

Net Element International, Inc.  
Form 10-Q  
November 14, 2013

**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, 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**

(State or other jurisdiction of incorporation  
or organization)

**98-0668024**

(I.R.S. Employer  
Identification No.)

**3363 NE 163<sup>rd</sup> Street, Suite 705  
North Miami Beach, Florida**

(Address of principal executive offices)

**33160**

(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

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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

The number of outstanding shares of common stock, \$.0001 par value, of the registrant as of November 14, 2013 was 28,214,797.

### **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-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 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 Three and Nine months ended September 30, 2013**  
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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****NET ELEMENT INTERNATIONAL, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash	\$ 3,925,765	\$ 3,546,787
Restricted cash	-	2,056,821
Notes receivable, net (current portion)	180,000	6,088,934
Accounts receivable	9,715,876	10,855,175
Advances to aggregators, net	754,488	4,777,033
Assets of discontinued operations	-	192,460
Prepaid expenses and other assets	566,667	487,995
Total current assets	15,142,796	28,005,205
Property and equipment, net	162,856	261,759
Note receivable, net (non-current portion)	340,000	-
Intangible assets, net	4,494,837	111,670
Goodwill	6,671,750	-
Investment in affiliate	46,113	-
Total assets	\$ 26,858,352	\$ 28,378,634
<b>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,021,211	\$ 498,424
Deferred revenue	170,402	-
Accrued expenses	2,646,102	910,022
Note payable (current portion)	1,677,525	-
Short term loans	10,155,334	9,400,164
Liabilities of discontinued operations	-	223,112
Due to related parties (current portion)	1,542,268	202,682
Total current liabilities	18,212,842	11,234,404
Due to related parties (non-current portion)	-	135,693
Note payable (non-current portion)	19,050,122	-
Total liabilities	37,262,964	11,370,097
<b>STOCKHOLDERS' (DEFICIT) EQUITY</b>		
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 28,214,797 and 28,303,659 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively)	2,822	2,830
Paid in capital	106,322,328	87,452,060
Stock subscription	509,105	-

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Accumulated other comprehensive income	217,123	278,565
Accumulated deficit	(114,735,617)	(70,621,481)
Noncontrolling interest	(2,720,373)	(103,437)
Total stockholders' (deficit) equity	(10,404,612)	17,008,537
Total liabilities and stockholders' (deficit) equity	\$ 26,858,352	\$ 28,378,634

See accompanying notes to unaudited condensed consolidated financial statements.

**NET ELEMENT INTERNATIONAL, INC.**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**COMPREHENSIVE LOSS**

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012 (As Restated)
Net revenues	\$ 6,520,788	\$ 170,691	12,996,538	222,207
Costs and expenses:				
Cost of revenues	4,646,245	26,767	9,036,826	66,791
General and administrative (includes \$75,000 and \$426,838 and \$225,000 and \$3,820,206 of non cash compensation for quarters and nine months ended Sep 30, 2013 and 2012, respectively)	2,928,528	1,617,052	9,193,026	7,005,657
Provision for loan losses	537,230	-	6,736,302	-
Goodwill impairment	-	-	11,200,000	-
Depreciation and amortization	796,985	53,937	1,449,659	134,307
Total costs and operating expenses	8,908,988	1,697,756	37,615,813	7,206,755
Loss from operations	(2,388,200)	(1,527,065)	(24,619,275)	(6,984,548)
Interest (expense) income, net	(973,256)	412,266	(2,043,353)	314,883
Other expense	(80,019)	(51,017)	(168,509)	(462,242)
Loss from continuing operations	(3,441,475)	(1,165,816)	(26,831,137)	(7,131,907)
Net loss attributable to the noncontrolling interest	266,001	45,990	835,642	118,739
Discontinued operations:				
Loss from operations of discontinued entities	(372,496)	(694,478)	(1,018,003)	(1,898,397)
Loss on disposition of assets pertaining to discontinued operations	(321,643)	-	(321,643)	-
Total discontinued operations	(694,139)	(694,478)	(1,339,646)	(1,898,397)
Net loss	(3,869,613)	(1,814,304)	(27,335,141)	(8,911,565)
Foreign currency translation gain (loss)	162,997	7,057	(101,761)	(1,819)
Comprehensive loss	\$ (3,706,616)	\$ (1,807,247)	\$ (27,436,902)	\$ (8,913,384)
Loss per share - basic and diluted continuing operations	\$ (0.11)	\$ (0.05)	\$ (0.92)	\$ (0.37)
Loss per share - basic and diluted discontinued operations	\$ (0.02)	\$ (0.04)	\$ (0.05)	\$ (0.10)
Total Net loss per share	(0.13)	(0.09)	(0.97)	(0.47)
Weighted average number of common shares outstanding - basic and diluted	28,163,337	\$ 19,314,379	28,173,573	19,083,270

See accompanying notes to unaudited condensed consolidated financial statements.





**NET ELEMENT INTERNATIONAL, INC.**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2013	2012 (As Restated)
Cash flows from operating activities:		
Net loss	\$ (27,335,141)	\$ (8,911,565)
Loss on disposition of assets pertaining to discontinued operations	321,643	-
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash compensation	225,000	3,803,862
Depreciation and amortization	1,449,659	134,307
Provision for loan losses	6,736,302	-
Impairment of goodwill	11,200,000	-
Non controlling interest	(835,642)	(118,739)
Changes in assets and liabilities, net of acquisitions and the effect of consolidation of equity affiliates		
Accounts receivable	1,620,499	(8,884,116)
Note receivable	(520,000)	(10,218,888)
Prepaid expenses and other assets	362,444	(229,702)
Accounts payable	1,543,485	9,170,102
Accrued expenses	(1,272,562)	209,509
Adjustments for operating activities of continuing operations	20,509,185	(6,133,665)
Adjustments for operating activities of discontinued operations	138,092	5,915,943
Total adjustment	20,647,277	(217,722)
Net cash used in operating activities	(6,366,221)	(9,129,287)
Cash flows from investing activities- net of acquisitions:		
Collections from notes receivable	4,694,605	-
Note payable (non-current portion)	-	-
Investment in Aptito	(228,113)	-
Capitalized web development and patent costs and equity effects	-	(70,265)
Disposal (purchase) of fixed assets	46,966	(221,903)
Net cash provided by investing activities	4,513,458	(292,168)
Cash flows from financing activities- net of acquisitions:		
Proceeds from note payable	755,170	4,164,470
Change in restricted cash	2,056,821	(1,763,386)
Cash paid for share repurchases	(482,400)	-
Due to related parties	38,591	8,087,259
Contributed capital from non-controlling shareholders	-	1,603,169
Repayments to related parties	(75,000)	(75,000)
Net cash provided by financing activities	2,293,182	12,016,512
Effect of exchange rate changes on cash	(61,441)	(1,819)
Net increase in cash	378,978	2,593,238
Cash at beginning of period	3,546,787	59,387
Cash at end of period	\$ 3,925,765	\$ 2,652,625
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$ 1,038,125	\$ 4,861
Supplemental disclosure of non-cash investing and financial activities in connection with business acquisition:		

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Issued and outstanding common stock (10% of TOT Group's common stock)- Unified	609,000	-
Assumed debt	20,631,000	-
Total value of consideration for Unified payments acquisition	21,240,000	-
Stock subscription in connection with acquisition of Aptito	718,750	-
Transfer of K1 Note Liability to T1T Lab, LLC in connection with divestiture of OOO Music1	2,000,000	-

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 global technology-driven group specializing in electronic commerce, mobile payments and transactional services. The Company owns and operates a global mobile payments and transaction processing provider. Together with its subsidiaries, the Company enables ecommerce and content-management companies to monetize their assets in ecommerce and mobile commerce environments.

The Company’s subsidiary TOT Group, Inc. (formerly known as TOT, Inc.) (“TOT Group”) is a multinational mobile payments and transaction processing holding company, which provides a range of flexible online and offline payment solutions. Clients include wireless carriers, content providers and merchants. TOT Group delivers comprehensive, end-to-end payment solutions to enable merchants to reliably accept cashless transactions at the point of sale (“POS”). From processing electronic payments at the POS to processing mobile commerce transactions to managing merchant terminals and providing information management services, TOT Group through its proprietary technology offers innovative solutions which allow its merchants to streamline their payments resources. Through TOT Group, the Company generates revenues from transaction fees, service fees, percentage of the dollar amount of each transaction and other fees associated with processing of cashless transactions at the points of sale. The Company serves merchants primarily in the retail, restaurant, supermarket, petroleum and hospitality sectors. In addition, TOT Group (through its subsidiary OOO TOT Money (“TOT Money”) operates the Company’s provider of carrier-integrated mobile payments solutions. TOT Money’s relationships with mobile operators give the Company substantial geographic coverage, a strong capacity for innovation in mobile payments and messaging, and the ability to offer customers In-App, P-SMS and Online and Carrier Billing solutions in over 49 countries.

During the third quarter of 2012, the Company's subsidiary, TOT Money, launched operations as a provider of carrier-integrated mobile payments solutions in Russia. Since then, TOT Money has continued seeking to expand its carrier-integrated mobile payments 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, certain subsidiaries of TOT Group acquired substantially all of the business assets of Unified Payments, LLC, a Delaware limited liability company ("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. See Note 4 for additional information regarding this acquisition.

On June 24, 2013, TOT Group, through its newly formed subsidiary Aptito, LLC (“Aptito”) acquired substantially all of the business assets of Aptito.com, Inc, a New York corporation. Aptito is a new generation of smart, customer engaged, patent-pending payments platform, mobile Point of Sale (“mPOS”), mobile commerce application and self-ordering Apple® iPad®-based kiosk. Through its disruptive, cloud-based payments platform Aptito offers merchants an innovative, socially driven, all-in-one digital software solution that offers a complete package of features for the food-service industry. Aptito’s Restaurant mPOS solution provides restaurants with tools to increase sales, productivity, and customer loyalty. Aptito’s suite of fully linked tools enables inventory management, complete payroll, staff scheduling, patron reservations and digital menus. More capable and less costly than traditional restaurant POS systems, Aptito’s system does not have the steep learning curve associated with typical POS products.

The Company previously owned several popular content monetization verticals (i.e., interests in online media businesses and operations) that were divested during the quarter ended September 30, 2013 (see Note 5 for additional information regarding this divestiture). As a result of this divestiture, the Company now has only one reportable business segment, consisting of mobile commerce and payment processing. Operations of the divested businesses are presented as discontinued operations.

The accompanying unaudited condensed consolidated financial statements include those of the Company and its wholly-owned and majority-owned subsidiaries. All intercompany balances and transactions with the Company’s subsidiaries have been eliminated upon consolidation. The unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America 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 and nine months ended September 30, 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 Securities and Exchange 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.

Significant estimates include (i) the valuation of acquired merchant portfolios (ii) the recoverability of long-lived assets, (iii) the remaining useful lives of long-lived assets, and (iv) the sufficiency of merchant, legal, and other reserves. On an ongoing basis, the Company evaluates the sufficiency and accuracy of its estimates. Actual results could differ from those estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and all liquid investments with an initial maturity of three months or less when purchased. 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. Except for one bank account at September 30, 2013 with a balance of \$303,816, our United States bank

balances did not exceed FDIC limits at September 30, 2013 and December 31, 2012.

The Company had approximately \$3,624,583 and \$315,000 in un-insured Russian, Ukrainian and Cayman Island bank accounts as of September 30, 2013 and December 31, 2012, respectively.

**Other Current Assets**

The Company maintains an inventory of terminals, which it uses to service both merchants and independent sales agents. If the terminals are sold for a fee, the Company expenses the cost of these terminals, plus any set up fees at the time of the sale. Many times, the Company will give away the terminals as an incentive. In this case the cost of the terminal plus any set up fees will be amortized over three years, which is the average length of a merchant contract. The Company has \$291,602 in terminals acquired, net of amortization, of which \$7,255 has been placed with merchants. Amortization of these terminals amounted to \$572 for the three months and nine months ended September 30, 2013.

### **Fixed Assets**

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

Expenditures for repairs and maintenance are charged to operating expense as incurred. Expenditures that increase the value or productive capacity of assets are capitalized. At the time of retirements, sales, or other dispositions of property and equipment, the original cost and related accumulated depreciation are removed from the respective accounts, and the gains or losses are presented as other expenses.

### **Intangible Assets**

Included in the Company's intangible assets are merchant portfolios, which represent the net book value of an acquired merchant customer base, and are amortized on a straight-line basis over their respective useful lives, generally three to five years. Merchant portfolios are assessed for impairment if events or circumstances indicate that their respective carrying values are not recoverable from the future anticipated undiscounted net cash flows attributable to such assets. In such cases, the amount of any potential impairment would be measured as the excess, if any, of carrying value over the fair value of such assets. There was no impairment at September 30, 2013.

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.

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: merchant portfolios, trade names, non-compete agreements, owned website names, customer relationships, and technology.

### **Accrued Residual Commissions**

The Company pays commissions to independent sales organization ("ISO's") and independent sales agents or to the Company's direct sales force based on the processing volume of the merchants enrolled. The commission payments are based on varying percentages of the volume processed by the Company on behalf of the merchants. Percentages vary based on the program type and transaction volume of each merchant. The Company reports commission payments as a cost of revenues in the accompanying consolidated statement of operations and comprehensive loss. As of September 30, 2013 the residual commission payable to ISO's and independent sales agents was \$217,159, and \$0 at December 31, 2012, which amounts are included in accounts payable in the accompanying consolidated balance sheets.

**Capitalized Customer Acquisition Costs, Net**

Capitalized customer acquisition costs consist of up-front cash payments made to certain ISO's for the establishment of new merchant relationships. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with merchant contracts. The up-front payment to the ISO is based on the estimated gross margin for the first year of the merchant contract. The deferred customer acquisition cost asset is recorded at the time of payment and the capitalized acquisition costs are primarily amortized on a straight-line basis over a period of three years.

Management evaluates the capitalized customer acquisition cost for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net undiscounted cash flows from underlying merchant relationships to the carrying amount of capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the carrying value of the capitalized customer acquisition costs, the impairment loss is charged to operations.



During the three months and nine months ended September 30, 2013, the Company recorded \$79,356 and \$361,736 in additional capitalized customer acquisition costs and \$27,853 and \$49,171, respectively, in related additional amortization. The balance of customer acquisition costs is \$312,407 at September 30, 2013 and reflected in intangible assets in the accompanying consolidated balance sheets.

### **Processing Liabilities and ISO Deposits**

The majority of the Company's processing liabilities include potential losses associated with bankcard and check processing. In addition, the Company maintains deposits from ISO's to offset potential liabilities from merchant chargeback processing. Disputes between a cardholder and a merchant periodically arise due to the cardholder's dissatisfaction with merchandise quality or merchant's services, and the disputes may not always be resolved in the merchant's favor. In some of the cases the transaction is "charged back" to the merchant and the purchase price is refunded to the cardholder by the credit card-issuing institution. If the merchant is unable to fund the refund, the Company is liable for the full amount of the transaction. The Company's obligation to stand ready to perform is minimal because the Company maintains a deposit from certain ISO's as an offset to potential contingent liabilities that are the responsibility of such merchants. The Company evaluates its ultimate risk and records an estimate of potential loss for chargebacks related to merchant fraud based upon an assessment of actual historical fraud loss rates compared to recent bankcard processing volume levels.

The amount recorded as of September 30, 2013 for the processing liability was \$107,669 and is included in long term debt in the accompanying consolidated balance sheets. There was no processing liability at December 31, 2012.

### **Fair Value Measurements**

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivables, notes receivable, trade payables and debt instruments. The carrying values of cash and cash equivalents, accounts receivable and trade payables are considered to be representative of their respective fair values due to the short-term nature of these instruments. The carrying amount of notes receivable are discounted to present value as further discussed in Note 6. The carrying amount of the long-term debt of \$22 million as of September 30, 2013 approximates fair value because the Company's current borrowing rate does not materially differ from market rates for similar bank borrowings. The long-term debt is classified as a Level 2 item within the fair value hierarchy.

The Company measures certain nonfinancial assets and liabilities at fair value on a nonrecurring basis. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The Company uses a three-level fair value hierarchy to prioritize the inputs used to measure fair value and maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 Quoted market prices in active markets for identical assets or liabilities as of the reporting date
- Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data
- Level 3 Unobservable inputs that are not corroborated by market data

These non-financial assets and liabilities include intangible assets and liabilities acquired in a business combination as well as impairment calculations, when necessary. The fair value of the assets acquired and liabilities assumed in connection with the Unified Payments acquisition, as discussed in Note 4, were measured at fair value by the Company at the acquisition date. The fair values of the Company's merchant portfolios are primarily based on Level 3 inputs and are generally estimated based upon independent appraisals that include discounted cash flow analyses

based on the Company's most recent cash flow projections, and, for years beyond the projection period, estimates based on assumed growth rates. Assumptions are also made regarding appropriate discount rates, perpetual growth rates, and capital expenditures, among others. In certain circumstances, the discounted cash flow analyses are corroborated by a market-based approach that utilizes comparable company public trading values, and, where available, values observed in private market transactions. The inputs used by management for the fair value measurements include significant unobservable inputs, and therefore, the fair value measurements employed are classified as Level 3. The goodwill impairment (see Note 1) was primarily based on observable inputs using company specific information and is classified as Level 3.

## Concentrations

The Company's revenue was \$6,520,788 and \$12,996,538 for the three months and nine months ended September 30, 2013. Of this, \$5,509,658 and \$10,110,588 was derived from processing of Visa®, MasterCard®, Discover® and American Express® card transactions \$1,011,130 and \$2,884,529 was derived from processing of mobile electronic payments, for the three months and nine months respectively

The credit card processing revenues of \$10,110,588 was derived from merchant customer transactions, which are processed primarily by three "third-party" processors. For the nine months ended September 30, 2013, the Company processed 21% of its total revenue with Cynergy Data, 31% with National Processing Company (NPC) and 22% with First Data.

The mobile electronic payment revenues of \$2,884,529 are derived from merchant customer transactions, which are processed primarily by two mobile operators. For the nine months ended September 30, 2013, the Company processed 10% of its total revenue with Beeline (OJSC Vimpelcom), and 10% with MTS (Mobile TeleSystems OJSC).

## Foreign Currency Transactions

The Company is subject to exchange rate risk in its foreign operations in Ukraine, the functional currency of which is Ukraine Hryvnia, and Russia, the functional currency of which is Russian Ruble, where the Company generates service fee revenues and interest income and incurs product development, engineering, website development, and general and administrative costs and expenses. 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 and cost of revenues for the nine-month period ended September 30, 2013 and 2012 are principally derived from the following sources:

*Service Fees.* Service fees in the current year are generated primarily from TOT Payments, LLC, TOT Money's payment processing and service fees from prior year are primarily 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.

The Company has multiple element arrangements that include bundled transactions with merchants encompassing annual PCI (payment card industry) fees, annual membership fees, and monthly processing fees.

The Company adopted accounting standard update No 2009-13, "Multiple Deliverable Revenue Arrangements" (ASU 2009-13). ASU 2009-13 requires the use of the relative selling price method of allocating total consideration to units of accounting in a multiple element arrangement and eliminates the residual method. This accounting principle requires an entity to allocate revenue in an arrangement using estimated selling price deliverables if it does not have vendor specific objective evidence (VSOE) or third party evidence (TPE) of selling price.

VSOE is the price charged when the same or similar product or service is sold separately. The Company defines VSOE as a median price of recent stand-alone transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately.

The Company evaluates each deliverable in its arrangements to determine whether it represents a separate unit of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value to our customers. The Company's products (i.e., terminals) and services qualify as separate units of accounting under ASU 2009-13.

The Company's payment processing division derives revenues primarily from the electronic processing of services including credit, debit and electronic benefits transfer card processing authorized and captured through third party networks, check conversion and guarantee, electronic gift certificate processing, and equipment leasing and sales. These revenues are recorded as bankcard and other processing transactions when processed.

Typically, fees charged to merchants for these processing services are based on a variable percentage of the dollar amount of each transaction and in some instances, additional fees are charged for each transaction. Merchant customers may also be charged miscellaneous fees, including statement fees, annual fees, monthly minimum fees, fees for handling chargebacks, gateway fees, and fees for other miscellaneous services.

The fair value for annual fees is based on the annual contract renewal price and is deemed to represent stand-alone selling price based upon VSOE. The fair value for processing is based on prices charged by our competitors for similar deliverables when sold separately and is deemed to represent stand-alone selling price based upon TPE.

Deferred revenue represents primarily amounts received in advance for annual fee billings and are recognized on a pro rata basis over the service period.

Generally, the Company (i) is the primary obligor in its arrangements with its merchant customers, (ii) has latitude in establishing the price of its services, (iii) has the ability to change the product and perform parts of the services, (iv) has discretion in supplier selection, (v) has latitude in determining the product and service specifications to meet the needs of its merchant customers, and (vi) assumes credit risk. In such cases, the Company reports revenues as gross of fees deducted by its sponsoring member banks, as well as fees deducted from card-issuing member banks and card associations (Visa/MasterCard) on behalf of its sponsoring member banks for interchange and assessments. These fees charged by the card associations to process the credit card transactions are recorded separately as cost of sales and interchange fees in the accompanying consolidated statement of operations.

Revenues from TOT Money are recognized as a percentage of amounts billed to mobile operators. Revenue is recognized when TOT Money's 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 providers 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.

Cost of services for TOT Money is comprised primarily of fees for short numbers provided by the mobile operators that are used to provide traffic from content providers.

Cost of services for TOT Payments is comprised primarily of processing fees paid to third parties attributable to providing transaction processing and other services to the Company's merchant customers. Interchange fees and cost of services are recognized as incurred, which generally occurs in the same period in which the corresponding revenue is recognized. Interchange fees are set by the card networks, and are paid to the card-issuing bank. Interchange fees are calculated as a percentage of the dollar volume processed plus a per transaction fee. The Company also pays Visa® and Mastercard® network dues.

## **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. Loss from continuing operations per common share is computed by dividing loss from continuing operations, applicable to common stockholders, by the weighted average number of common shares outstanding during the period. Loss from discontinued operations per common share is computed by dividing loss from discontinued operations, applicable to common stockholders, by the weighted-average number of common shares outstanding during the period. 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 September 30, 2013 and December 31, 2012, the Company had 8,938,900 warrants issued and outstanding that are anti-dilutive in effect.

## **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. As part of its June 30, 2013 financial statement closing process, as well as the Company's review of the valuation performed in connection with the Unified Payments business combination, the Company determined that the reported goodwill of its TOT Payments reporting unit as of June 30, 2013 was impaired.

The carrying amount of this reporting unit was negative as of June 30, 2013, thus the Company performed Step 2 of the goodwill impairment test as during the second quarter. The fair value of the reporting unit was determined based on a combination of the income approach (discounted cash flow analysis) and market approach. The result of the Step 2 analysis indicated that the TOT Payments reporting unit's goodwill was impaired by approximately \$11.2 million at June 30, 2013. The Company recorded no goodwill impairment charges for the three months ended September 30, 2013.

## **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 September 30, 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 September 30, 2013.

**Reclassification**

Certain balances for the nine months ended September 30, 2012 and the balance sheet at December 31, 2012 have been reclassified to conform to the September 30, 2013 presentation. This reclassification is primarily related to the discontinued operations.



## Recently Issued and Adopted Accounting Guidance

### *Recently Issued Accounting Guidance*

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This update provides that an entity that has unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date should present the unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This update is effective for reporting periods beginning after December 15, 2013. The Company does not believe the adoption of this guidance will have a material impact on the Company's unaudited condensed consolidated financial statements.

### *Recently Adopted Accounting Guidance*

In July 2012, the FASB issued ASU 2012-02, *Intangibles-Goodwill and Other (Topic 350)* which amended then existing guidance by giving an entity the option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. Previous guidance required an entity to test indefinite-lived intangible assets for impairment, on at least an annual basis, by comparing the fair value of the asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. This update is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company adopted this guidance on January 1, 2013. The adoption of this guidance did not have a material impact on the Company's unaudited condensed consolidated financial statements.

In March 2013, the FASB issued ASU 2013-05, *Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity (a consensus of the FASB Emerging Issues Task Force)* ("ASU 2013-05"). The objective of ASU 2013-05 is to resolve diversity in practice regarding the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. ASU 2013-05 is effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The Company is currently evaluating the potential impact of this ASU on its condensed unaudited consolidated financial statements.

## NOTE 2. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

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:

### Continuing Operations:

The following entities make up our continuing operations: (1) TOT Group, Inc. ("TOT Group"), a 89% owned subsidiary formed in Delaware; (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) OOO Net Element Russia ("Net Element Russia"), a wholly owned subsidiary formed in Russia (5) Music 1.

### Discontinued Operations:

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The following entities make up our discontinued operations: (1) A&R Music Holdings, LLC, a wholly owned subsidiary formed in Florida (operations ceased January 31, 2013); (2) OOO Music1 (formerly a subsidiary of NETE Russia and divested on September 25, 2013) (3) Ya Talant (divested on September 25, 2013) (4) Splinex (also the parent company of IT Solutions, LTD and also divested On September 25, 2013), (5) MotorSport (also the parent of Motorsport.com, Inc. also divested on September 25, 2013), (6) Openfilm, Inc. (also the parent of Openfilm Studiso, LLC (company closed June 2013)) and (7) Zivos, LLC (Ukraine) (divested September 25, 2013),

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

TOT Group is the parent company of TOT Payments, LLC, (TOT Payments) a wholly owned subsidiary formed in Florida, Aptito, LLC, a 80% owned subsidiary formed in Florida (acquired June 18, 2013) and OOO TOT Group Russia, a wholly owned subsidiary formed in Russia.

- TOT Payments, LLC is the parent company of:
  - Process Pink, LLC, a wholly owned subsidiary formed in Florida;
  - TOT HPS, LLC, a wholly owned subsidiary formed in Florida;
  - TOT FBS, LLC, a wholly owned subsidiary formed in Florida;
  - TOT New Edge, LLC, a wholly owned subsidiary formed in Florida; and
  - TOT BPS, LLC, a wholly owned subsidiary formed in Florida.
- OOO TOT Group Russia, is the parent company of its 99% owned OOO TOT Money (a company formed in Russia) (30% of TOT Money was owned by Net Element Russia until September 15, 2013 when this interest was transferred to OOO TOT Group Russia).
- Netlab is the parent company of Tech Solutions LTD.
- A&R Music Holdings (f/k/a Music1) is the parent company of A&R Music Live, LLC ("A&R Music Live") (operations discontinued January 31, 2013).
- Net Element Russia is the parent company of OOO TOT Group and OOO Music1 (Russia) (operations discontinued September 25, 2013). Net Element Russia owned 30% of OOO TOT Money until September 15, 2013 when this interest was transferred to OOO TOT Group Russia.

In addition, the Statement of Operations and Statement of Cash Flows contain activity through September 25, 2013 for discontinued operations of our on-line media businesses. On September 25, 2013, the Company entered into a Contribution Agreement with T1T Lab, LLC, a Florida limited liability company, and T1T Group, LLC, a Delaware limited liability company, pursuant to which, on September 25, 2013, the Company contributed to T1T Lab all of its membership and participation interests in its subsidiaries Openfilm, LLC, Motorsport, LLC, Splinex, LLC, LegalGuru, LLC and MUSIC 1 LLC (a/k/a OOO Music1). There are no amounts reported on the Balance Sheet for the discontinued entities at September 30, 2013 given the divestiture occurred on September 25, 2013. Prior periods have been reclassified to isolate and report the results from operations of these discontinued entities and prior period assets and liabilities.

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 September 30, 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 continuing operations of \$8.1 million for the nine months ended September

30, 2013, an accumulated deficit of \$114.7 million and negative working capital of \$3.1 million at September 30, 2013. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

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 could harm the Company's revenues and materially adversely affect its financial condition and results of operations. The Company faces all of the risks inherent in a new business, including the need for significant additional capital, management's potential underestimation of initial and ongoing costs, and potential delays and other problems in connection with developing the Company's technologies and operations.

The Company is continuing with its plan to further grow and expand its payment processing operations 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 AND ACQUISITIONS TRANSACTIONS

##### **Net Element, Inc. Merger**

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 financial statements as of December 31, 2012 and for the three months and year to date ended September 30, 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.

## Unified Payments Acquisition

On April 16, 2013, the Company entered into a Contribution Agreement (the “Contribution Agreement”) with Unified Payments, LLC, a Delaware limited liability 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. As consideration for Unified Payments’ and its subsidiaries’ contribution of their assets to TOT Group subsidiaries, (a) the Company contributed to a subsidiary of TOT Group 70% of the equity interests in the Company’s subsidiary, OOO TOT Money (through which the Company operates its mobile commerce payment processing business); (b) TOT Group issued to Unified Payments 10% of TOT Group’s issued and outstanding common stock which was valued at approximately \$600,000 (valued based on a discounted cash flow analysis of TOT Group adjusted for a lack of marketability discount); and (c) TOT Group assumed approximately \$20.6 million in liabilities of Unified Payments and its subsidiaries.

The following table summarizes the estimated fair value of consideration paid and the allocation of purchase price as of the date of acquisition (in millions). The allocation of purchase price to the fair value of tangible and intangible assets and liabilities, including the estimated useful lives of acquired assets, is provisional and remains preliminary as management continues to assess the valuation of these items and any ultimate purchase price adjustments based on the final assets and net working capital, as prescribed by the purchase agreement.

	April 16th, 2013
	(in Millions)
Purchase Consideration:	
Assumption of Debt	\$ 20.6
Issuance of TOT Group Stock (10%)	0.6
Total Consideration Transferred	\$ 21.2
Purchase Price Allocation to Identifiable assets acquired and liabilities assumed	
Current Assets	\$ 0.9
Merchant Portfolios	4.4
Other Intangible Assets	1.0
Current Liabilities	(2.1)
Total Identifiable Net Assets	4.2
Goodwill	17.0
Total Purchase Price Allocation	\$ 21.2

Intangible assets and merchant portfolios will be amortized in a manner consistent with the pattern in which the related benefits are expected to be consumed. Goodwill arising from the acquisition represents the estimated value of Unified Payments’ presence in key high growth markets, its assembled workforce, its management team's industry-specific project management expertise and synergies expected to be achieved from the combined operations of Unified Payments and TOT Money.

As part of its June 30, 2013 financial statement closing process, as well as the Company’s review of the independent valuation performed in connection with the Unified Payments business combination, the Company determined that the reported goodwill of its TOT Payments unit as of June 30, 2013 is impaired. See Note 1, Impairment of long-lived assets.

### **Aptito Acquisition**

On June 18, 2013, Aptito, LLC (“Aptito”), an indirect subsidiary of the Company, entered into an Asset Purchase Agreement with Aptito.com, Inc., a New York corporation (“Seller”), pursuant to which Aptito acquired on such date substantially all of the business assets of Seller. The business assets sold to Aptito by Seller include the development, implementation and sales of an all-in-one, cloud-based, digital point-of-sale software and customer relations management and payments platform, including the Restaurant mPOS, a tablet-based point-of-sale solution that combines traditional point-of-sale functionality with mobile ordering, payments, social media, intelligent offers, mobile applications, loyalty and transactional data all in one solution using Seller’s (and now Aptito’s) cloud-based payments platform.

As consideration for the acquired business assets, (a) Aptito assumed and simultaneously repaid \$145,000 of outstanding indebtedness (with an original principal balance totaling \$200,000); (b) the Company agreed to issue to Seller 125,000 restricted shares of the Company’s common stock, which shares will vest quarterly over 12 months (valued at \$718,750). The total purchase consideration was \$918,750 and ascribed to goodwill. At September 30, 2013, 36,460 shares with a value of \$209,645 have been vested.

The allocation of purchase price to the fair value of tangible and intangible assets and liabilities is provisional and remains preliminary as management continues to assess the valuation of these items and any ultimate purchase price adjustment based on final assets and net working capital, as prescribed by the purchase agreement and valuation.



The Company's subsidiary, TOT Group, which owns an 80% membership interest in Aptito, has an option to purchase Seller's 20% membership interest in Aptito at any time after December 31, 2014 or at any time upon a change of control (as defined in Aptito's limited liability company agreement) of Aptito, with the purchase price based on the fair market value of Aptito as of the end of the calendar month immediately preceding TOT Group's request for a valuation in accordance with the terms of the option, payable in cash, cancellation of indebtedness, shares of common stock or a combination of the foregoing.

### **Global Motorsports Media and Andrew John Maitland**

On May 17, 2013, the Company acquired Global Motorsports Media in exchange for \$35,410 in cash compensation paid over time. Included in the purchase was the business name, on-going benefit of existing contracts, existing client base and database of information used to manage and conduct business.

Additionally, we entered into a Services Agreement for twelve months with Andrew John Maitland (Andrew) for management of the ongoing operations of the business and training of Net Element employees in methods used so they can be replicated across other entertainment assets of the business. Andrew will be provided with monthly consulting fee of \$6,640 pursuant to this service agreement.

As described further in Note 5, Motorsport, LLC and Motorsport.com were divested on September 25, 2013. The Global Motorsports Media business and the contract for services with Andrew were both part of the divestiture.

### **Unaudited Pro Forma Information - Acquisitions**

The following unaudited supplemental pro forma results of operations include the results of operations of each of the companies acquired in the second quarter of 2013 described above as if each had been consolidated as of January 1, 2012, and have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined companies for the periods presented or that may be achieved by the combined companies in the future. Future results may vary significantly from the results reflected in the following pro forma financial information because of future events and transactions, as well as other factors, many of which are beyond the Company's control. Additionally, GMM Motorsports Media was divested on September 25, 2013 (see Note 5).

The unaudited pro forma combined results of operations for the three and nine months ended September 30, 2013 and 2012 have been prepared by adjusting the historical results of the Company to include the historical results of the acquisitions described above as if they occurred January 1, 2012. The pro forma results of operations do not include any adjustments to eliminate the impact of acquisition related costs or any cost savings or other synergies that may result from these acquisitions. As noted above, the pro forma results of operations do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future and certain entities have been divested (see Note 5).

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
NET Revenues	\$ 6,520,788	\$ 19,625,563	\$ 16,492,203	\$ 48,136,690
Net Loss from continuing operations	\$ (3,441,475)	\$ (28,091,723)	\$ (2,560,874)	\$ (11,183,615)

### **Quickpay Letter of Intent**

On June 27, 2013, the Company and its subsidiary, TOT Group, Inc., entered into a letter of intent to acquire substantially all of the business assets of nine entities collectively referred to as “Quickpay,” which include Quickpay USA, Inc., UPC-Kazakhstan, LLP, United Processing System of Panama, Inc., Quickpay Multinational Payment System LTD, MPS, LLC, MPS, LTD, Quickpay Columbia SAS, System Quickpay, LLC and Express MIT, LLC. After our due diligence, management has determined that Quickpay was not a fit for our business model and has not moved forward with the acquisition.

## NOTE 5. DISCONTINUED OPERATIONS

On September 25, 2013, the Company entered into a Contribution Agreement (the "Divestiture Contribution Agreement") with T1T Lab, LLC, a Florida limited liability company ("T1T Lab"), and T1T Group, LLC, a Delaware limited liability company ("T1T Group"), pursuant to which, on September 25, 2013, the Company contributed to T1T Lab all of its membership and participation interests in its subsidiaries Openfilm, LLC, Motorsport, LLC, Splinx, LLC, LegalGuru, LLC and MUSIC 1 LLC (a/k/a OOO Music1) (collectively, the "Disposed Subsidiaries"). The Disposed Subsidiaries constitute all of the Company's interests in online media businesses and operations (referred to herein collectively as the Company's "entertainment assets"). As described further below, following the transactions effectuated pursuant to the Divestiture Contribution Agreement, the Company currently indirectly owns a minority interest in the Disposed Subsidiaries through its 10% membership interest in T1T Lab. The Company disposed its entertainment assets in order to focus its business operations on mobile payments, transactional services and related technologies and to reduce the significant expenses associated with developing and maintaining the entertainment assets.

Pursuant to the Divestiture Contribution Agreement, the Company contributed to T1T Lab all of its membership and participation interests in the Disposed Subsidiaries and agreed to make an initial capital contribution to T1T Lab in the amount of \$1,259,000 (recorded as part of Due to related Parties (current portion) on the balance sheet), payable in full or in installments when requested by T1T Lab but in no event later than within the 12-month period after September 25, 2013 (unless such period is mutually extended in writing by the Company and T1T Group).

Subject to T1T Lab's prior written approval, a portion of the Company's initial capital contribution may be made in the form of future services provided by the Company, with the value of such services to be agreed upon in writing between the Company and T1T Group prior to providing such services. The amount of the Company's initial capital contribution is a negotiated amount required for T1T Lab to acquire the Disposed Subsidiaries. In exchange for such contributions, the Company was issued a 10% membership interest in T1T Lab and T1T Lab assumed \$2,162,158 in liabilities (including \$2,000,000 owed by the Company to K 1 Holding Limited pursuant to a promissory note dated May 13, 2013) related to the Disposed Subsidiaries. In addition, all intercompany loans payable by the Disposed Subsidiaries to the Company, on the one hand, and by the Company to the Disposed Subsidiaries, on the other hand, were forgiven by the Company and by T1T Lab (as applicable).

Pursuant to the Divestiture Contribution Agreement, T1T Group agreed to contribute to T1T Lab from time to time when requested by T1T Lab such services and/or cash as determined by T1T Group in its sole and absolute discretion in order to manage and operate the Disposed Subsidiaries and their respective businesses. In exchange for such contributions, T1T Group was issued a 90% membership interest in T1T Lab. T1T Group is wholly-owned by Enerfund, LLC (which is wholly-owned by Mike Zoi, a director and majority stockholder of the Company).

Based on the foregoing, and in conformity with applicable accounting guidance, the Disposed Subsidiaries qualify as a discontinued operation. Accordingly, financial results of the Disposed Subsidiaries have been reported as discontinued operations in the accompanying consolidated statements of income for all periods presented.

Summarized results of the Company's discontinued operations are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues	\$ 17,395	\$ 20,709	\$ 14,484	\$ 81,821
Loss Before Income taxes	(694,139)	(797,903)	(1,339,646)	(2,125,026)

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Income Tax Benefit	-	13,969	-	13,969
Net Loss from Discontinued Operations	\$ (694,139)	\$ (694,478)	(1,339,646)	(1,898,397)

As of December 31, 2012, the aggregate components of assets and liabilities classified as discontinued operations and included in current assets and current liabilities consisted of the following:

	December 31 2012
Cash	\$ 32,950
Other Current Assets	29,055
Net Fixed Assets	29,258
Due from related parties	-
Intangible assets	101,196
Total Assets	\$ 192,459
Accounts Payable and Accrued Expenses	87,419
Due to related parties	135,693
Other short term loans	-
Total Liabilities	\$ 223,112
Net assets (deficit) of discontinued operations	\$ (30,653)

#### NOTE 6. NOTES RECEIVABLE

As of September 30, 2013 and December 31, 2012, the Company had net notes receivable of \$520,000, \$180,000 of which is current portion and \$340,000 is non-current portion, and \$6,088,934, respectively, as follows:

	September 30, 2013	December 31, 2012
RM Invest	\$ -	\$5,188,934
Note receivable from former general director	1,834,302	-
Infratont Equities, Inc.	-	1,791,475
Less: Allowance for uncollectible note receivable	(1,314,302)	(891,475)
Total note receivable, net	\$520,000	\$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 was 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). 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. As of June 30, 2013, the loan was fully satisfied.

**Infratont**

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 the former general director of the Company’s subsidiary, TOT Money, and he owns a 20% interest in RM Invest, a payment processing business in Russia. During the quarter ended June 30, 2013, the Company determined the Infratont loan was uncollectible and wrote off the balance of \$991,475.

**Former General Director TOT Money**

The Company commenced its carrier-integrated mobile payment payments solutions operations, through its subsidiary TOT Money, during the third quarter of 2012. These operations consist of TOT Money paying aggregators for content to be provided to mobile operators. Aggregators are businesses that contract for content from many content providers and provide processing volume to TOT Money. During the final quarter of 2012 and the nine months ended September 30, 2013, TOT Money’s former general director was providing advances to aggregators based on projected processing volumes. Although the Company has a history of transactions with most aggregators, we do not obtain financial statements or bank references to complete a full credit review of each aggregator. In addition, aggregator advances are unsecured. As of December 31, 2012 and March 31, 2013, the Company established a 10% reserve on these aggregator advances based on actual and estimated processing volumes subsequent to these dates, and concluded that the net aggregator advances were recoverable as of December 31, 2012 and March 31, 2013.

During the second quarter of 2013, our new CEO and CEO’s appointed management of TOT Group Russia completed analyzing our aggregator and mobile operator relationship including having discussions with select aggregators. As part of this review, it was determined that the former general director of TOT Money provided advances to aggregators which exceeded the future processing volumes to be provided by these aggregators. As a result of this review, during the second quarter of 2013 it was concluded that a significant amount of these advances would not be recoverable in the form of future business from the aggregators. The former general director took responsibility for a certain amount of these advances and agreed to a settlement. The former general director currently serves as commercial director with responsibility to develop and promote new business.

As part of the settlement discussed above, the Company entered into a settlement agreement with the former general director of TOT Money pursuant to which TOT Money is to receive \$3.8 million to repay certain agreed upon amounts. The term of repayment will be dictated by the volume of future TOT Money business developed as repayment and is based on profit distributions to the former general director, which will be withheld until the \$3.8 million settlement is recovered. The Company has discounted the value of the estimated monthly repayments included in notes receivable in the accompanying consolidated balance sheets.

Management discounted the settlement agreement as follows:

Face value of Note	\$3,811,023	
Term of Note	43 Months	
Imputed Interest Rate	21	%
Present value of Note	1,834,302	
Allowance for uncollectable note receivable	(1,314,302)	
Book value of note	\$520,000	

Due to the past history of losses of the TOT Money operations, the Company decided to establish a reserve of approximately \$1.1 million on the discounted note receivable balance at June 30, 2013. For the quarter ended September 30, 2013, the Company established an additional \$200,000 loss provision bringing the total allowance to \$1.3 million. The additional provision was taken because third quarter results did not produce profit sharing as projected. The book value of the note, net of the allowance, is recorded as \$180,000 in the current portion of notes receivable and \$340,000 as the long-term portion of notes receivable. Depending on the collectability analysis, management will accrete the value of the note each month by approximately \$46,000 by recognizing interest income. Management will also assess the collectability of the receivable on a quarterly basis and adjust the allowance accordingly. See further discussion in Note 7.

## NOTE 7. ACCOUNTS RECEIVABLE AND ADVANCES TO AGGREGATORS

Accounts receivable consist of amounts due from processors and Russian mobile operators. Total accounts receivable amounted to \$9.7 million at September 30, 2013, consisting of \$8.4 million in amounts due from Russian mobile operators and \$1.3 million of TOT Payments, Inc. merchant receivables.

The \$1.3 million is net of a \$2.1 million allowance for amounts due from First Data as the result of an ongoing lawsuit (See Note 14). The effect, net of interchange and Visa/Master card costs, was a charge to bad debt in the amount of \$703,768 during the third quarter, in addition, there were additional charges to bad debts for \$60,321 for ACH rejects in the normal course of operations, resulting in a total charge to provision for bad debt of \$764,089. We had no provision for bad debt for the three months ended September 30, 2012.

The cycle of the TOT Payments processing business begins when TOT Payments charges merchants for processing services, based on a variable percentage of the dollar amount of each transaction and in some instances, additional fees are charged for each transaction. Merchant customers may also be charged miscellaneous fees, including statement fees, annual fees, monthly minimum fees, fees for handling chargebacks, gateway fees, and fees for other miscellaneous service.

The cycle of the Russian TOT Money mobile payment processing business begins with TOT Money paying aggregators for traffic to be provided to mobile operators. Aggregators 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.

As discussed in Note 6, during the second quarter of 2013, the Company concluded that a significant amount of aggregator advances would not be recoverable in the form of future business from the aggregators. In addition, based on its review of transactions with aggregators, the Company concluded that no additional allowance for unrecoverable advances for the three months ended September 30, 2013 was required. The Company had previously recorded loss provisions of approximately \$6.7 million in the prior quarter and during 2012.

In June of 2013, TOT Money entered into a new agreement with the general director, pursuant to which he was relieved of his position as general director and appointed as commercial director with responsibility to develop and promote new business. A new general director of TOT Money was appointed to manage the business and operations. New controls were implemented to pre-verify all payments to aggregators with the mobile operators to ensure the traffic is validated. Additionally, an agreement was reached with the former general director for the Company to recover \$3.8 million in a settlement agreement. This settlement agreement is recorded as a note receivable for \$520,000, which is the present value of \$3.8 million less a reserve for \$1.1 million, given repayment will be from future profit sharing and TOT Money has not been historically profitable. TOT Money expects to recover within 48 months through the holdback of profit sharing payments with the former general director. Once the former general director has repaid the \$3.8 million settlement, he will again be entitled to receive normal monthly profit distributions.

Effective July 1, 2013, the TOT Money changed its policy where it no longer advances more than 1 week of funds to aggregators for future processing volume. Additionally, all traffic in excess of 1 week advance is verified with the mobile operator before payments are approved to aggregators. Advances to aggregators totals \$754,488 as of September 30, 2013.

The Company monitors all accounts receivable, notes receivable and transactions with mobile operators and aggregators on a quarterly basis to ensure collectability and the adequacy of loss provisions. Considerations include



payment history, business volume history, financial statements of borrower, projections of borrower and other standard credit review documentation. Management uses its best judgment to adequately reserve for future losses after all available information is reviewed.

NOTE 8. FIXED ASSETS

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

	Useful life (in years)	September 30, 2013	December 31, 2012
Furniture and equipment	3 - 10	\$ 254,175	\$ 325,522
Computers	2 - 5	255,062	283,513
Leasehold improvements*		-	19,956
Total		509,237	628,991
Less: Accumulated depreciation		(346,381)	(367,232)
Total fixed assets, net		\$ 162,856	\$ 261,759

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

Depreciation expense was \$54,501 and \$53,937 for the three months ended September 30, 2013 and 2012, respectively, and \$138,518 and \$134,307 for the nine months ended September 30, 2013 and 2012, respectively.

NOTE 9. INTANGIBLE ASSETS

Merchant Portfolios

The following table reflects the Company's merchant portfolio at their cost and net carrying value as of September 30, 2013:

	Fair Market Value	Remaining Useful Life in Months	Accumulated Amortization	Net
Process Pink Payments	\$ 1,447,089	18	\$ 368,008	\$ 1,079,081
TOT BPS	1,852,851	15	543,438	\$ 1,309,413
TOT HPS	102,050	15	29,931	\$ 72,119
TOT FBS	968,010	22	209,146	\$ 758,864
	\$ 4,370,000		\$ 1,150,523	\$ 3,219,477

The useful lives of merchant portfolios represent management's best estimate over which the Company will recognize the economic benefits of these 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 over 24 months on a straight-line basis. The Company also capitalizes projects from the point of start to the point the application, service or website is publicly launched. Amortization is straight-line over 24 months. Impairment is reviewed quarterly to ensure only viable active project costs are capitalized. Capitalized website development costs are included in other assets.

During the three months and nine months ended September 30, 2013, two key executives signed covenants not to compete. These covenants have a three-year life and have an estimated fair market value of \$711,667 as of September 30, 2013.

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At September 30, 2013 and December 31, 2012, the Company had \$4,494,837 of intangible assets of which \$3,783,170 was attributed to TOT Group as follows:

	Domain Name	IP Software	Portfolios	Client Acquisition Costs	Covenant non to compete	Capitalized Patent Cost	
Balance at January 1, 2013	\$173,750	\$-				\$37,920	\$
Additions	-	-	-	-		-	
Amortization	-	-	-	-		(1,009)	
Impairment	-	-	-	-		-	
Balance at March 31, 2013	\$173,750	\$-	\$-	\$-	\$-	\$36,911	\$
Additions	-	258,748	4,370,000	282,380	840,000	-	
Amortization	-	-	(501,817)	(20,220)	(58,333)	(1,009)	
Impairment	-	-	-	-		-	
Balance at June 30, 2013	\$173,750	\$258,748	\$3,868,183	\$262,160	\$781,667	\$35,902	\$
Additions	-	-	-	78,100	-	-	
Amortization	-	(7,462)	(648,706)	(27,853)	(70,000)	-	
Divested	(173,750)					(35,902)	
Impairment	-	-	-	-		-	
Balance at September 30, 2013	\$-	\$251,286	\$3,219,477	\$312,407	\$711,667	\$-	\$

Amortization expense for the three months and nine months ended September 30, 2013 was \$754,021 and \$1,336,409, respectively and \$0 for the three months and nine months ended September 30, 2012.

The following table presents the estimated aggregate amortization expense of other intangible assets for the next five years. The table displays amortization expense for the three months ending December 31, 2013 and the years ending December 31, 2014-2017.

2013	\$756,207
2014	2,777,272
2015	653,508
2016	138,635
2017	-
Thereafter	169,215
Total	\$4,494,837

NOTE 10. INVESTMENT IN AFFILIATE

On September 25, 2013, the Company divested certain non-core business entities as discussed in Note 5 Discontinued Operations pursuant to a Contribution Agreement with T1T Lab, LLC (an affiliate owned by Mike Zoi). Through its 10% membership interest in T1T Lab, the Company retained a 10% interest in the divested entities and the Company is required to invest an additional \$1.2 million into T1T Lab, LLC over the next twelve months pursuant to the Contribution Agreement. The investment, which amounted to \$46,113, is accounted for under the cost method since the Company owns 10% of T1T Lab, LLC and does not influence the operations of T1T Lab, LLC.

NOTE 11. SHORT TERM LOANS

As of September 30, 2013, the Company had approximately \$10.1 million in short term loans under a short term factoring agreement with Alfa-Bank, which 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 the factoring agreement with Alfa-Bank; and (ii) \$1.8 million under a credit agreement with Alfa-Bank that was entered by 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 factoring 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 nine 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 September 30, 2013 and December 31, 2012, respectively. The Company's short term payable due to factoring was \$10,155,334 at September 30, 2013.

#### NOTE 12. ACCRUED EXPENSES

At September 30, 2013 and December 31, 2012, accrued expenses amounted to \$2,646,102 and \$910,022 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 September 30, 2013 and December 31, 2012.

	September 30, 2013	December 31, 2012
Accrued professional fees	\$ 920,642	\$ 470,382
Promotional expense	19,601	221,311
Accrued interest	336,583	39,421
Accrued payroll and bonus	1,139,691	36,816
Other accrued expenses	229,585	142,092
	\$ 2,646,102	\$ 910,022

Included in accrued payroll and bonus is \$1,066,091 of accrued performance bonuses attributed to the TOT Group subsidiaries, consisting of bonuses that were owed at the date of the Unified Payments acquisition, plus a discretionary bonus accrual.

#### NOTE 13. LONG TERM DEBT

The Company assumed several long-term debt obligations in connection with its acquisition of the business assets of Unified Payments on April 16, 2013, which are summarized in the below tables.

The components of the Company's outstanding long-term debt as of September 30, 2013 are as follows:

MBF Merchant Capital LLC	\$4,880,649
RBL Capital Group, LLC	2,768,944
Capital Sources	2,300,000
Georgia Notes	10,649,548
Other	128,506
Subtotal	\$20,727,647
Less Current Portion	1,677,525
Long Term Debt	\$19,050,122

### **MBF Merchant Capital, LLC**

The note payable to MBF Merchant Capital, LLC has a loan balance of \$4,880,649, with a stated interest rate of 9.75% and monthly interest payments of \$43,699 per month through May 15, 2015 and a balloon payment of \$5,000,584 (includes accrued interest), which is due on May 15, 2015.

### **RBL Capital Group, LLC**

The Company assumed two long-term notes with RBL Capital Group, LLC:

One note provided for a 15.635% interest rate and an assumed balance of the note, which was \$1,532,853 at the acquisition date. The note requires monthly payments of \$77,560 per month and is secured by the residuals received by a legacy processor of Process Pink. The Company assumed an amendment whereby, in the event that the cash flow ratio, as defined in the loan agreement is at the end of any calendar month less than 2:1 for three consecutive months, then the Company will be obligated to increase the monthly principal and interest payment to be \$125,000 until such time the ratio falls below 2:1 for two consecutive months. Certain prepayment penalties exist, up to a maximum of 4% of the amount pre-paid, if the note is paid prior to maturity. The loan is collateralized by a security agreement whereby the lender has a senior priority security interest in the assets of the borrower. As of September 30, 2013, the lender has agreed not to accelerate any payments.

The second note provided for a 15.635% interest rate and an assumed balance of the note, which was \$1,673,485 at the acquisition date. The note requires monthly payments of \$84,584 per month and is secured by residuals received by a legacy processor of TOT BPS, LLC. The Company assumed an amendment whereby, in the event of the cash flow ratio, as defined in the loan agreement, is at the end of any calendar month less than 1.7:1 for two consecutive months, then the Company will be obligated to increase the monthly principal and interest payment to be \$125,000 until such time the ratio falls below 1.7:1 for two consecutive months. As of September 30, 2013, the lender has agreed not to accelerate any payments.

### **Capital Sources of New York**

The Company assumed the outstanding note payable of \$2,300,000 in principal due to Capital Sources of New York. Under the terms of the note, the note is interest only through February 1, 2014, at which time principal and interest is payable in 24 equal installments. The note bears interest at a rate of 15% per annum. The note is unsecured. The total principal outstanding under the note was \$2,300,000 as of September 30, 2013. The Company recorded interest expense related to the note of \$86,250 for the three months ended September 30, 2013.



## **K 1 Holding Limited**

On May 14, 2013, the Company executed and delivered to K 1 Holding Limited (“K1 Holding”) a promissory note, dated May 13, 2013, in the principal amount of \$2 million, in connection with a loan in such amount made by K1 Holding to the Company. Proceeds from the loan are required to be used for general business purposes of the Company. Since there is no interest stated on this note, the Company used the effective interest method to calculate imputed interest at an effective rate of 13.25%. The Company recognized a discount on the loan of \$463,358, resulting in an initial present value of \$1,536,642. This discount will be amortized over the life of the loan as interest expense. As of September 30, 2013 the present value of the note was \$1,553,609 and the remaining discount amounted to \$446,391. For the three months and nine months ended September 30, 2013 the Company recognized \$16,967 of imputed interest on the note. The outstanding principal balance of the promissory note is required to be repaid no later than May 14, 2015 and may be prepaid in whole or in part at any time without penalty or charge. The unpaid principal balance of the promissory note will become immediately due and payable by the Company upon certain events of default, including in certain circumstances if the Company or its property becomes the subject of certain voluntary or involuntary bankruptcy or insolvency proceedings or if the Company fails to timely pay principal under the promissory note and such failure continues for five business days. K1 Holding is an affiliate of Igor Yakovlevich Krutoy. Mr. Krutoy, through K1 Holding, owns a 33% interest in the Company’s subsidiary OOO Music1.

At the time the K1 Note was entered into by the Company and the related loan made by K1 Holding to the Company, the Company was negotiating a letter agreement dated May 13, 2013 with TGR Capital, LLC and K1 Holding. The draft of that letter agreement at that time provided that, as a condition to K1 Holding making the foregoing loan to the Company and to K1 Holding entering into an agreement to provide certain business development consulting services to the Company, (i) the Company would issue to K1 Holding a number of restricted shares of common stock of the Company equal to 2% of the total issued and outstanding shares of common stock of the Company at the time of issuance and (ii) TGR Capital, LLC would transfer to K1 Holding such number of restricted shares of common stock of the Company as is needed to bring K1 Holding’s and Mr. Krutoy’s aggregate beneficial ownership of common stock of the Company to 10% of the total issued and outstanding shares of common stock of the Company at the time of such transfer. TGR Capital, LLC is an affiliate of the Company’s director and majority stockholder, Mike Zoi. As of the date this Report was filed with the Commission, neither the letter agreement nor the services agreement has been finalized or entered into by the parties. On September 25, 2013, the K1 Note was assumed by T1T Lab in connection with divestiture of entertainment assets on that date.

As of the date of this Report was filed with the Commission, the parties have agreed in principal that, pursuant to the foregoing letter agreement, (i) the Company would issue to K1 Holding a number of restricted shares of common stock of the Company equal to 4% (instead of 2% as initially contemplated) of the total issued and outstanding shares of common stock of the Company at the time of issuance and (ii) TGR Capital, LLC would transfer to K1 Holding such number of restricted shares of common stock of the Company as is needed to bring K1 Holding's and Mr. Krutoy's aggregate beneficial ownership of common stock of the Company to 10% of the total issued and outstanding shares of common stock of the Company at the time of such transfer (decreasing the amount of shares required to be transferred by TGR Capital, LLC to K1 Holding from 8% to 6% of the total issued and outstanding shares of common stock of the Company). However, since as of the date this Report was filed with the Commission the foregoing letter agreement has not yet been finalized or entered into by the parties, the foregoing provisions remain subject to continuing negotiations and subject to entering into a definitive binding agreement, and therefore such provisions are not binding on the Company and are subject to change. The issuance by the Company of any shares of its common stock to K1 Holding pursuant to the letter agreement is subject to approval of the Company’s shareholders.

Similarly, the consulting services agreement described above also has not been finalized or entered into by the parties as of the date this Report was filed with the Commission. As of the date this Report was filed with the Commission, the current draft of such consulting services agreement provides that K1 Holding would provide investor relations services for the Company and its affiliates outside the United States and that K1 Holding would assist the Company



and its affiliates with future negotiations and maintaining their relationship with Mobile TeleSystems OJSC, MegaFon OJSC, OJSC VimpelCom (a/k/a Beeline) and their respective affiliates.

### Georgia Notes, LLC

Pursuant to the Contribution Agreement entered into by the Company on April 16, 2013 with Unified Payments, TOT Group, Oleg Firer and Georgia Notes 18 LLC, on January 1, 2014, the preferred membership interest in Unified Payments plus payable in kind interest accrued thereon will be converted into a 8% interest only loan with a face value of approximately \$13.1 million (interest compounding annually with a balloon payment of approximately \$13.1 million due on January 1, 2017) and upon such conversion, such loan will be assumed by a subsidiary of TOT Group. This convertible preferred membership interest is classified as long term debt in the accompanying consolidated balance sheets, at its present value of \$10,649,548, which includes accrued interest, in accordance with the Contribution Agreement.

### Scheduled Debt Principal Repayment

Scheduled principal repayments on all debt, including Georgia Notes, LLC are as follows:

Three months ended December 31, 2013	\$590,819
Year ended December 31, 2014	2,776,454
Year ended December 31, 2015	6,830,761
Year ended December 31, 2016	-
Year ended December 31, 2017	13,268,000
Total	\$23,466,034

### NOTE 14. COMMITMENTS AND CONTINGENCIES

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.

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. This agreement was part of the divestiture of Motorsport.com on September 25, 2013.

On May 10, 2013, the Company entered into a new lease agreement, which is dated as of May 1, 2013, for approximately 5,200 square feet of office space located at 3363 N.E. 163rd Street, Suites 705 through 707, North Miami Beach, Florida 33160. The Company moved its corporate headquarters and principal executive office to this location in June 2013. The term of the lease agreement is from May 1, 2013 through December 31, 2016, with monthly rent at the rates of \$16,800 per month (or \$134,400 for the initial eight-month period) for the period from May 1, 2013 through December 31, 2013, \$17,640 per month (or \$211,680 per year) for the period from January 1, 2014 through December 31, 2014, \$18,522 per month (or \$222,264 per year) for the period from January 1, 2015 through December 31, 2015 and \$19,448.10 per month (or \$233,377.20 per year) for the period from January 1, 2016 through December 31, 2016.

Until May 31, 2013 we leased approximately 6,500 square feet of office space in Miami, Florida at annual rent of \$201,695. Beginning in January 2013 until the lease term expired, Enerfund, LLC, which is wholly owned by our director and majority stockholder, Mike Zoi, used part of this office space and paid a pro-rata amount of the rent in an amount equal to \$8,500 per month (or \$102,000 per year). The lease term expired May 31, 2013 and we relocated to Unified Payments' office in North Miami Beach (described in the preceding paragraph) upon the expiration of the lease.

As discussed in Note 7, the Company entered into a settlement agreement with the former general director of TOT Money. Pursuant to the agreement, the former general director is to receive profit sharing of 30% of the TOT Money profit as adjusted by certain items listed in the settlement agreement if they relevant for the period. The amounts due for profit sharing are currently being applied to the settlement agreement balance (\$3.8 million). Once the settlement agreement is repaid, the former general director will begin to receive his 30% profit sharing payments on a going forward basis.

The Company also leases office space in Russia and the Ukraine. Total rent expense for these leases was \$103,051 and \$62,968 for the three months ended September 30, 2013 and 2012, respectively. Future minimum lease payments are \$105,469 for 2013 and \$178,425 for 2014, respectively.

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.

#### **Yehuda Keller**

On December 10, 2010, Yehuda Keller, among others, ("Plaintiffs") filed an action against, among other entities, Merchant Capital Portfolios, LLC, MPS Oldco, PPP Oldco, their parent company, and other affiliates of the parent (collectively "Defendants"), alleging, among other things, the Company failed to make certain residual payments to Plaintiffs after assuming the obligations of such payments in the purchase of certain assets from the Plaintiffs.

The Defendants disputed the allegations made by the Plaintiffs. During 2011, the parties were actively engaged in negotiating a settlement to the case. The Company has not reached a final settlement with the Plaintiff but has a reserve as of September 30, 2013 to cover its legal fees and the estimated settlement of the case, which is included in accrued expenses in the accompanying consolidated balance sheet as of September 30, 2013. As of the date this Report was filed with the Commission, this matter is still active on the Court docket. According to the docket, motions were made to dismiss the complaint against certain named defendants, including those companies previously associated with Unified Payments. An order was entered in connection with the motion filed only dismissing the case against one of the named defendants and an appeal was filed for reconsideration of the motion. To the best of our knowledge the appeal has not yet been heard.

**First Data Corporation**

On July 30, 2013, TOT Payments, LLC, brought an action against First Data Corporation in the State of New York Supreme Court(Index No. 652663-2013). The amount of damages being sought is \$10,000,000 per cause. In its complaint, TOT Payments claims that the defendant breached its obligations pursuant to a 2006 Marketing Agreement entered into between Money Movers of America, Inc. (MMOA) and Paymentech, Inc. (the "MMOA Agreement") to pay MMOA monthly residual income on various merchant accounts boarded with Paymentech pursuant to the MMOA Agreement. TOT Payments, through a series of historic transactions, is the successor in interest to the rights and obligations of MMOA in the MMOA Agreement. The defendant is the successor in interest to Paymentech. On July 15, 2013, the defendant failed to pay to TOT Payments the monthly residuals otherwise due as the defendant alleges that the MMOA Agreement was lawfully terminated in April 2012 and that the defendant had 180 days after the termination notice to move the MMOA merchants to a new platform failing which the defendant could withhold residual payments and that the defendant would own all merchant accounts boarded under the MMOA Agreement. The amount of the unpaid residuals, are between \$150,000 and \$250,000 net of all interchange charges. TOT Payments disputes receiving proper notice and is disputing the rights of the defendant to withhold monthly residuals due. There was an adjournment because of the motions made in the appellate division. Plaintiffs' opposition to First Data's motion to dismiss (for lack of standing) was filed on Oct. 24. Defendant's Reply to Plaintiff's opposition was due Oct. 31. Defendant's filed both a memorandum in support and an affirmation in support to dismiss and oral argument was heard Nov. 1, 2013. The next hearing date for the Motion to Dismiss is scheduled for November 25, 2013.

## Other Legal Proceedings

The Company is also involved in certain legal proceedings and claims, which arise in the ordinary course of business. In the opinion of the Company, based on consultations with outside counsel, the results of any of these ordinary course matters, individually and in the aggregate, are not expected to have a material effect on its results of operations, financial condition, or cash flows. As more information becomes available, if the Company should determine that an unfavorable outcome is probable on such a claim and that the amount of such probable loss that it will incur on that claim is reasonably estimable, it will record a reserve for the claim in question. If and when the Company records such a reserve, it could be material and could adversely impact its results of operations, financial condition, and cash flows.

## NOTE 15. RELATED PARTY TRANSACTIONS

As of September 30, 2013, the Company had \$1,542,268 due to related parties, consisting primarily of \$1,240,302 to T1T Lab, and \$301,996 due to Enerfund, LLC (which is wholly-owned by Mike Zoi, a director and majority stockholder of the Company).

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](http://www.arlive.com) and related intellectual property rights (which transfers and assignments were completed on February 8, 2013). The remaining liability for severance to Mr Strothers was assumed by T1T Lab in the divesture on September 25, 2013 (See Note 5). 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](http://www.music1.com) and [www.music1.ru](http://www.music1.ru). The Company recorded a charge of approximately \$84,000 to reflect the loss on disposition of business during the three months ended March 31, 2013, which is reflected in other expense in the accompanying consolidated statements of operations for the nine months ended September 30, 2013. This liability was assumed by T1T Lab, LLC on September 25, 2013 in the divesture of the entertainment assets.

## NOTE 16. 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 during the nine months ended September 30, 2012.

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 recorded a corresponding compensation charge for \$1,333,333 to recognize the difference between \$6.00 per share and the market price of the stock on February 23, 2012 of \$10.00 per share during the nine months ended September 30, 2012.

On April 6, 2012, the Company entered into a Joint Venture Agreement with Igor Yakovlevich Krutoy. Pursuant to the Joint Venture Agreement, the parties agreed to form a limited liability company under the laws of the Russian Federation named Music1 (“Music1 Russia”), which would be owned 67% by the Company’s newly formed subsidiary Net Element Russia and 33% by a newly formed company controlled by Mr. Krutoy which is to be named K1 Holdings. The general purpose of the Music1 Russia joint venture is to promote the Company’s [www.music1.com](http://www.music1.com) platform in the Commonwealth of Independent States (CIS) countries (comprised of participating states of the former Soviet Union).

For a nominal amount, K1 Holdings acquired a 33% ownership interest in Music1 Russia. The Company agreed to contribute to Music1 Russia (i) exclusive, non-assignable, royalty-free, perpetual, world-wide rights to use and operate the Internet domain [www.music1.com](http://www.music1.com) (the "Website"), (ii) non-exclusive, non-assignable, limited, royalty-free, perpetual, world-wide rights to use the Company's Launchpad computer system technology for the operation of Internet based contests, (iii) non-exclusive, non-assignable, limited, royalty-free, perpetual, world-wide rights to integrate the Company's Music Brain technology into the Website and (iv) not less than \$2 million in the form of an interest-free loan to maintain the operations of Music1 Russia. Mr. Krutoy also agreed to (i) provide monetization opportunities; propositions and other business development introductions identified by Music1 Russia as having significant business potential and (ii) act as an advisor and Chairman of the Board of Directors of Music1 Russia for a period of two years. As consideration for such advisory services and services as Chairman of the Board of Directors of Music1 Russia, the Company agreed to issue Mr. Krutoy 125,000 shares of restricted stock of the Company, with half of such shares issued to Mr. Krutoy within one month after he becomes Chairman of Music1 Russia and the other half of such shares issued to Mr. Krutoy within one month after the start of the second calendar year of his term as Chairman of Music1 Russia. The Company did not issue any shares of restricted stock to Mr. Krutoy during the three months ended September 30, 2012.

Pursuant to the Joint Venture Agreement, the first \$4 million of distributions by Music1 Russia are required to be made 50% to Net Element Russia and 50% to K1 Holdings. Thereafter, the next \$13 million of distributions by Music1 Russia are required to be made 100% to Net Element Russia. Thereafter, distributions by Music1 Russia are required to be made in proportion to Net Element Russia's and K1 Holdings' respective ownership interests in Music1 Russia.

In accordance with the Joint Venture Agreement, on September 6, 2012 Mr. Krutoy entered into a Subscription Agreement to purchase 333,333 shares of Net Element common stock for an aggregate purchase price of \$2 million, which amount was funded on June 6, 2012. A compensation charge of \$800,000 was recorded to recognize the difference between the fair value and contracted value of shares provided during the nine months ended September 30, 2012.

#### Other

During December 2012, the Company's Board of Directors authorized, and the Company announced on December 10, 2012, a plan permitting the repurchase by the Company of up to \$2.5 million of issued and outstanding shares of the Company's common stock in open market or privately negotiated transactions during the 24-month period ending December 10, 2014. For the nine months ended September 30, 2013, the Company repurchased 170,322 shares of its common stock for \$477,966 or an average of \$2.81 per share including 137,207 shares that were repurchased by the Company in a private transaction outside the parameter of the publicly announced repurchase plan.

#### NOTE 17. WARRANTS

At September 30, 2013, the Company had 8,938,900 warrants outstanding (as a result of 1,100 warrants exercised during 2012) with a weighted average exercise price of \$7.50 and a weighted average contract term of 4.01 years.

On January 22, 2013, the Company filed a post-effective amendment on Form S-3 to its registration statement on Form S-4 (File No. 333-182076), as subsequently amended, in order to register the issuance and sale by the Company of up to 4,600,000 shares of common stock upon the exercise of warrants that were originally issued by the Company (then known as Cazador Acquisition Corporation Ltd.) in connection with its initial public offering, which warrants became exercisable upon the consummation of the transactions contemplated by the Merger Agreement between the Company and Net Element dated as of June 12, 2012. Each warrant entitles the holder thereof to purchase one share of common stock upon payment of the exercise price of \$7.50 per share. As of the date this Report was filed with the Commission, that post-effective amendment has not been declared effective by the Commission.

On February 12, 2013, the Company filed a registration statement on Form S-3 (File No. 333-186621), as subsequently amended, in order to register (i) the resale from time to time by the selling security holders identified therein of up to 4,340,000 warrants that were originally issued by the Company (then known as Cazador Acquisition Corporation Ltd.) to Cazador Sub Holdings Ltd. in connection with a private placement prior to the Company's initial public offering and that became exercisable beginning on April 2, 2013, and (ii) the issuance and sale by the Company of up to 4,340,000 shares of common stock upon exercise of such warrants. Each warrant entitles the holder thereof to purchase one share of common stock upon payment of the exercise price of \$7.50 per share. As of the date this Report was filed with the Commission, that registration statement has not been declared effective by the Commission. Of the 4,340,000 warrants issued, Francesco Piovanetti (the former Chief Executive Officer and a former director of the Company) and David P. Kelley II (a current director of the Company) own 3,609,631 and 14,000 warrants, respectively, to purchase an aggregate of 3,623,631 shares of the Company's common stock.

#### NOTE 18. INCOME TAXES

There was no U.S. or foreign current or deferred income tax provision for the three months ended September 30, 2013 and 2012.

As of September 30, 2013 and December 31, 2012 the Company has a full valuation on its net deferred tax assets. The Company's net deferred tax assets are primarily composed of net operating loss carryforwards ("NOLs"). These NOLs total approximately \$30.6 million and \$25.0 million for federal, approximately \$18.7 million and \$13.2 million for state, and approximately \$9.1 million and \$1.5 million for foreign as of September 30, 2013 and December 31, 2012, respectively. Federal and state NOLs could be subject to limitations if, within any three year period prior to the expiration of the applicable carryforward period, there is a greater than 50% change in ownership of the Company.

In order to fully utilize the net deferred tax assets, the Company will need to generate sufficient taxable income in future years to utilize its NOLs prior to their expiration. ASC Topic 740, "*Income Taxes*", requires the Company to analyze all positive and negative evidence to determine if, based on the weight of available evidence, the Company is more likely than not to realize the benefit of the net deferred tax assets. The recognition of the net deferred tax assets and related tax benefits is based upon the Company's conclusions regarding, among other considerations, estimates of future earnings based on information currently available, current and anticipated customers, contracts and product introductions, as well as historical operating results and certain tax planning strategies.

The Company has evaluated the available evidence and the likelihood of realizing the benefit of its net deferred tax assets. From its evaluation, the Company has concluded that based on the weight of available evidence, it is not more likely than not that the Company will realize any of the benefit of its net deferred tax assets. Accordingly, as of September 30, 2013, the Company maintained a full valuation allowance totaling approximately \$14.4 million.

#### NOTE 19. SEGMENT INFORMATION

The Company previously owned several popular content monetization verticals (i.e., interests in online media businesses and operations) that were divested during the quarter ended September 30, 2013 (see Note 5 for additional information regarding this divestiture). As a result of this divestiture, the Company now has only one reportable business segment, consisting of mobile commerce and payment processing. Operations of the divested businesses are presented as discontinued operations.

#### NOTE 20. RESTATEMENT OF FINANCIAL STATEMENTS

In connection with the audit of the Company's financial statements for the fiscal year ended December 31, 2012, adjustments were made to the Company's equity accounting for certain first and second quarter 2012 transactions. The

effects of these adjustments were included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Commission. The statement of operations and comprehensive loss and statements of cash flows for the nine months ended September 30, 2012 have been restated for these adjustments, as reflected in the following pages.



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	Nine Months Ended September 30, 2012 Restatement		Nine Months Ended September 30, 2012 (As Restated)
Net Revenues	\$ 222,207	\$ -	\$ 222,207
Operating Expenses			
Cost of revenues	66,791		66,791
Business development	-	-	-
General and administrative	4,440,106	2,565,551	7,005,657
Product development	-	-	-
Depreciation and amortization	134,307	-	134,307
Total operating expenses	4,641,204	2,565,551	7,206,755
Loss from operations	(4,418,997)	(2,565,551)	(6,984,548)
Non-operating expense			
Interest income (expense)	314,883	-	314,883
Other income (expense)	(411,225)	-	(411,225)
Loss before income tax provision	(4,515,339)	(2,565,551)	(7,080,890)
Income tax provision	(51,017)	-	(51,017)
Net Loss from operations	(4,566,356)	(2,565,551)	(7,131,907)
Loss from discontinued operations	(1,898,397)	-	(1,898,397)
Net loss attributable to the noncontrolling interest	118,739	-	118,739
Net loss	\$ (6,346,014)	\$ (2,565,551)	\$ (8,911,565)
Other comprehensive income			
Foreign currency translation gain	(1,819)	-	(1,819)
Comprehensive loss	\$ (6,347,833)	\$ (2,565,551)	\$ (8,913,384)
Net loss per share - basic and diluted	\$ (0.33)	\$ -	\$ (0.47)
Weighted average number of common shares outstanding - basic and diluted	19,083,270	-	19,083,270

The restatement adjustment of \$2,565,551 is comprised of:

- \$425,550 is comprised of \$800,000 in non-cash compensation expense related to a subscription agreement with Igor Krutoy, pursuant to which shares of common stock were sold to Mr. Krutoy below the market price at the time of sale and (\$374,450) relating to an adjustment to non-cash compensation expense for the modification of the employment agreement with Richard Lappenbusch.

- \$1,333,334 in non-cash compensation expense related to a subscription agreement entered into with one of our current directors, Kenges Rakishev, pursuant to which shares of common stock were sold to Mr. Rakishev below the market price at the time of sale.

- \$806,667 in non-cash compensation expense related to a subscription agreement entered into with one of our current directors, Felix Vulis, pursuant to which shares of common stock and warrants were sold to Mr. Vulis below the market price at the time of sale

The adjustment of non-cash compensation expense for \$2,565,551 made to the statements of operations as set forth above is also reflected in an adjustment to the statement of cash flows as follows:



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	Nine Months Ended September 30, 2012	Restatement	Nine Months Ended September 30, 2012 (As Restated)
Cash flows from operating activities:			
Net loss	\$(6,346,014)	\$(2,565,551)	\$ (8,911,565)
Adjustments to reconcile net loss to net cash used in operating activities:	-	-	-
Loss attributable to Investment in Subsidiary	-	-	-
Decrease in noncontrolling interests	(118,739)	-	(118,739)
Loan discount interest expense	-	-	-
Depreciation and amortization	134,307	-	134,307
Non-cash compensation	3,803,862	-	3,803,862
Issuance of shares for service	-	-	-
Changes in assets and liabilities, net of acquisitions and the effect of consolidation of equity affiliates:	-	-	-
Prepaid expenses and other assets	(229,702)	-	(229,702)
Deposits	-	-	-
Account receivable	(8,884,116)	-	(8,884,116)
Notes receivable	(10,218,888)	-	(10,218,888)
Deferred Tax Assets	-	-	-
Due to related parties	-	-	-
Accounts payable	9,170,102	-	9,170,102
Loan payable	-	-	-
Accrued expenses	209,509	-	209,509
Adjustments for operating activities of continuing operations	(6,133,665)	-	(6,133,665)
Adjustments for operating activities of discontinued operations	5,915,943	-	5,915,943
Total adjustments	(217,722)	-	(217,722)
Net cash used in operating activities	(6,563,736)	(2,565,551)	(9,129,287)
Cash flows from investing activities	-	-	-
Note receivable	-	-	-
Note payable (non- current portion)	-	-	-
Change in restricted cash	-	-	-
Capitalized web development and patent costs	(70,265)	-	(70,265)
Purchase of fixed assets	(221,903)	-	(221,903)
Net cash used in investing activities	(292,168)	-	(292,168)
Cash flows from financing activities:	-	-	-
Contributed capital from non-controlling equity investors	1,603,169	-	1,603,169
Change in restricted cash	(1,763,386)	-	(1,763,386)
Repayments of note payable	(75,000)	-	(75,000)
Notes payable	4,164,470	-	4,164,470
Advances on related party notes	8,087,259	-	8,087,259
	12,016,512	-	12,016,512

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Net cash provided by (used in) financing activities

Effect of exchange rate changes on cash	(1,819)	-	(1,819)
Net increase (decrease) in cash	5,158,789	(2,565,551)	2,593,238
		-	
Cash at beginning of period	59,387	-	59,387
Cash at end of period	\$5,218,176	\$(2,565,551)	\$ 2,652,625

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion should be read and evaluated in conjunction with the unaudited condensed consolidated financial statements and notes thereto contained in this Report and with the discussion under "Forward-Looking Statements" on page 2 at the beginning of this Report and the Risk Factors set forth in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013 and in Part II, Item 1A of this Report.*

### **Overview; Recent Developments**

We currently have one reportable business segment, consisting of mobile commerce and payment processing. During the six months ended June 30, 2013, we had two reportable business segments, consisting of (i) mobile commerce and payment processing, and (ii) entertainment and culture Internet destinations. However, during the quarter ended September 30, 2013, we divested all of our interests in online media businesses and operations (which comprised our entertainment and culture Internet destinations business segment), which are presented as discontinued operations. During the three months and nine months ended September 30, 2012, we had one reportable business segment, consisting of entertainment and culture Internet destinations.

The Company's subsidiary TOT Group, Inc. (formerly known as TOT, Inc.) ("TOT Group") is a multinational, mobile payments and transaction processing holding company, which provides a range of flexible online and offline payment solutions. Clients include wireless carriers, content providers and merchants. TOT Group delivers comprehensive, end-to-end payment solutions to enable merchants to reliably accept cashless transactions at the point of sale ("POS"). From processing electronic payments at the POS to processing mobile commerce transactions to managing merchant terminals and providing information management services, TOT Group through its proprietary technology offers innovative solutions which allow its merchants to streamline their payments resources. Through TOT Group, the Company generates revenues from transaction fees, service fees, percentage of the dollar amount of each transaction and other fees associated with processing of cashless transactions at the points of sale. The Company serves merchants primarily in the retail, restaurant, supermarket, petroleum and hospitality sectors. In addition, TOT Group (through its subsidiary OOO TOT Money ("TOT Money")) operates the Company's provider of carrier-integrated mobile payments solutions. TOT Money's relationships with mobile operators give the Company substantial geographic coverage, a strong capacity for innovation in mobile payments and messaging, and the ability to offer customers In-App, P-SMS and Online and Carrier Billing solutions in over 49 countries.

During the third quarter of 2012, our subsidiary, TOT Money, launched operations as a provider of carrier-integrated mobile payments solutions in Russia. Since then, TOT Money has continued seeking to expand its carrier-integrated mobile payments 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, certain subsidiaries of TOT Group acquired substantially all of the business assets of Unified Payments, LLC, a Delaware limited liability company. 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 4 to the accompanying notes to unaudited condensed consolidated financial statements.

On September 25, 2013, we entered into a Contribution Agreement (the Divestiture Contribution Agreement) with T1T Lab, LLC, a Florida limited liability company (T1T Lab), and T1T Group, LLC, a Delaware limited liability company (T1T Group), pursuant to which, on September 25, 2013, we contributed to T1T Lab all of our membership and participation interests in our subsidiaries Openfilm, LLC, Motorsport, LLC, Splinx, LLC, LegalGuru, LLC and MUSIC 1 LLC (a/k/a OOO Music1) (collectively, the Disposed Subsidiaries). The Disposed Subsidiaries constitute all of the Company's interests in online media businesses and operations (referred to herein collectively as the Company's "entertainment assets"). Following the transactions effectuated pursuant to the Divestiture Contribution Agreement, the Company currently indirectly owns a minority interest in the Disposed Subsidiaries through its 10% membership interest in T1T Lab and the other 90% membership interest in T1T Lab is owned by T1T Group (which is indirectly wholly-owned by Mike Zoi, a director and majority stockholder of the Company). The Company disposed its entertainment assets in order to focus its business operations on mobile payments, transactional services and related technologies and to reduce the significant expenses associated with developing and maintaining the entertainment assets. For additional information regarding the divestiture of the Company's entertainment assets, see Note 5 of the accompanying notes to unaudited condensed consolidated financial statements.

Since our inception, we have incurred significant operating losses (for additional information, see "Liquidity and Capital Resources" below). If we fail to maintain our relationships with merchants, mobile phone providers, content providers, lenders and other business partners, it could harm our revenues and materially adversely affect our financial condition and results of operations. We face all of the risks inherent in a new business, including the need for significant additional capital, management's potential underestimation of initial and ongoing costs, and potential delays and other problems in connection with developing our technologies and operations.

### **Results of Operations for the Three Months Ended September 30, 2013 and 2012**

We reported a net loss of \$3,869,613 or (\$0.13) per share, for the three months ended September 30, 2013 versus a net loss of \$1,814,304, or (\$0.09) per share, for the three months ended September 30, 2012. Loss from continuing operations (including loss attributable to the noncontrolling interest) was \$3,175,474 or (\$0.11) per share for the three months ended September 30, 2013 versus loss from continuing operations (including loss attributable to the noncontrolling interest) of \$1,119,826 or (\$0.05) per share for the three months ended September 30, 2012. The loss from discontinued operations was \$694,139 or (\$0.02) per share for the three months ended September 30, 2013 versus a loss from discontinued operations of \$694,478 or \$(0.04) per share for the three months ended September 30, 2012. Basic and diluted weighted average shares outstanding were 28,163,337 and 19,314,379 for the three months ended September 30, 2013 and 2012, respectively.

Net revenues consist of payment processing fees, advertising fees, license fees and membership fees. Net revenues for the three months ended September 30, 2013 were \$6,520,788 of which \$6,519,599 were payment processing fees from

our subsidiary TOT Group, Inc. This consisted of \$5,496,038 from its subsidiary TOT Payments (which consists of the former operations of Unified Payments, which we acquired on April 16, 2013), \$1,011,130 from its subsidiary TOT Group Russia (which owns TOT Money, our mobile commerce payment processing operations in Russia) and \$12,431 from Aptito. Additionally, we earned \$1,189 from NETE Russia. Net revenues for the three months ended September 30, 2012 were \$170,691, which were primarily comprised of service fees generated by our entertainment assets, which were divested during the three months ended September 30, 2013 (see also Note 5 of the accompanying notes to unaudited condensed consolidated financial statements). The increase in net revenues in the three months ended September 30, 2013 compared to the three months ended September 30, 2012 is primarily a result of the Unified Payments acquisition and the launch of our mobile commerce payment processing operations in Russia during the third quarter of 2012 through TOT Money. Our results of operations for the three months ended September 30, 2012 consist primarily of processing fees from our TOT Money subsidiary.

Operating expenses totaled \$8,908,988 for the three months ended September 30, 2013 versus \$1,697,756 for the three months ended September 30, 2012, representing an increase of \$7,211,232. The primary reason for the increase in operating expenses is our acquisition of the operations of Unified Payments on April 16, 2013 and the commencement of TOT Money's operations in Russia during the third quarter of 2012.

Cost of revenues represents direct costs of generating revenues, including commissions, purchases of short numbers, content acquired and created and certain payroll expense that is directly related to revenue creation. Cost of revenues for the three months ended September 30, 2013 was \$4,646,245 as compared to \$26,767 for the three months ended September 30, 2012, which represents an increase of \$4,619,478. The increase in cost of revenues is primarily attributable to \$4,645,999 in cost of revenues from TOT Group, Inc. due to the Unified Payments acquisition and operations of TOT Money. Of the \$4,645,999, TOT Payments (which owns the business operations acquired from Unified Payments) accounted for \$4,432,192. The primary costs are \$3,387,575 of interchange fees, \$231,571 of Visa® and MasterCard® charges, \$684,707 of outside sales commissions and \$128,339 in processing costs. The primary difference between \$4,645,999 and \$4,432,192 belongs to TOT Money (which first began operations in the third quarter of 2012) for the purchase of short numbers to facilitate creation of payment processing revenues.

General and administrative expenses were \$2,928,528 for the three months ended September 30, 2013 as compared to \$1,617,052 for the three months ended September 30, 2012, representing an increase of \$1,311,476. General and administrative expenses for the three months ended September 30, 2013 and 2012 consisted of operating expenses not otherwise delineated in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss, including certain salaries, benefits, taxes, professional fees, travel, rent, Internet expenses and other expenses required to run our business. General and administrative expenses for the three months ended September 30, 2013 and 2012 were attributable to:

Category	Three Months Ended Sep 30, 2013	Three Months Ended Sep 30, 2012	Increase / (Decrease)
Non-cash compensation expense	\$ 75,000	\$ 426,838	\$ (351,838)
Salaries, benefits, taxes and contractor payments	1,234,438	713,773	520,665
Professional fees	988,974	288,958	700,016
Rent	160,337	119,647	40,690
Product development	-	8,943	(8,943)
Business development	15,851	5,882	9,969
Travel expense	191,369	30,275	161,094
Filing fees	22,120	80,951	(58,831)
Other expenses	240,439	(58,215)	298,654
Totals	\$ 2,928,528	\$ 1,617,052	\$ 1,311,476

Non-cash compensation expense was \$75,000 and \$426,838 for the three months ended September 30, 2013 and 2012, respectively. During the three months ended September 30, 2013, we recorded stock compensation expense to the members of our Board of Directors in the amount of \$75,000 to accrue for quarterly board fees which the Company agreed to pay in shares of the Company's common stock. For the three months ended September 30, 2012, we incurred \$426,838 in non-cash compensation expense comprised primarily of \$256,381 in vested options expense and \$168,339 in deferred compensation amortization.

Salaries, benefits, taxes and contractor payments were \$1,234,438 for the three months ended September 30, 2013 as compared to \$713,773 for the three months ended September 30, 2012, representing an increase of \$520,665. The



increase was mainly due to TOT Group which reported \$589,349 of this amount, of which \$224,155 was attributed to TOT Payments (began operations on April 16, 2013 as a result of acquiring the operations of Unified Payments), \$168,504 for TOT Money, \$174,428 for TOT Group's executive management and \$22,262 for Aptito for the three months ended September 30, 2013.

Professional fees were \$988,974 for the three months ended September 30, 2013 as compared to \$288,958 for the three months ended September 30, 2012, representing an increase of \$700,016. The most significant increases in professional fees were attributable to general legal fees for \$165,727, accounting / auditing fees for \$103,387 and consulting fees for \$433,528, partially offset by a (\$15,476) decrease in SEC compliance legal fees during the three months ended September 30, 2013 versus the three months ended September 30, 2012. General legal expenses increased \$165,727 due to the use of additional outside legal counsel to assist in the reorganization of the Company after its merger transaction with Net Element. Accounting and auditing fees were \$103,387 higher as the Company changed auditors from a local firm to a national firm and additional services were required in connection with the merger and acquisitions. The consulting fees were higher by \$433,528 primarily as a result of adding TOT Group. The \$433,528 primarily consisted of \$68,622 in computer support fees for Aptito, \$19,358 in professional fees and \$228,714 in management consulting and data entry for TOT Money, offset by a \$83,166 decrease in Yapik, Music1 and Corporate.

Rent expense increased by \$40,690, or 34%, from \$119,647 for the three months ended September 30, 2012 to \$160,337 for the three months ended September 30, 2013, primarily due to the acquisition of Unified Payments' operations and the move of our principal executive office to the offices previously occupied by Unified Payments in North Miami Beach. For April and May, the Company maintained two locations and moved into the North Miami Beach office in June consolidating to one office.

Business development expenses were \$15,851 for the three months ended September 30, 2013 as compared to \$5,882 for the three months ended September 30, 2012.

Travel expenses were \$191,369 for the three months ended September 30, 2013 as compared to \$30,275 for the three months ended September 30, 2012. Travel costs were higher for the three months ended September 30, 2013 due to increased travel to Russia in connection with the Russian operations of TOT Money.

Other expenses were \$240,439 for the three months ended September 30, 2013 as compared to \$(58,215) in other expenses for the three months ended September 30, 2012. Included in the \$240,439 of other expenses for the three months ended September 30, 2013 were incremental other expenses from our Russian operations of \$34,766 (telephone \$15,659, office supplies (\$2,304), training (\$2,972), car expenses (\$3,994) and other expenses (\$9,837)) and other expense from TOT Group's operations of \$182,706 consisting of office expenses (\$53,042), performance bonuses (\$86,874), communications (\$16,734) and other corporate expenses of (\$26,056).

We recorded a provision for loan losses of \$537,230 for the three months ended September 30, 2013, the majority of which is comprised of \$764,089 due to reserving revenues and costs related to the First Data boarded merchants in our Process Pink portfolio, as the result of an ongoing lawsuit with First Data, partially offset by a net recovery of \$226,859 by TOT Money. We had no provision for loan losses for the three months ended September 30, 2012.

Depreciation and amortization expense consists of depreciation expense on fixed assets used by the Company and the amortization of merchant portfolios, client acquisition costs, capitalized website development, intellectual property and deferred compensation expenses. Depreciation and amortization expense was \$796,985 for the three months ended September 30, 2013 as compared with \$53,937 for the three months ended September 30, 2012. The \$743,048 increase in depreciation and amortization expenses was primarily a result of adding assets from TOT Group, of which \$677,231 was attributable to TOT Payments (began April 16, 2013 as a result of the Unified Payments Acquisition). The \$677,231 from TOT Payments primarily includes amortization of merchant portfolios (\$648,705) and client acquisition costs (\$27,853).

Total interest expense for the three months ended September 30, 2013 amounted to \$973,256 versus \$412,266 in interest income for the three months ended September 30, 2012. This was primarily due to TOT Group's assumption of \$20,408,167 of indebtedness in connection with its acquisition of the business operations of Unified Payments,

which resulted in interest expense of \$1,139,150 for the three months ended September 30, 2013. This includes \$448,519 of accrued interest for the loan payable to Georgia Notes, LLC of \$10,293,881 at September 30, 2013 (see Note 13 of the accompanying notes to unaudited condensed consolidated financial statements. Pursuant to the Contribution Agreement entered into by the Company on April 16, 2013 with Unified Payments, TOT Group, Oleg Firer and Georgia Notes 18 LLC, on January 1, 2014, the preferred membership interest in Unified Payments plus payable in kind interest accrued thereon will be converted into a 8% interest only loan (interest compounding annually with a balloon payment due on January 1, 2017) and, upon such conversion, such loan will be assumed by a subsidiary of TOT Group. This convertible preferred membership interest is held by Georgia Notes, LLC and is classified as long term debt in the accompanying consolidated balance sheets. Interest expense for the three months ended September 30, 2013 also includes \$178,312 of interest on a factoring line that TOT Money has with Alfa Bank.

There was \$463,291 in interest income for the three months ended September 30, 2012 relating to notes receivable from one of our Russian subsidiaries. This was partially offset by interest expense from convertible loans from Enerfund to Net Element (\$51,025 in interest expense at 5% per annum) with principal balances totaling \$4,092,000.

The net loss attributable to non-controlling interests amounted to \$266,001 for the three months ended September 30, 2013 as compared to \$45,990 for the three months ended September 30, 2012. The \$266,001 primarily consists of \$238,177 attributed to Net Element International. The non-controlling interest reflects the results of operations of subsidiaries that are allocable to equity owners other than the Company.

### **Discontinued Operations**

For the three months ended September 30, 2013, the Company recorded a loss of \$372,496, net of tax, from operations of discontinued entities that primarily related to the divestiture of its Openfilm, Legal Guru, Motorsport, Splinx and 000 Music 1, subsidiaries.

### **Results of Operations for the Nine Months Ended September 30, 2013 and 2012**

We reported a net loss of \$27,335,141 or \$(0.97) per share for the nine months ended September 30, 2013 versus a net loss of \$8,911,565 (as restated), or \$(0.47) per share, for the nine months ended September 30, 2012. Of this, loss from continuing operations (including loss attributable to the noncontrolling interest) was \$25,995,495 or \$(0.92) per share for the nine months ended September 30, 2013 versus loss from continuing operations (including loss attributable to the noncontrolling interest) of \$7,013,168 or \$(0.37) per share for the nine months ended September 30, 2012. Loss from discontinued operations was \$1,339,646 or \$(0.05) per share for the nine months ended September 30, 2013 versus loss from discontinued operations of \$1,898,397 or \$(0.10) per share for the nine months ended September 30, 2012. Basic and diluted weighted average shares outstanding were 28,173,573 and 19,083,270 for the nine months ended September 30, 2013 and 2012, respectively.

Net revenues consist of payment processing fees, advertising fees, license fees and membership fees. Net revenues for the nine months ended September 30, 2013 were \$12,996,538, of which \$12,995,117 (\$868,151 were from when TOT Money was consolidated with Net Element Russia and \$12,126,966 were from TOT Group, Inc) were from payment processing fees. Of the \$12,126,966, \$10,097,636 was from TOT Payments (which consists of the former operations of Unified Payments, which we acquired on April 16, 2013), \$2,016,377 was from TOT Money, and \$12,953 from Aptito. Net revenues for the nine months ended September 30, 2012 were \$222,207 (as restated), which were primarily comprised of service fees generated by our entertainment assets, which were divested during the three months ended September 30, 2013 (see also Note 5 of the accompanying notes to unaudited condensed consolidated financial statements). The increase in net revenues for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 is primarily a result of the Unified Payments acquisition and the launch of our mobile commerce payment processing operations in Russia during the third quarter of 2012 through TOT Money. Our results of operations for the nine months ended September 30, 2012 include only the operations of our entertainment assets, which were divested during the three months ended September 30, 2013.

Operating expenses totaled \$37,615,813 for the nine months ended September 30, 2013 versus \$7,206,755 (as restated) for the nine months ended September 30, 2012, representing an increase of \$30,409,058. The primary reason for the increase in operating expenses is our acquisition of the operations of Unified Payments on April 16, 2013, which resulted in a \$8,970,035 increase in cost of revenues and \$11,200,000 of non-cash goodwill impairment losses. In addition, we recorded a \$6,736,302 provision for loan losses and unrecoverable advances and we incurred \$1,315,352 of increased depreciation and amortization expenses and \$2,187,369 of increased general and administrative expenses in the nine months ended September 30, 2013, which contributed to our increased operating expenses as compared to the nine months ended September 30, 2012. Each of these expense items is discussed further below.



Cost of revenues represents direct costs of generating revenues, including commissions, purchases of short numbers, content acquired and created and certain payroll expense that is directly related to revenue creation. Cost of revenues for the nine months ended September 30, 2013 was \$9,036,826 as compared to \$66,791 (as restated) for the nine months ended September 30, 2012, which represents an increase of \$8,970,035. The increase in cost of revenues is primarily due to \$8,770,493 in cost of revenues from TOT Group, Inc. due to the Unified Payments acquisition and operations of TOT Money. The primary costs in TOT Group, Inc. were attributed to TOT Payments (which was formed as a result of the Unified Payments acquisition), which amounted to \$8,216,055 (this included \$6,368,534 of interchange fees, \$418,209 of Visa® and MasterCard® charges, \$1,207,976 of outside sales commissions and \$60,802 in processing costs). The primary difference between \$8,770,493 and \$8,216,055 belongs to TOT Money (which first began operations in the third quarter of 2012) for the purchase of short numbers to facilitate creation of payment processing revenues.

General and administrative expenses were \$9,193,026 for the nine months ended September 30, 2013 as compared to \$7,005,657 (as restated) for the nine months ended September 30, 2012, representing an increase of \$2,187,369. General and administrative expenses for the nine months ended September 30, 2013 and 2012 consisted of operating expenses not otherwise delineated in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss, including certain salaries, benefits, professional fees, travel, rent, Internet expenses and other expenses required to run our business. General and administrative expenses for the nine months ended September 30, 2013 and 2012 were attributable to:

Category	Nine Months Ended Sep 30, 2013	Nine Months Ended Sep 30, 2012	Increase / (Decrease)
Non-cash compensation expense	\$ 225,000	\$ 3,820,206	\$ (3,595,206)
Salaries, benefits, taxes and contractor payments	3,250,901	1,847,810	1,403,091
Professional fees	3,348,821	805,399	2,543,422
Rent	454,426	297,004	157,422
Product development	12,050	61,221	(49,171)
Business development	34,641	484,161	(449,520)
Travel expense	646,260	117,826	528,434
Filing fees	85,057	99,607	(14,550)
Other expenses	1,135,870	(527,577)	1,663,447
Totals	\$ 9,193,026	\$ 7,005,657	\$ 2,187,369

Non-cash compensation expense was \$225,000 and \$3,820,206 for the nine months ended September 30, 2013 and 2012, respectively. During the first nine months of 2013 we recorded stock compensation expense to the members of our Board of Directors in the amount of \$225,000 to accrue for quarterly board fees which the Company agreed to pay in shares of the Company's common stock. For the nine months ended September 30, 2012 (restated), we incurred \$3,820,206 in non-cash compensation expense primarily comprised of \$800,000 in non-cash compensation expense relating to a subscription agreement with Igor Krutoy, pursuant to which shares of common stock were sold to Mr Krutoy below the market price at the time of the sale, \$1,333,334 in compensation expense related to a subscription agreement entered into with one of our current directors, Kenges Rakishev, pursuant to which shares of common stock were sold to Mr. Rakishev below the market price at the time of sale, \$806,667 in compensation expense related to a subscription agreement entered into with one of our current directors, Felix Vulis, pursuant to which shares of common stock and warrants were sold to Mr. Vulis below the market price at the time of sale, \$351,667 in compensation expense for options issued or vesting and \$490,878 for deferred compensation amortization.

Salaries, benefits, taxes and contractor payments were \$3,250,901 for the nine months ended September 30, 2013 as compared to \$1,847,810 for the nine months ended September 30, 2012, representing an increase of \$1,403,091. The

increase was mainly due to TOT Group which reported \$1,043,759 (\$434,652 attributed to TOT Payments, LLC, which was formed and began operations April 16, 2013 as a result of acquiring the operations of Unified Payments, \$237,142 for TOT Money Russia and TOT Corporate for \$301,263) for the nine months ended September 30, 2013. In addition, Net Element Russia had an increase of \$523,970, Music1 had an increase of \$22,104, and Corporate had an increase of \$136,558, partially offset by a decrease in Netlabs (\$97,659) and Yapik (\$82,449) during the nine months ended September 30, 2013 as compared to the same period during 2012. Net Element Russia began operations in the second quarter of 2012 and TOT Money had no expenses in the first nine months ended September 30, 2012.

Professional fees were \$3,348,821 for the nine months ended September 30, 2013 as compared to \$805,399 for the nine months ended September 30, 2012, representing an increase of \$2,543,422. The most significant increases in professional fees were attributable to general legal fees (\$859,218), accounting / auditing fees (\$857,520) and consulting fee (\$767,411). General legal expenses increased \$859,218 during the nine months ended September 30, 2013 versus the nine months ended September 30, 2012 due to the use of additional outside legal counsel to assist in the reorganization of the Company after its merger transaction with Net Element. Accounting and auditing fees were \$857,520 higher as the Company changed auditors from a local firm to a national firm and there was additional work related to the merger and acquisitions. Consulting fees were \$767,411 higher due to addition of TOT Group, which primarily was for executive management consulting and data entry for TOT Payments (\$245,755), computer support fees for Aptito (\$68,622), executive and management consulting for TOT Money (\$433,304) and other outside services (\$19,730).

Rent expense increased by \$157,422, or 53%, from \$297,004 for the nine months ended September 30, 2012 to \$454,426 for the nine months ended September 30, 2013, primarily due to the acquisition of Unified Payments' operations and the move of our principal executive office to the offices previously occupied by Unified Payments in North Miami Beach. For April and May, the Company maintained two locations and moved into the North Miami Beach office in June, consolidating to one office.

Business development expenses were \$34,641 for the nine months ended September 30, 2013 as compared to \$484,161 for the nine months ended September 30, 2012. The reduction was mainly due to the decrease in corporate development efforts and development expenses of Yapik and Music1, which were divested during the three months ended September 30, 2013.

Travel expenses were \$646,260 for the nine months ended September 30, 2013 as compared to \$117,826 for the nine months ended September 30, 2012. Travel costs were higher for the nine months ended September 30, 2013 due to increased travel to Russia in connection with the Russian operations of TOT Money. Our Russian operations were not started until the second quarter of 2012 (and we did not launch TOT Money's operations until the third quarter of 2012) so there was no extensive Russian travel during the first nine months of 2012.

Other expenses were \$1,135,870 for the nine months ended September 30, 2013 as compared to (\$527,577) in other expenses for the nine months ended September 30, 2012. This consisted of \$725,505 attributed to NETE Russia as follow: foreign translation costs (\$599,689), communications (\$42,172), office supplies (\$14,925), bank charges (\$12,067) and other expenses of (\$56,652). In addition there was \$277,599 for TOT Group as follows: performance bonuses (\$166,873), office expenses (\$83,428), and communications (\$27,298).

We recorded a provision for loan losses of \$6,736,302 for the nine months ended September 30, 2013, which is primarily comprised of \$4,490,128 in loss provision for advances to aggregators, \$1,352,933 in loss provision for notes receivable and \$703,767 from reserving revenue and costs related to the First Data lawsuit (See Note 14 of the accompanying notes to unaudited condensed consolidated financial statements and Liquidity and Capital Resources below) and \$60,322 from net ach rejects in the normal course of operations. We had no provision for loan losses for the nine months ended September 30, 2012.

During the second quarter of 2013, our new CEO and CEO's appointed management of newly created TOT Group Russia completed analyzing our aggregator and mobile operator relationship including having discussions with select aggregators. As part of this review, it was determined that TOT Money's former general director had provided advances to aggregators, which exceeded the future processing volumes to be provided by these aggregators. As a result, the Company recorded a provision for unrecoverable advances of approximately \$5.8 million for the three months ended June 30, 2013 related to unrecoverable aggregator advances. The Company had previously recorded loss provisions of approximately \$1.0 million in the previous quarter and during 2012. In June of 2013, TOT Money entered into a new agreement with the general director, pursuant to which he was relieved of his position as general



director and appointed a commercial director with responsibility to develop and promote new business. A new general director of TOT Money was appointed to manage the business and operations. New controls were implemented to pre-verify all payments to aggregators with the mobile operators to ensure the traffic is validated. Additionally, an agreement was reached with the former general director for the Company to recover \$3.8 million he agreed he was responsible to repay. For additional information, see Notes 6 and 7 of the accompanying notes to unaudited condensed consolidated financial statements.

During the nine months ended September 30, 2013 the Company recognized \$11,200,000 of non-cash, goodwill impairment losses relating to the goodwill from the Unified Payments acquisition. In connection with that acquisition, the Company recorded goodwill of approximately \$17 million. As part of its financial statement closing processes, as well as the Company's review of its valuation of the Unified Payments business combination, the Company determined that the reported goodwill of its TOT Payments reporting unit was impaired.

The carrying amount of this reporting unit was negative as of September 30, 2013, thus the Company performed a step 2 analysis of the goodwill impairment test as of September 30, 2013. The fair value of the reporting unit was determined based on a combination of the income approach (discounted cash flow analysis) and market approach (guideline public company method). The result of the step 2 analysis indicated that the TOT Payment reporting unit's goodwill was impaired by approximately \$11.2 million as of June 30, 2013. The Company recorded a goodwill impairment charge of approximately \$11.2 million for the nine months ended September 30, 2013.

Depreciation and amortization expense consists of depreciation expense on fixed assets used by the Company and the amortization of merchant portfolios, client acquisition costs and capitalized website development, intellectual property and deferred compensation expenses. Depreciation and amortization expense was \$1,449,659 for the nine months ended September 30, 2013 as compared with \$134,307 for the nine months ended September 30, 2012. The \$1,315,352 increase in depreciation and amortization expense was primarily due to an increase of \$1,200,129 (primarily due to \$1,150,523 for portfolio amortization and \$48,073 of amortization due to client acquisition costs) attributed to TOT Payments.

Total interest expense for the nine months ended September 30, 2013 amounted to \$2,043,353 versus \$314,883 of interest income for the nine months ended September 30, 2012. This was primarily due to TOT Group's assumption of \$20,408,167 of indebtedness in connection with its acquisition of the business operations of Unified Payments, which resulted in interest expense of \$1,318,321 for the nine months ended September 30, 2013. This includes \$571,678 of interest expense on notes payables that had a total balance of \$10,649,548 at September 30, 2013 and \$746,373 of interest for the loan payable to Georgia Notes, LLC of \$10,293,881 at September 30, 2013 (see Note 12 of the accompanying notes to unaudited condensed consolidated financial statements). Pursuant to the Contribution Agreement entered into by the Company on April 16, 2013 with Unified Payments, TOT Group, Oleg Firer and Georgia Notes 18 LLC, on January 1, 2014, the preferred membership interest in Unified Payments plus payable in kind interest accrued thereon will be converted into a 8% interest only loan (interest compounding annually with a balloon payment due on January 1, 2017) and, upon such conversion, such loan will be assumed by a subsidiary of TOT Group. This convertible preferred membership interest is held by Georgia Notes, LLC and is classified as long term debt in the accompanying consolidated balance sheets. Interest expense for the nine months ended September 30, 2013 also includes \$478,755 of interest on a factoring line that TOT Money has with Alfa Bank.

There was \$314,883 in interest income for the nine months ended September 30, 2012 relating to notes receivable from one of our Russian subsidiaries.

Other expenses for the nine months ended September 30, 2013 amount to \$168,509, which is primarily due to the loss of \$93,661 on the disposal of A&R Music Live, LLC, and \$56,354 for other local taxes in Russia for TOT Money. Other expenses for the nine months ended September 30, 2012 related primarily to the amendment of amounts payable to former Motorsport.com owners.

The net loss attributable to non-controlling interests amounted to \$835,642 for the nine months ending September 30, 2013 as compared to \$118,739 for the nine months ending September 30, 2012. The \$835,642 was primarily attributed to TOT Group (\$842,473), offset by a gain in Yapik of \$6,165 and Net Element Russia \$666. The non-controlling interest reflects the results of operations of subsidiaries that are allocable to equity owners other than the Company.

### **Discontinued Operations**

For the nine months ended September 30, 2013, the Company recorded a loss of \$1,339,646, net of tax, from discontinued operations that primarily related to the divestiture of its Openfilm, Legal Guru, Motorsport, Splinx and 000 Music1, subsidiaries.

### **Going Concern**

Since our inception, we have incurred significant operating losses. We incurred net losses totaling \$27.3 million for the nine months ended September 30, 2013 and net losses totaling \$8.9 million for the nine months ended September 30, 2012. We had negative cash flows from operating activities of \$6.4 million and \$9.1 million for the nine months ended September 30, 2013 and September 30, 2012, respectively. At September 30, 2013, we had negative working capital of \$3.1 million and an accumulated deficit of \$114.7 million. These conditions raise substantial doubt about

our ability to continue as a going concern. The independent auditors' report on our consolidated financial statements for the year ended December 31, 2012 contains an explanatory paragraph expressing substantial doubt as to our ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern. See also Note 3 of the accompanying notes to unaudited condensed consolidated financial statements and "Liquidity and Capital Resources" below.

## Liquidity and Capital Resources

The Company's total assets at September 30, 2013 were \$26,858,352 compared to \$28,378,634 at December 31, 2012. The change in total assets is primarily attributable to decreases in net notes receivable (which decreased \$5,568,934 including current and non-current portions), net advances to aggregators (which decreased \$4,022,545), restricted cash (which decreased \$2,056,821) and accounts receivable (which decreased \$1,139,299), partially offset by increases in goodwill (which increased \$6,671,750), net intangible assets (which increased \$4,383,167) and cash (which increased \$378,978) as of September 30, 2013 compared to December 31, 2012. Goodwill and net intangible assets increased primarily in connection with TOT Group's acquisition of the assets and operations of Unified Payments. Net notes receivable decreased primarily due to the repayment in full of the loan made by TOT Money to RM Invest (at December 31, 2012, the outstanding balance was \$5,568,934), the write off of the loan made by the Company to Infratont Equities (at December 31, 2012, the outstanding balance was \$991,475) which was determined to be uncollectible, partially offset by an increase by the new note receivable owed to the Company pursuant to a settlement agreement with the former general director of TOT Money, the discounted value of which is reflected on our September 30, 2013 balance sheet at \$180,000 for the current portion and \$340,000 for the non-current portion of the receivable).

Net advances to aggregators decreased \$4,022,545 due to the provisions of these assets during the second quarter of 2013. During the second quarter of 2013, our new CEO and CEO's appointed management of newly created TOT Group Russia completed analyzing our aggregator and mobile operator relationship including having discussions with select aggregators. During this review, it was determined that TOT Money's former general director had approved additional advances beyond what the volume of future business would support. As a result, the Company recorded a provision for unrecoverable advances of approximately \$5.7 million for the three months ended June 30, 2013 related to unrecoverable aggregator advances. The Company had previously recorded loss provisions of approximately \$1.0 million in the previous quarter and during 2012. In June of 2013, TOT Money entered into a new agreement with the general director, pursuant to which he was relieved of his position as general director and appointed a commercial director with responsibility to develop and promote new business. A new general director of TOT Money was appointed to manage the business and operations. New controls were implemented to pre-verify all payments to aggregators with the mobile operators to ensure the traffic is validated. Additionally, an agreement was reached with the former general director for the Company to recover \$3.8 million he agreed he was responsible to repay. For additional information, see Notes 6 and 7 of the accompanying notes to unaudited condensed consolidated financial statements.

A settlement agreement for \$3.8 million was reached with TOT Money's former general director, who continues as an employee of TOT Money in a business development capacity. This settlement agreement reduces the aggregator advance balance by \$0.7 million (which is the present value of \$3.8 million less an additional reserve for \$1.3 million given such amounts will be repaid with profit sharing and TOT Money has historically been unprofitable. Once the former general director has repaid the \$3.8 million settlement, he will again be entitled to receive normal monthly profit distributions.

Restricted cash was \$2,056,821 at December 31, 2012, consisting of approximately \$1.8 million deposited in a segregated bank account pursuant to our credit facility with Alfa-Bank and \$250,000 in a certificate of deposit. Restricted cash was \$0 at September 30, 2013 due to the liquidation of the certificate of deposit in February 2013 and due to the repayment of debt under the credit facility with Alfa-Bank on February 14, 2013. The Company paid off the credit facility on February 14, 2013 in order to eliminate interest expense under the credit line and free up the restricted cash.

Accounts receivable of \$9,715,876 at September 30, 2013 versus \$10,855,175 at December 31, 2012 decreased \$1,139,299 primarily due to cash collections.

At September 30, 2013, we had total current assets of \$15,142,796, including \$3,925,765 of cash, \$180,000 in current notes receivable, \$9,715,876 of accounts receivable, \$754,488 of advances to aggregators (in-transit funding to our content providers to prevent delays in business operations) and \$566,667 of prepaid expenses and other assets,. At December 31, 2012, we had total current assets of \$28,005,205, including \$3,546,787 of cash, \$2,056,821 of restricted cash (consisting of approximately \$1.8 million deposited in a segregated bank account pursuant to our credit facility with Alfa-Bank, and \$250,000 in a certificate of deposit that was liquidated in February 2013), \$6,088,934 in net notes receivable, \$10,855,175 of accounts receivable, \$4,777,033 in net advances to aggregators, \$487,995 of prepaid expenses and other assets and \$192,460 of assets of discontinued operations.

As of the date this Report was filed with the Commission, management expects that our cash flows from operations and existing available cash will not be sufficient to fund our current operations through 2013. We have had a significant increase in our capital requirements during the 2013 fiscal year due to our expanding payment processing operations, including as a result of our acquisition of the business assets of Unified Payments. In connection with the closing of our acquisition of Unified Payments' business assets on April 16, 2013, we assumed, among other obligations and liabilities, approximately \$20.5 million of Unified Payments' long-term debt (which includes approximately \$10.2 million owed in respect of an outstanding preferred equity interest in Unified Payments that is to be converted on January 1, 2014 into a 8% interest only loan and assumed on such date by a subsidiary of TOT Group) and approximately \$10.3 million of other liabilities. Such long-term debt (including the outstanding preferred equity interest in Unified Payments, LLC) currently bears interest at rates ranging from 8% to 15.635% and has maturity dates ranging from October 2014 until January 2016. For additional information, see Notes 1 and 13 of the accompanying notes to unaudited condensed consolidated financial statements. We also are seeking a way to buy, license or build our own mobile payment processing system since we are currently using the payment processing systems of SDSP Group in Russia for a monthly fee.

We currently believe that we will require an additional \$11.5 million in financing to continue operations as currently conducted (including to complete the integration of Unified Payments' operations and purchase credit card portfolios) and to pay for other currently anticipated capital expenditures over the next 12 months. We have historically been dependent upon our director and majority stockholder, Mike Zoi (including entities directly or indirectly controlled by Mr. Zoi), and/or other affiliates of the Company, to fund our operations and we are exploring additional sources of financing in order to meet our financial requirements. We expect that a portion of our working capital will be derived internally from repayment of invested capital from OOO TOT Money. Additional funds may be raised through debt financing and/or the issuance of equity securities, there being no assurance that any type of financing on terms satisfactory to us will be available or otherwise occur. Debt financing must be repaid regardless of whether we generate revenues or cash flows from operations and may be secured by substantially all of our assets. Any equity financing or debt financing that requires the issuance of equity securities or warrants to the lender would cause the percentage ownership by our current stockholders to be diluted, which dilution may be substantial. Also, any additional equity securities issued may have rights, preferences or privileges senior to those of existing stockholders. If such financings are not available when required or are not available on acceptable terms, we may be unable to implement our business plans or take advantage of business opportunities, any of which could have a material adverse effect on our business, financial condition, results of operations and/or prospects and may ultimately require us to suspend or cease operations, which could cause investors to lose the entire amount of their investment.

Operating activities used approximately \$6.4 million of cash for the nine months ended September 30, 2013, compared to \$9.1 million (as restated) of cash for the nine months ended September 30, 2012. The net loss for the nine months ended September 30, 2013 was \$27.3 million. This includes several non-cash expenses, including \$6.7 million of provision for unrecoverable advances, \$11.2 million impairment of goodwill, \$1.4 million in depreciation and amortization expenses and \$0.2 million of non-cash compensation expense. Operating uses of cash for the nine months ended September 30, 2013 included \$1.3 million used for reduction in accrued expenses and \$0.5 million for a note receivable from the former general director of TOT Money. This was offset by increase in \$0.4 million of prepaid expenses and other assets, by cash generated from collections of mobile operator receivables of \$1.6 million and \$1.5 million in accounts payable.

Investing activities provided \$4.5 million of cash for the nine months ended September 30, 2013, compared to providing \$.29 million of cash for the nine months ended September 30, 2012. The increase in cash provided in investing activities for the nine months ended September 30, 2013 was primarily attributable to \$4.7 million of collections on two loans originally made during 2012 (which are described below) offset by \$0.2 million investment in Aptito.

We did not have any outstanding loans receivable during the nine months ended September 30, 2012.

On July 12, 2012, our 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 \$6.6 million in U.S. dollars), which, on August 16, 2012, was increased to 300 million Russian rubles (approximately \$9.8 million in U.S. dollars). RM Invest is 20% owned by TOT Money's former general director, Tcahai Hairullaevich Katcaev. The original interest rate on the loan was 10% from the date of advance to the date of scheduled repayment and the original stated maturity date of the loan was October 31, 2012. On February 25, 2013, TOT Money refinanced the loan with RM Invest and extended the maturity date until October 1, 2013. The loan was fully satisfied in April 2013. For additional information, see Note 6 of the accompanying notes to unaudited condensed consolidated financial statements.

In addition, on November 26, 2012, the Company entered into a loan agreement with Infracore Equities, Inc., pursuant to which the Company loaned \$1,791,475 to Infracore Equities for the purpose of providing the borrower with working capital and funding of business development in general. As of June 30, 2013, the outstanding principal loan balance and accrued interest was \$991,475. The loan was scheduled to mature November 15, 2013 and accrued interest at a rate of 1.75% per month, payable quarterly commencing in March 2013. As of June 30, 2013, the

Company wrote-off this loan against loss reserves for \$991,475 because the loan was deemed uncollectible. For additional information, see Note 6 of the accompanying notes to unaudited condensed consolidated financial statements.

Financing activities provided \$2.3 million of cash during the nine months ended September 30, 2013, compared to providing \$12 million of cash during the nine months ended September 30, 2012. Cash flows from financing activities for the nine months ended September 30, 2013 primarily consisted of the additional borrowing from TOT Money's factoring line (\$0.8 million), \$2.1 million in restricted cash reductions (due to the repayment of debt under TOT Money's credit facility with Alfa-Bank on February 14, 2013), partially offset by cash paid for share repurchases (\$0.5 million) and repayments to related parties (\$0.1 million).

At September 30, 2012, the Company (then known as Cazador Acquisition Corporation Ltd.) had \$46,165,000 of restricted cash held in trust. In connection with our merger with Net Element on October 2, 2012, those public shareholders who voted against the Merger and duly exercised their shareholder redemption rights were able to redeem their ordinary shares for approximately \$10.036 per share, representing the pro rata share of the aggregate amount then on deposit in the Company's trust account. The public shareholders redeemed 1,956,645 ordinary shares for a total amount of approximately \$19.6 million. After shareholder redemptions of approximately \$19.6 million, transaction expenses of approximately \$1.6 million and repaying certain related party debt totaling approximately \$13 million, the Company received approximately \$12 million of cash proceeds from the trust account.

On August 17, 2012, 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 on the initial amount borrowed under the Credit Agreement is 3.55% per annum. 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 nine 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. As of December 31, 2012, the Company had restricted cash pursuant the Credit Agreement of \$1.8 million. 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 outstanding balance under this credit facility was \$0 at September 30, 2013.

On September 28, 2012, TOT Money entered into a factoring agreement with Alfa-Bank. Pursuant to the agreement, TOT Money agreed to assign to Alfa-Bank its accounts receivable as security for financing in an aggregate amount of up to 300 million Russian rubles (approximately \$9.8 million in U.S. dollars) provided by Alfa-Bank to TOT Money. On January 14, 2013, the agreement was amended to increase the maximum aggregate amount of financing available under the factoring agreement by 100 million Russian rubles (approximately \$3.3 million in U.S. dollars) to 400 million Russian rubles (approximately \$13.1 million in U.S. dollars). 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 to 100 Russian rubles 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% 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. The balance under the factoring agreement was approximately \$10.2 million in U.S. dollars at September 30, 2013.

In connection with its acquisition of the business assets of Unified Payments on April 16, 2013, the Company assumed several long-term debt obligations with an aggregate outstanding amount of \$10,207,138 as of September 30, 2013. Such long-term debt currently bears interest at rates ranging from 9.75% to 15.635% and has maturity dates ranging from October 2014 until January 2016. In addition, pursuant to the Contribution Agreement entered into by the Company on April 16, 2013 with Unified Payments, TOT Group, Oleg Firer and Georgia Notes 18 LLC, on January 1, 2014, the preferred membership interest in Unified Payments plus payable in kind interest accrued thereon will be converted into a 8% interest only loan (interest compounding annually with a balloon payment due on January 1, 2017) and, upon such conversion, such loan will be assumed by a subsidiary of TOT Group. This convertible preferred membership interest is classified as long term debt with a balance of \$10.6 million in the accompanying consolidated balance sheets. For additional information, see Notes 1 and 13 of the accompanying notes to unaudited condensed consolidated financial statements.

In addition, on May 14, 2013, the Company executed and delivered to K 1 Holding Limited a promissory note, dated May 13, 2013, in the principal amount of \$2 million, in connection with a loan in such amount made by K1 Holding to the Company. Proceeds from the loan are required to be used for general business purposes of the Company. Amounts payable by the Company pursuant to the promissory note do not accrue interest. The outstanding principal balance of the promissory note is required to be repaid no later than May 14, 2015 and may be prepaid in whole or in part at any



time without penalty or charge. On September 25, 2013, this loan was assumed by T1T Lab, LLC in connection with the disposition of our entertainment assets to T1T Lab, LLC on that date. For additional information, see Notes 5 and 13 of the accompanying notes to unaudited condensed consolidated financial statements.

#### **Off-balance sheet arrangements**

At September 30, 2013, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

#### **Recently Issued and Adopted Accounting Guidance**

##### *Recently Issued Accounting Guidance*

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This update provides that an entity that has unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date should present the unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This update is effective for reporting periods beginning after December 15, 2013. The Company does not believe the adoption of this guidance will have a material impact on the Company's unaudited condensed consolidated financial statements.

*Recently Adopted Accounting Guidance*

In July 2012, the FASB issued ASU 2012-02, *Intangibles-Goodwill and Other (Topic 350)* which amended then existing guidance by giving an entity the option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. Previous guidance required an entity to test indefinite-lived intangible assets for impairment, on at least an annual basis, by comparing the fair value of the asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. This update is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company adopted this guidance on January 1, 2013. The adoption of this guidance did not have a material impact on the Company's unaudited condensed consolidated financial statements.

In March 2013, the FASB issued ASU 2013-05, *Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity (a consensus of the FASB Emerging Issues Task Force)* ("ASU 2013-05"). The objective of ASU 2013-05 is to resolve diversity in practice regarding the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. ASU 2013-05 is effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The Company is currently evaluating the potential impact of this ASU on its condensed unaudited consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**Item 4. Controls and Procedures.**

Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of the end of the period covered by this Report, our management conducted an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective because of material weaknesses in financial control that were not remediated which included:

- Control Environment: inadequate documented policies and procedures, lack of segregation of duties, and recently comprised Audit committee.
- Control Activities: testing of internal controls
- Information and Communication: lack of adequacy of financial information and general computer controls over Russian subsidiaries.
- Monitoring: monitor design and operation of controls.

During 2013, remediation efforts for these identified material weaknesses have included establishing audit committee standard quarterly meetings with minutes recorded between the audit committee, senior financial management and external auditors, and the development of a committee charter with established responsibilities.

Although we believe that we have established appropriate transaction approval criteria as of September 30, 2013, we do not have sufficient personnel to provide an independent review of journal entries, account analyses, monitoring or adequate risk assessment functions. Further, during early 2013, because we had inadequate supervision of, and review of expenditures authorized by the former general director of TOT Money (as described further below). This inadequate supervision, coupled with unclear review responsibilities by the limited number of personnel employed, resulted in unsupported advances to aggregators. During the second quarter of 2013, our new CEO and CEO's appointed management of TOT Group Russia, completed analyzing our aggregator and mobile operator relationship including having discussions with select aggregators. As part of this review it was determined that the former general director of TOT Money provided advances to aggregators which exceeded the future business to be provided by these aggregators. During previous quarters, the Company had established a 10% reserve on these aggregator advances based on actual and estimated processing volumes subsequent to December 31, 2012 and March 31, 2013, and concluded that the net aggregator advances were recoverable as of these dates. As a result of this review during the second quarter of 2013, it was concluded that a significant amount of these advances would not be recoverable in the form of future business from the aggregators. The former general director took responsibility for a certain amount of these advances and agreed to a settlement. The former general director currently serves as commercial director with responsibility to develop and promote new business. A new general director of TOT Money was appointed to manage its business and operations. New controls were implemented with the mobile operators assistance, to pre-verify all payments to aggregators and to ensure the traffic is validated. Additionally, an agreement was reached with the former general director for the Company to recover \$3.8 million he agreed he was responsible to repay.

Management intends to focus its remediation efforts in the near term on designing revised accounting and financial reporting policies and procedures that will help ensure that adequate internal controls over financial reporting are met, proper resources (systemic and team members) are in place, and control design enhancements are completed. Management intends to review the general computer controls surrounding its foreign subsidiaries' billing and financial reporting systems in order to help ensure that all material weaknesses are remediated. Evaluation of the necessary functionality for new financial reporting systems and that selection decision is currently expected to be completed by December 31, 2013.

Except as described above in this Item 4, there were no changes in our internal control over financial reporting during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal proceedings.**

As a result of our acquisition of the business assets of Unified Payments, LLC on April 16, 2013, certain of our subsidiaries are successors in interest to one or more defendants in the following Yehuda Keller matter. In addition to the proceedings described below, the Company and/or its subsidiaries is, and may from time to time in the future be, involved in certain legal proceedings and claims that arise in the ordinary course of business. Such proceedings and/or claims could ultimately result in damage awards, settlement payments and/or other negative consequences.

On December 29, 2010, Yehuda Keller, Alexander Tyrel Rosean, Yaacov Lipsker, Lechaim Merchant Services Corp., Merchant Development Group, Zalman Blachman, Moshe Wisnefsky, Yekusiel Chanin and Shellie Zuckerman and Susan Hillman as Trustees of The Woods Exemption Trust commenced an action against Merchant Capital Portfolios, LLC, Business Payment Systems, LLC, Oleg Firer, Leon Goldstein, Anthony W. Holder, Star Capital Holding Corp., Star Capital Management, LLC, Star Capital JV, LLC, Process Pink, LLC, Merchant Processing Services Corp., Unified Pay Corporation, MMOA Inc. a.k.a. Money Movers of America, Inc., National Processing Company, RBL Capital Group, LLC, The ComVest Group, ComVest Investment Partners, Cynergy Holdings LLC, Cynergy Data, LLC, Cynergy Prosperity Plus, LLC and Does 1 through 100, in the Supreme Court of the State of New York, County of New York (Index No. 652408-2010E). The complaint alleges, among other things, that the defendants failed to make certain residual payments to the plaintiffs after allegedly assuming such payment obligations when certain of the defendants purchased certain merchant accounts from a third party owner. The alleged causes of action include claims for, among other things, breach of contract, breach of the implied covenant of good faith and fair dealing, equitable estoppel, promissory estoppel, promissory fraud, tortious interference with contract, unjust enrichment, conversion, fraudulent conveyance and fraud, and seek an unspecified amount of damages. As of the date this Report was filed with the Commission, this matter is still active on the Court docket. According to the docket, motions were made to dismiss the complaint against certain named defendants, including those companies previously associated with Unified Payments. An order was entered in connection with the motion filed only dismissing the case against one of the named defendants and an appeal was filed for reconsideration of the motion. To the best of our knowledge the appeal has yet be heard.

On July 30, 2013, TOT Payments, LLC brought an action against First Data Corporation in the State of New York Supreme Court (Index No. 652663-2013). In its complaint, TOT Payments claims that the defendant breached its obligations pursuant to a 2006 Marketing Agreement entered into between Money Movers of America, Inc. (MMOA) and Paymentech, Inc (the “MMOA Agreement”) to pay MMOA monthly residual income on various merchant accounts boarded with Paymentech pursuant to the MMOA Agreement. TOT Payments, through a series of historic transactions, is the successor in interest to the rights and obligations of MMOA in the MMOA Agreement. The defendant is the successor in interest to Paymentech. On July 15, 2013, the defendant failed to pay to TOT Payments the monthly residuals otherwise due as the defendant alleges that the MMOA Agreement was lawfully terminated in April 2012 and that the defendant had 180 days after the termination notice to move the MMOA merchants to a new platform failing which the defendant could withhold residual payments and that the defendant would own all merchant accounts boarded under the MMOA Agreement. The amount of the unpaid residuals are between \$150,000 and \$250,000 net of all interchange charges. TOT Payments disputes receiving proper notice and is disputing the rights of the defendant to withhold monthly residuals due. The complaint seeks, among other things, compensatory damages in the amount of \$10 million for each cause of action, punitive damages in an amount exceeding \$10 million for each cause of action and orders requiring the defendant to account to TOT Payments for all residuals and other sums withheld, declaring that the MMOA Agreement is enforceable and requiring the defendant to comply with its obligations under the MMOA Agreement. The defendants filed a motion to dismiss for lack of standing. TOT Payments’ opposition to the defendant’s motion to dismiss was filed on October 24, 2013. The defendants’ reply to TOT Payments’ opposition was due October 31, 2013. The defendants filed both a memorandum in support and an affirmation in support to dismiss and oral argument was heard November 1, 2013. The next hearing date for the motion to dismiss is scheduled for November 25, 2013.

#### **Item 1A. Risk Factors.**

As a result of the divestiture of our interests in online media businesses and operations as described in Note 5 of the accompanying notes to unaudited condensed consolidated financial statements, our principal business currently is not subject to the risk factors set forth under the heading “Risks Related to Our Website Businesses (Entertainment and Culture Internet Destinations)” in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. However, we are subject to the risk factors set forth under that heading to the extent of our 10% membership interest in T1T Lab, LLC, which currently owns our former membership and participation interests in Openfilm, LLC, Motorsport, LLC, Splinx, LLC, LegalGuru, LLC and MUSIC 1 LLC (a/k/a OOO Music1). There otherwise have been no material changes in risk factors during 2013 through the date of this Report from those previously discussed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013. In reading and evaluating the information set forth in this Report we refer you to the issues, uncertainties and risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and in our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

##### **Recent Sales of Unregistered Securities**

During the fiscal quarter ended September 30, 2013, the Company entered into agreements to issue the below securities without registration under the Securities Act of 1933, as amended (the “Securities Act”). All of the below unregistered issuances of securities were or will be made pursuant to the exemption from registration requirements provided by Section 4(a)(2) of the Securities Act and comparable exemptions under applicable state securities laws. Except as expressly set forth below, the individuals and entities to which the Company issued securities are unaffiliated with the Company. For each of such sales, no advertising or general solicitation was employed in selling the securities. The sales were made to a limited number of persons, all of whom had a preexisting substantive relationship with the Company, its directors or its executive officers, and transfer was restricted by the Company in

accordance with the requirements of the Securities Act.

On September 4, 2013, the Company entered into a letter agreement, dated as of August 28, 2013 (the “Exchange Agreement”), with Oleg Firer, Steven Wolberg, Georgia Notes 18 LLC and Vladimir Sadvoskiy, pursuant to which the Company has agreed, subject to approval of the Company’s shareholders, to issue such number of shares of common stock of the Company equal to 10% of the Company’s issued and outstanding common stock as of the date of issuance of such shares in exchange for the Company’s acquisition of the outstanding 10% minority interest in the Company’s 90%-owned subsidiary, TOT Group, Inc. Mr. Firer is Chief Executive Officer and a director of the Company and Mr. Wolberg is Chief Legal Officer and Secretary of the Company.

Pursuant to the Exchange Agreement, the Company will purchase (i) from Oleg Firer 45,000 shares of common stock of TOT Group, representing 4.5% of TOT Group's outstanding shares of common stock, in exchange for the issuance to Mr. Firer of such number of shares of common stock of the Company equal to 4.5% of the Company's issued and outstanding common stock as of the date of issuance of such shares, (ii) from Steven Wolberg 20,000 shares of common stock of TOT Group, representing 2% of TOT Group's outstanding shares of common stock, in exchange for the issuance to Mr. Wolberg of such number of shares of common stock of the Company equal to 2% of the Company's issued and outstanding common stock as of the date of issuance of such shares, (iii) from Georgia Notes 18 LLC 30,000 shares of common stock of TOT Group, representing 3% of TOT Group's outstanding shares of common stock, in exchange for the issuance to Georgia Notes 18 LLC of such number of shares of common stock of the Company equal to 3% of the Company's issued and outstanding common stock as of the date of issuance of such shares and (iv) from Vladimir Sadovskiy 5,000 shares of common stock of TOT Group, representing 0.5% of TOT Group's outstanding shares of common stock, in exchange for the issuance to Mr. Sadovskiy of such number of shares of common stock of the Company equal to 0.5% of the Company's issued and outstanding common stock as of the date of issuance of such shares.

### **Issuer Purchases of Equity Securities**

In December 2012, our Board of Directors authorized, and we announced on December 10, 2012, a plan permitting the repurchase by the Company of up to \$2.5 million of issued and outstanding shares of the Company's common stock in open market or privately negotiated transactions during the 24-month period ending December 10, 2014. Repurchases, if and when effectuated, will be made subject to market conditions, applicable legal requirements (including federal and state securities laws as well as rules and regulations of the Commission) and other factors. The repurchase plan does not obligate the Company to acquire any particular amount of common stock and the plan may be modified, extended or terminated at any time at the Company's discretion. There were no repurchases during the third quarter ended September 30, 2013.

### **Item 5. Other Information.**

None.

### **Item 6. Exhibits.**

A list of the exhibits filed as a part of this Report is set forth on the Exhibit Index that follows page 47 of this Report and is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Net Element International, Inc.

Date: November 14, 2013

By: /s/ Jonathan New  
Name: Jonathan New  
Title: Chief Financial Officer  
(Principal Financial Officer  
and Duly Authorized  
Signatory)



**EXHIBIT INDEX**

Exhibit Number	Description
2.1	Contribution Agreement, dated September 25, 2013, among T1T Lab, LLC, Net Element International, Inc. and T1T Group, LLC (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the Commission on September 25, 2013)
10.1	Letter Agreement, dated August 28, 2013, among Net Element International, Inc., Oleg Firer, Steven Wolberg, Vladimir Sadovskiy, Georgia Notes 18, LLC, Kenges Rakishev and Mike Zoi (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on September 10, 2013)
10.2*	Agreement of K1 Holding Limited related to assumption by T1T Lab, LLC of Promissory Note, dated May 13, 2013, in the original principal amount of \$2 million originally made by Net Element International, Inc. and payable to K1 Holding Limited
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. § 1350
101**	The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language), is furnished electronically herewith: (i) Unaudited Condensed Consolidated Balance Sheets; (ii) Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss; (iii) Unaudited Condensed Consolidated Statements of Cash Flows; and (iv) Notes to Unaudited Condensed Consolidated Financial Statements.

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\* Filed herewith.

\*\* XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.