxes on transaction processing or VAT on content;
- the impact on our growth and profitability if the markets for the services that we offer fail to expand or if such markets contract;
- our ability (or inability) to continue as a going concern;
- the willingness of the Company's majority stockholders, 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 impact on our operating results as a result of impairment of our goodwill and intangible assets;
- our material weaknesses in internal control over financial reporting and our ability to maintain effective controls over financial reporting in the future; and
- the other factors described in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and in Part II, Item 1A of this Report and our subsequent filings with the U.S. Securities and Exchange Commission (the "Commission").

If these or other risks and uncertainties (including those described in Part I, Item 1A of our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2015 and in Part II, Item 1A of this Report 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. We undertake no obligation to publicly revise any forward-looking statement to reflect circumstances or events after the date of this Report to reflect the occurrence of unanticipated events. You should, however, review the factors and risks described in the reports we file from time-to-time with the Commission after the date of this Report.

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, Inc.

Form 10-Q

For the Three Months Ended September 30, 2016

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PART I — FINANCIAL INFORMATION**NET ELEMENT, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	\$ 1,385,286	\$ 1,025,747
Accounts receivable, net	5,866,714	5,198,993
Prepaid expenses and other assets	1,425,685	1,106,016
Total current assets, net	8,677,685	7,330,756
Fixed assets, net	128,470	162,123
Intangible assets, net	4,153,065	5,423,880
Goodwill	9,643,752	9,643,752
Other long term assets	792,834	353,050
Total assets	23,395,806	22,913,561
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	5,650,932	5,858,837
Accrued expenses	5,654,994	2,975,066
Deferred revenue	878,913	743,910
Notes payable (current portion)	147,577	518,437
Due to related parties	447,660	329,881
Total current liabilities	12,780,076	10,426,131
Notes payable (net of current portion)	4,047,140	3,446,563
Total liabilities	16,827,216	13,872,694
STOCKHOLDERS' EQUITY		
Series A Convertible Preferred stock (\$.0001 par value, 1,000,000 shares authorized, no shares issued and outstanding at September 30, 2016 and December 31, 2015)	-	-
Common stock (\$.0001 par value, 400,000,000 shares authorized and 15,099,845 and 11,261,959 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively)	1,510	1,126
Paid in capital	163,285,658	154,361,694
Accumulated other comprehensive loss	(2,188,390)	(1,565,822)
Accumulated deficit	(154,618,755)	(143,955,048)
Noncontrolling interest	88,567	198,917
Total stockholders' equity	6,568,590	9,040,867

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Total liabilities and stockholders' equity	\$ 23,395,806	\$ 22,913,561
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See accompanying notes to unaudited condensed consolidated financial statements.

NET ELEMENT, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net revenues				
Service fees	\$12,874,386	\$12,675,123	\$34,355,912	\$25,122,250
Branded content	1,135,266	-	4,607,647	-
Total Revenues	14,009,652	12,675,123	38,963,559	25,122,250
Costs and expenses:				
Cost of service fees	10,683,897	10,705,327	28,285,984	20,787,216
Cost of branded content	1,011,271	-	4,279,218	-
General and administrative	2,284,737	2,159,170	6,372,361	6,778,751
Non-cash compensation	732,701	601,371	3,108,274	1,804,113
Bad debt expense	301,170	284,384	678,150	425,225
Depreciation and amortization	764,886	851,636	2,497,538	1,916,901
Total costs and operating expenses	15,778,662	14,601,888	45,221,525	31,712,206
Loss from operations	(1,769,010)	(1,926,765)	(6,257,966)	(6,589,956)
Interest expense, net	(608,716)	(1,605,034)	(1,186,207)	(3,007,216)
(Loss) gain on change in fair value and settlement of beneficial conversion derivative	-	(1,083,028)	-	939,008
Loss from stock value guarantee	(1,559,281)	-	(3,722,142)	-
Gain on debt extinguishment	-	79,325	-	79,325
Gain on asset disposal	-	44,928	-	68,786
Other income (expense)	433,784	(46,204)	392,257	(49,492)
Net loss before income taxes	(3,503,223)	(4,536,778)	(10,774,058)	(8,559,545)
Income taxes	-	-	-	-
Net loss	(3,503,223)	(4,536,778)	(10,774,058)	(8,559,545)
Net loss attributable to the noncontrolling interest	33,683	23,577	110,350	42,850
Net loss attributable to Net Element, Inc. stockholders	(3,469,540)	(4,513,201)	(10,663,708)	(8,516,695)
Dividends for the benefit of preferred stockholders	-	(621,273)	-	(1,146,470)
Net loss attributable to common stockholders	(3,469,540)	(5,134,474)	(10,663,708)	(9,663,165)
Foreign currency translation	(96,786)	(189,644)	(622,568)	(414,168)
Comprehensive loss attributable to common stockholders	\$(3,566,326)	\$(5,324,118)	\$(11,286,276)	\$(10,077,333)