

Net Element, Inc.  
Form 10-Q  
May 15, 2012

**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 March 31, 2012

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 000-51108

Net Element, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**

**20-0715816**

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

**1450 S. Miami Avenue**

**Miami, Florida**

**33130**

(Address of principal executive offices) (Zip Code)

**(305) 507-8808**

(Registrant's telephone number, including area code)

**Not applicable**

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

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

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

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

Large accelerated filer

Accelerated filer

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

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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, \$.001 par value, of the registrant as of May 11, 2012 was 761,531,553.

## Defined Terms

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

## Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that reflect the current views of our management with respect to future events. 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," "may," "will," "will continue," "seeks," "should," 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 we undertake no obligation to update any forward-looking statement in light of new information or future events, although we intend to continue to meet our ongoing disclosure obligations under the U.S. securities laws and under other applicable laws. Forward-looking statements involve inherent risks and uncertainties, most of which are difficult to predict and are generally beyond our control. We caution 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: our ability (or inability) to continue as a going concern, the willingness of our controlling stockholders, TGR Capital, LLC and Enerfund, LLC, which are controlled by our Chairman and CEO, Mike Zoi, to continue investing in Net Element to fund our working capital requirements, our ability (or inability) to obtain additional financing in sufficient amounts or on acceptable terms when needed, our ability (or inability) to adequately address the material weaknesses in our internal control over financial reporting, development or acquisition of additional online media businesses, attracting and retaining competent management and other personnel, successful implementation of our business strategy, continued development and market acceptance of our technology, protection of our intellectual property, and successful integration and promotion of any business developed or acquired by us. If these or other risks and uncertainties (including those described in our Annual Report, as amended, on Form 10-K for the fiscal year ended December 31, 2011 filed with the U.S. Securities and Exchange Commission (the "Commission") and our subsequent filings with the Commission) materialize, or if the assumptions underlying any of these statements prove incorrect, our 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, Inc.**

**Form 10-Q**

**For the Quarter Ended March 31, 2012**

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**PART I — FINANCIAL INFORMATION****Item 1. Financial Statements.****NET ELEMENT, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

ASSETS	March 31, 2012	December 31, 2011
Current assets		
Cash	\$635,145	\$83,173
Deposits	52,129	52,129
Contract receivable, net	5,939	6,285
Prepaid expenses and other assets	264,640	266,583
Total current assets	957,853	408,170
Fixed assets		
Furniture and equipment	211,427	205,886
Computers	228,363	212,019
Leasehold improvements	19,955	19,955
Less: accumulated depreciation	(235,004 )	(208,858 )
Total fixed assets (net)	224,741	229,002
Other Assets		
Capitalized website development and intangible assets (net)	735,043	608,823
Goodwill	422,223	422,223
Total other assets	1,157,266	1,031,046
Total assets	\$2,339,860	\$1,668,218
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	399,236	238,955
Due to related parties (current portion)	1,722,141	1,768,637
Accrued expenses	908,422	884,499
Total current liabilities	3,029,799	2,892,091
Long term liabilities		
Due to related parties (non-current portion)	3,805,502	3,999,751

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Total long term liabilities	3,805,502	3,999,751
Total liabilities	6,835,301	6,891,842

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' DEFICIT

Preferred stock (\$.001 par value, 100,000,000 shares authorized and no shares issued and outstanding)	-	-
Common stock (\$.001 par value, 2,500,000,000 shares authorized and 761,531,553 and 742,341,113 shares issued and outstanding)	761,530	742,339
Treasury stock, at cost; 6,250,000 shares	(2,641,640 )	(2,641,640 )
Paid in capital	51,552,978	48,458,205
Deferred compensation	(395,747 )	(385,912 )
Accumulated other comprehensive loss	(24 )	(124 )
Accumulated deficit	(53,658,028)	(51,274,033)
Noncontrolling interest	(114,510 )	(122,459 )
Total stockholders' deficit	(4,495,441 )	(5,223,624 )
Total liabilities and stockholders' deficit	\$2,339,860	\$1,668,218

See accompanying notes to unaudited condensed consolidated financial statements



**NET ELEMENT, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net Revenues	\$74,810	\$78,146
Operating Expenses		
Cost of revenues	100,585	86,823
Business development	185,519	32,284
General and administrative	1,641,516	20,198,892
Product development	50,711	5,000
Depreciation and amortization	68,663	41,255
Total operating expenses	2,046,994	20,364,254
Loss from operations	(1,972,184 )	(20,286,108 )
Non-operating expense		
Interest income (expense)	(72,674 )	(24,915 )
Other income (expense)	(411,225 )	(45,942 )
Loss before income tax provision	(2,456,083 )	(20,356,965 )
Income tax provision	-	-
Net Loss from operations	(2,456,083 )	(20,356,965 )
Net loss attributable to the noncontrolling interest	72,088	42,068
Net loss	(2,383,995 )	(20,314,897 )
Other comprehensive income		
Foreign currency translation gain	100	-
Comprehensive loss	\$(2,383,895 )	\$(20,314,897 )
Net loss per share - basic and diluted	\$(0.00 )	\$(0.03 )
Weighted average number of common shares outstanding - basic and diluted	752,792,562	668,410,995

See accompanying notes to unaudited condensed consolidated financial statements.



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

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Cash flows from operating activities:		
Net loss	\$(2,383,995)	\$(20,314,897)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss attributable to investment in subsidiary	411,225	45,942
Decrease in noncontrolling interests	(72,088 )	(42,068 )
Loan discount interest expense	2,859	-
Depreciation and amortization	68,663	41,255
Non-cash compensation	521,771	18,949,148
Changes in assets and liabilities, net of acquisitions and the effect of consolidation of equity affiliates:		
Prepaid expenses and other assets	(8,994 )	39,463
Deposits	-	6,000
Contract receivable, net	346	(36,485 )
Due from related parties	(46,492 )	(1,536,399 )
Due to related parties	-	1,196,480
Accounts payable	160,278	48,013
Accrued expenses	23,923	46,747
Total adjustments	1,061,491	18,758,096
Net cash used in operating activities	(1,322,504)	(1,556,801 )
Cash flows from investing activities		
Deconsolidation of Korlea-TOT subsidiary	-	(83,361 )
Cash acquired in acquisition of subsidiary	-	8,838
Capitalized web development and patent costs	(168,738 )	(102,279 )
Purchase of fixed assets	(21,886 )	(102,168 )
Net cash used in investing activities	(190,624 )	(278,970 )
Cash flows from financing activities:		
Contributed capital from non-controlling equity investors	2,140,000	-
Payments on related party note	(75,000 )	-
Net cash provided by financing activities	2,065,000	-
Effect of exchange rate changes on cash	100	-
Net increase (decrease) in cash	551,972	(1,835,771 )

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Cash at beginning of period	83,173	2,500,253
Cash at end of period	\$635,145	\$664,482

Supplemental Disclosure of Cash Flow Information

Cash paid during the year for:

Interest	\$-	\$940
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Non-cash investing and financing activities:

Common stock issued for acquisition of Openfilm LLC	\$-	\$-
Common stock issued to settle stock subscription liability	\$-	\$880,000
Contributed capital due from JV partner	\$28,972	\$-

See accompanying notes to unaudited condensed consolidated financial statements.

**NET ELEMENT, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Basis of Presentation**

Net Element, Inc. (“we,” “us,” “our” or the “Company”), formerly TOT Energy, Inc., was organized on February 6, 2004 under the laws of the State of Delaware under the name Splinx Technology, Inc., which was a wholly-owned subsidiary of Splinx, LLC, a Florida limited liability company that is currently known as TGR Capital, LLC (a company indirectly wholly-owned by our Chairman and Chief Executive Officer, Mike Zoi). On January 18, 2005, the Company merged with a subsidiary of Ener1, Inc., a public reporting company. Pursuant to that merger, the Company issued 5,000,000 shares of its common stock to Ener1, Inc., which then distributed those shares as a dividend to its shareholders. That distribution was registered with the Commission, which resulted in the Company becoming a public reporting company.

Since April 1, 2010, we have pursued a strategy to develop and acquire technology and applications for use in the online media industry. During September 2010, we changed our name to Net Element, Inc. in furtherance of our shift in business focus. As part of our strategy to develop an online media company, on December 14, 2010, we acquired Openfilm, LLC, a Florida limited liability company that is engaged in the development of technology and operation of a website that supports the advancement of independent film on the Internet. Additionally, on February 1, 2011, we acquired Motorsport, LLC, a Florida limited liability company that now holds 100% (initial purchase was for an 80% interest and we subsequently bought out the remaining minority position) of the outstanding common stock of Motorsport.com, Inc., a Florida corporation engaged in the operation of a news and information website relating to the international motorsport industry, and Music1, LLC, a Florida limited liability company that owns 97% of the membership interests in A&R Music Live, LLC, a Georgia limited liability company that owns and operates two websites that provide an online social community and marketplace for musicians, songwriters, producers and record companies and an opportunity to showcase artist talents. As a result of these acquisitions, we now operate several online media websites in the film, auto racing and emerging music talent markets.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Commission for reporting on Form 10-Q. Accordingly, certain information and footnotes required for complete financial statements are not included herein. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. These results have been determined on the basis of generally accepted accounting principles and practices applied consistently with those used in the preparation of the Company’s financial statements for the three months ended March 31, 2012. Operating results for the three months ended March 31, 2012 are not necessarily

indicative of the results that may be reported for any particular quarterly period or the year ending December 31, 2012. 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, 2011 included in the Company's Annual Report on Form 10-K filed with the Commission.

#### Basis of Consolidation

The unaudited condensed consolidated financial statements include the accounts of Net Element, Inc., the accounts of our wholly-owned subsidiaries, Openfilm, LLC and its wholly-owned subsidiaries Openfilm, Inc., Openfilm Studios, LLC and Zivos, LLC (Ukraine for 2011 only), the accounts of our wholly-owned subsidiary Netlab Systems, LLC, its wholly-owned subsidiary Tech Solutions LTD (formerly known as Netlab Systems, LTD) (Cayman Islands) and the accounts of its representative offices in Russia and Ukraine, the accounts of our 100%-owned subsidiary NetLab Systems IP, LLC, the accounts of our 70%-owned subsidiary LegalGuru LLC, the accounts of our 75%-owned subsidiary Yapik LLC, the accounts of our 85%-owned subsidiary Splinex, LLC and its wholly-owned subsidiary IT Solutions LTD (formerly known as Splinex LTD)(Cayman Islands), the accounts of our wholly-owned subsidiary Music1, LLC and its 97%-owned subsidiary A&R Music Live, LLC (Music1, LLC and A&R Music Live, LLC are sometimes together referred to in this Report as "Music"), and the accounts of our wholly-owned subsidiary Motorsport, LLC and its wholly-owned subsidiary Motorsport.com, Inc. (the Company acquired the remaining 20% interest not owned in Motorsport.com, Inc. on January 10, 2012). All material intercompany accounts and transactions have been eliminated in this consolidation.

## Use of Estimates

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

## Cash

We maintain our U.S. Dollar-denominated cash in several non-interest bearing bank deposit accounts. All non-interest bearing transaction accounts are fully insured, regardless of the balance in the account, at all FDIC insured institutions. As such, our bank balances did not exceed FDIC limits at March 31, 2012 and December 31, 2011.

We maintain bank accounts in Russia, Ukraine and Cayman Islands associated with our offshore engineering offices. The following details the balances and countries where we maintain foreign bank balances:

<b>Location</b>	<b>Country</b>	<b>US Dollar Equivalent Balance at 03/31/12</b>	<b>US Dollar Equivalent Balance at 12/31/11</b>
Netlab Systems, LLC Russian Representative Office	Russia	\$6,022	\$4,516
Netlab Systems, LLC Ukrainian Representative Office	Ukraine	\$28	\$4,178
Zivos, LLC	Ukraine	\$9	\$69
Tech Solutions, LTD (fka Netlab Systems, LTD)	Cayman Islands	\$1,284	\$971

## Fixed Assets

We depreciate our furniture, servers, data center software and equipment over a term of 5 years. Computers and client software are depreciated over terms between 2 and 5 years. Leasehold improvements are depreciated over the shorter of the economic life or terms of each lease. All of our assets are depreciated on a straight-line basis for financial statement purposes.

#### Intangible Assets

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

We capitalize our 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.

We also capitalize direct expenses associated with filing of patents and patent applications and amortize the capitalized intellectual property costs over five years beginning when the patent is approved.



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

Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. Goodwill and certain intangible assets are assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify potential impairment by comparing the fair value of the reporting unit with its net book value (or carrying amount), goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary.

If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

#### Foreign Currency Transactions

We are subject to exchange rate risk in our foreign operations in Ukraine and Russia where we incur product development, engineering and website development and hosting costs. The Ukraine and Russian engineering operations pay a majority of their expenses in their local currencies, exposing us to exchange rate risk. Ukrainian salaries and consulting fees are negotiated and paid in U.S. dollars.

We do not engage in any currency hedging activities.

## Revenue Recognition

We recognize revenue when four basic criteria are met: persuasive evidence of a sales arrangement exists; performance of services has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. We consider persuasive evidence of a sales arrangement to be the receipt of a signed contract or 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. We record cash received in advance of revenue recognition as deferred revenue.

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

Our revenues for the three months ended March 31, 2012 and 2011 were principally derived from the following services:

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

*Service Fees.* Service fee is generated primarily from A&R Music Live where aspiring artists pay industry professionals to review, critique and suggest improvements of music submitted on-line for review.

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

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

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

#### Net Loss Per Share

Basic net loss per common share is computed by dividing net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares issuable upon exercise of common stock options or warrants. In periods when losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents because their inclusion would be anti-dilutive.

#### Fair Value of Financial Instruments

Our financial instruments consist mainly of cash deposits, short-term payables and related party payables. We believe that the carrying amounts of third-party financial instruments approximate fair value, due to their short-term maturities.

#### Impairment of Long-Lived Assets

We review our long-lived assets for impairment whenever events or changes indicate that the carrying amount of an asset or group of assets may not be recoverable. No impairment losses were recorded during the three months ended March 31, 2012 and the twelve months ended December 31, 2011.

## Uncertain Tax Positions

We review uncertain tax positions on an ongoing basis and related reserves are adjusted in light of changing facts and circumstances, including progress of tax audits, developments in case law, and expirations of statutes of limitations. Based on information currently available, we anticipate that over the next ninety days ongoing audit activity should be resolved relating to uncertain tax positions (See Note 14).

## NOTE 2. GOING CONCERN CONSIDERATIONS

Our condensed 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. We had negative cash flows from continuing operating activities of \$1,322,504 for the three months ended March 31, 2012, and a working capital deficit of \$2,071,946 and accumulated deficit of \$53,658,028 at March 31, 2012. We have historically been primarily dependent upon TGR Capital, LLC, Enerfund, LLC or Mike Zoi (as a result of his controlling interest in TGR and Enerfund) to fund our operations. See Note 15.

Management is continuing with its plan to build a diversified portfolio of online media and technology assets. Management believes that its current operating strategy, combined with continued funding by our primary stockholder, will provide the opportunity for us to continue as a going concern; however, there is no assurance this will occur. The accompanying condensed consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Our independent auditors' report on our consolidated financial statements for the period ended December 31, 2011 contains an explanatory paragraph about our ability to continue as a going concern. Management believes that its current operating strategy, as described herein, provides the opportunity for the Company to continue as a going concern; however, there is no assurance this will occur.

NOTE 3. SEGMENT INFORMATION

At March 31, 2012 and March 31, 2011, our sole reportable business segment was our online businesses in music, film, motorsport and professional marketing services.

NOTE 4. ACQUISITIONS OF MOTORSPORT, LLC AND MUSIC1, LLC

On February 1, 2011, we entered into a purchase agreement with Enerfund, LLC, a company controlled by Mike Zoi, to purchase all of the issued and outstanding interests in Motorsport, LLC, a Florida limited liability company that held 80% of the outstanding common stock of Motorsport.com, Inc., a Florida corporation engaged in the operation of a news and information website relating to the international motorsport industry. Motorsport, LLC purchased its 80% interest in Motorsport.com, Inc. on December 17, 2010. We paid Enerfund an aggregate of \$130,000 (exclusive of a \$20,000 contingent payment relating to the purchase of certain domain names) and agreed to take over responsibility for the obligations of Motorsport, LLC contained in the Stock Purchase Agreement dated December 17, 2010 pursuant to which Motorsport, LLC acquired its 80% interest in Motorsport.com, Inc., which obligations included, among other things, the aggregate payment to the original stockholders of Motorsport.com, Inc. of an additional \$450,000 payable in four quarterly installments, without interest, commencing on December 1, 2013. The domain names and related registrations were not purchased, as required, by June 16, 2011; hence the contingent amount (\$20,000) will not be paid. The original sellers have a security interest in the domain names of Motorsport.com, Inc. as collateral for payment of the additional purchase price.

On January 10, 2012, the terms of the December 17, 2010 Stock Purchase Agreement were amended, reducing the \$450,000 payment to \$300,000, payable in four annual cash installments of \$75,000 commencing January 10, 2012, plus the issuance of 1,333,333 shares of the Company's common stock on January 10, 2012. In addition, on January 10, 2012, Motorsport exercised its option to acquire the remaining 20% interest in Motorsport.com, Inc. held by the original stockholders for the issuance to the sellers of an aggregate of 3,333,333 shares of the Company's common stock. The Company recognized a loss of \$411,225 for this transaction which was recorded in other expense for the three months ended March 31, 2012.

The net assets of Motorsport, LLC were recorded at book basis ("carryover historical cost") as the transaction was accounted for as a merger of entities under common control. The following table provides summary balance sheet information of Motorsport, LLC as of the date of acquisition (February 1, 2011):

Cash	\$-
------	-----

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Accounts receivable	6,179
Property & equipment	509
Other assets	651,716
Accounts Payable & Accrued Expenses	(7,224 )
Notes Payable	(590,565)
Net assets	\$60,615

If we had acquired Motorsport, LLC on January 1, 2011, the results of operations of the Company would have changed by the following amounts (Motorsport, LLC results for January, 2011):

Sales	\$3,994
Gross Profit	(8,625 )
Total operating expenses	24,124
Net loss from continuing operations	(32,749)
Net loss attributable to non-controlling interest	5,839
Net loss	\$(26,910)

On January 31, 2011, Motorsport, LLC entered into a loan agreement with Enerfund, LLC (a company controlled by Mike Zoi) in the principal amount of \$184,592. The annual interest rate was 5% payable annually on December 31. The loan was scheduled to mature on the third anniversary of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued interest due at that time. On February 24, 2011, this loan was repaid with accrued interest for an aggregate amount of \$186,808.

Also on February 1, 2011, we acquired Music1, LLC, a Florida limited liability company, from Enerfund, LLC (a company controlled by Mike Zoi), for an aggregate purchase price of \$15,000. Music1, LLC owns 97% of the membership interests in A&R Music Live, LLC, a Georgia limited liability company that operates a website that provides a musical artist discovery service. Music1, LLC purchased its interest in A&R Music Live, LLC from Stephen Strother, the Founder and President of Music1, on November 8, 2010. The remaining 3% of the membership interests in A&R Music Live, LLC is owned by Stephen Strother. We were required to invest at least \$500,000 in Music1 by December 31, 2012, which requirement was met during the fourth quarter of 2011. Additionally, Mr. Strother has granted a royalty free license to Music1 to use certain technology owned by him for the term of his employment agreement.

The net assets of Music1, LLC have been recorded at book basis (“carryover historical cost”) as the transaction was accounted for as a merger of entities under common control. The following table provides summary balance sheet information for Music1, LLC as of the date of acquisition (February 1, 2011).

Cash	\$8,838
Accounts receivable	117
Other assets	11,294
Accounts Payable	(11,935 )
Notes Payable	(130,993)
Net deficiency in assets	\$(122,679)

If we had purchased Music1, LLC on January 1, 2011, the results of operations for the Company would have changed by the following amounts (Music1, LLC results for January, 2011):

Sales	\$4,941
Gross Profit	225
Total operating expenses	(38,219)
Net loss from continuing operations	(37,994)
Net loss attributable to non-controlling interest	841
Net loss	\$(37,153)

On January 31, 2011, Music1, LLC entered into a loan agreement with Enerfund, LLC (a company controlled by Mike Zoi) in the principal amount of \$128,890. The annual interest rate was 5% payable annually on December 31. The loan was scheduled to mature on the third anniversary of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued interest due at that time. On February 24, 2011, this loan was repaid with accrued interest for an aggregate of \$131,827.

NOTE 5. JOINT VENTURES

We formed a joint venture in the Czech Republic, Korlea-TOT Energy s.r.o., in July 2008 with Korlea Invest Holding AG of Switzerland (“Korlea”). We invested \$56,000 in exchange for our 51% of the share capital in the joint venture. Korlea-TOT was expected to engage in marketing and trading of oil and natural gas in Eastern Europe. To date, the joint venture has not engaged in any significant operating activity. We deconsolidated Korlea-TOT as of January 1, 2011 and we have adjusted the investment to its net realizable value. We intend to sell our ownership interest in Korlea-TOT to Korlea in exchange for a cash payment equal to 51% of the cash balance in the joint venture on the date of sale. Consummation of this transaction is subject to obtaining certain approvals and making certain filings overseas. We expect that this transaction will be completed during 2012.

On March 17, 2011, we formed a wholly-owned subsidiary, Splinx, LLC, a Florida limited liability company. Splinx, LLC is intended to develop technology and web services for use in our products and services and certain other licensed applications focused in the areas of three dimensional (3D) imagery and video. During 2011, Splinx issued 15% of its equity to certain of its employees and consultants as incentive and equity based compensation.

Effective as of March 29, 2011, we entered into a joint venture arrangement (the “LegalGuru JV Agreement”) with Curtis Wolfe in connection with the formation of LegalGuru LLC, a Florida limited liability company. The Company owns a 70% interest in LegalGuru LLC and Mr. Wolfe, who is a director and Secretary of the Company and Chief Executive Officer and Chairman of LegalGuru LLC, through Lobos Advisors, LLC (a company of which Mr. Wolfe is the President and managing member), owns a 30% interest in LegalGuru LLC. Pursuant to the LegalGuru JV Agreement, the parties agreed to invest up to an aggregate of \$1,000,000 in the joint venture, with Mr. Wolfe investing up to \$200,000 and the Company investing up to \$800,000. Mr. Wolfe is the Chief Executive Officer and Chairman of LegalGuru LLC at a salary, beginning March 1, 2011, of \$10,000 per month, of which, beginning June 16, 2011, \$8,000 is payable in cash and \$2,000 is payable in stock options of the Company. Upon launch of the website and commencement of commercial operations (currently expected in the second quarter of 2012), Mr. Wolfe’s salary was to increase to \$20,000 per month (\$15,000 from LegalGuru LLC and \$5,000 from the Company), from which we would have withheld an amount equal to \$100,000 over one year as part of Mr. Wolfe’s investment obligations in LegalGuru LLC. Mr. Wolfe has the right, for 36 months from the date of the LegalGuru JV Agreement, to convert his interest in LegalGuru LLC into 3,000,000 shares of our common stock.



On June 16, 2011, we entered into a Subscription Agreement, with a related party that is employed by Yapik LLC, pursuant to which we sold a 15% ownership interest in our subsidiary Yapik LLC in exchange for a \$100,000 investment in Yapik LLC, which was received on June 20, 2011. The investor has an option, which is exercisable for 36 months, to convert the 15% ownership interest in Yapik LLC into 1,500,000 shares of common stock of the Company.

On April 24, 2012, we entered into an amended and restated joint venture agreement, dated as of December 31, 2011 (the "Amended Agreement"), with Curtis Wolfe regarding the Company's subsidiary LegalGuru LLC. The Amended Agreement amends and restates the LegalGuru JV Agreement described above (the "Original Agreement"). The Amended Agreement requires the Company and Mr. Wolfe to invest up to an aggregate of \$900,000 in LegalGuru LLC, with Mr. Wolfe investing up to an aggregate of \$100,000 and the Company investing up to an aggregate of \$800,000. As noted above, the Original Agreement required the Company and Mr. Wolfe to invest up to an aggregate of \$1,000,000 in LegalGuru LLC, with Mr. Wolfe investing up to an aggregate of \$200,000 and the Company investing up to an aggregate of \$800,000. In connection with the \$100,000 reduction in the amount required to be invested in LegalGuru LLC by Mr. Wolfe, Mr. Wolfe agreed to maintain his current salary of \$10,000 per month, with \$8,000 of such amount paid in cash and \$2,000 paid in stock options of the Company, until LegalGuru LLC generates at least \$500,000 in revenue. As of March 31, 2012, Mr. Wolfe had invested \$71,279 in LegalGuru LLC and the Company had invested \$830,983 in LegalGuru LLC. The Company agreed that Mr. Wolfe would be entitled to serve on the Company's Board of Directors for so long as the Company holds a majority interest in LegalGuru LLC. Mr. Wolfe continues to have the right, for 36 months from March 29, 2011, to convert his interest in LegalGuru LLC into 3,000,000 shares of our common stock.

Pursuant to the governing documents, distributions to the members of LegalGuru LLC are to be made in accordance with their respective percentage ownership interests. The LLC Agreement provides that Mr. Wolfe shall have the right to be appointed as a director of LegalGuru LLC and to appoint one other director of LegalGuru LLC, and that the Company shall have the right to appoint one director of LegalGuru LLC. The LLC Agreement grants each member of LegalGuru LLC rights of first refusal and tag along and drag along rights with respect to a member's proposed sale of its membership interest in LegalGuru LLC.

See Note 15 for information regarding certain joint venture arrangements entered into subsequent to March 31, 2012.

#### NOTE 6. GOODWILL AND INTANGIBLE ASSETS

We capitalize certain costs for website development projects. Specifically, we capitalize projects that are significant in terms of functional value added to the site. A capitalized project would be closer to a full product launch than an incremental or point release update. Costs for updates are expensed as incurred. Capitalized costs are amortized to

depreciation and amortization expense over twenty-four months on a straight-line basis. We also capitalize start-up projects from the point of start to the point the application, service or website is publicly launched. Amortization is straight-line over twenty-four months and charged to depreciation and amortization. Impairment is reviewed quarterly to ensure only viable active project costs are capitalized.

Capitalized website development costs are included in other assets. For the three months ended March 31, 2012, we capitalized \$161,588 of website development costs related to our Music, social network (Yapik), and legal websites. Additionally, we amortized \$26,510 to depreciation and amortization expense for the three months ended March 31, 2012 leaving a balance of \$542,314 for capitalized website development.

For the three months ended March 31, 2012, we capitalized patent costs for \$7,150 and we amortized \$1,008, leaving a balance of \$28,393 for capitalized patent costs on that date.

Additionally, on February 1, 2011, we acquired Motorsport, LLC and Music1, LLC from a related party (Enerfund) and we assumed the balance sheets of Motorsport, LLC and Music1, LLC with existing intangible assets as follows:

Intangible Asset	Motorsport, LLC	Music1, LLC
Content	\$ 14,376	\$4,791
Domain Name	95,833	6,503
Customer List	95,833	-
Goodwill	442,223	-
TOTALS	\$ 648,265	\$ 11,294

For the three months ended March 31, 2011, we capitalized 92,378 in website development costs and amortized \$2,465, leaving a balance of of \$89,913 on March 31, 2011.

NOTE 7. FIXED ASSETS

Depreciation and amortization expense was \$68,663 for the three months ended March 31, 2012 and \$41,255 for the three months ended March 31, 2011.

NOTE 8. ACCRUED EXPENSES

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.

At March 31, 2012 and December 31, 2011, accrued expenses consisted of the following:

	March 31, 2012	December 31, 2011
Accrued professional fees	\$ 112,200	\$ 122,500
Promotion Expense	50,000	50,000
Accrued interest	253,786	183,971
Accrued payroll	94,359	122,223
Deferred revenue	184,772	185,362
Other accrued expenses	213,305	220,443
	\$908,422	\$ 884,499

NOTE 9. NOTES PAYABLE

On December 14, 2010, the Company assumed a \$1,667,020 loan to Openfilm from Enerfund, LLC when the Company purchased Openfilm on that date. The loan agreement is dated December 10, 2010 and matures two years from that date. The annual interest rate is 5% payable annually on December 31.

On January 31, 2011, Motorsport, LLC entered into a loan agreement with Enerfund, LLC in the principal amount of \$184,592. The annual interest rate was 5% payable annually on December 31. The loan was scheduled to mature on the third anniversary of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued interest due at that time. On February 24, 2011, this loan was repaid with accrued interest for an aggregate amount of \$186,808.

On January 31, 2011, Music1, LLC entered into a loan agreement with Enerfund, LLC in the principal amount of \$128,890. The annual interest rate was 5% payable annually on December 31. The loan was scheduled to mature on the third anniversary of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued interest due at that time. On February 24, 2011, this loan was repaid with accrued interest for an aggregate of \$131,827.

On May 16, 2011, we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$2,000,000, which is the balance outstanding at March 31, 2012. The annual interest rate is 5.0% and principal and interest is due on or before April 27, 2014. The loan may be pre-paid at any time without penalty. Outstanding principal may be converted by Enerfund at any time into shares of common stock of the Company at a conversion price of \$0.11 per share.

On October 24, 2011, we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$1,600,000, which is the outstanding balance at March 31, 2012. The annual interest rate under the note is 5% and principal and interest is due on or before October 24, 2014. The note may be pre-paid at any time without penalty. Outstanding principal under the note may be converted by Enerfund, LLC at any time into shares of common stock of the Company at a conversion price of \$0.11 per share. Upon conversion of the note, the Company is required to issue to Enerfund, LLC a five-year warrant to purchase a number of shares of common stock of the Company equal to the number of shares issued upon such conversion with an exercise price of \$0.11 per share.

At December 31, 2011, Enerfund had made advances to the Company for \$100,785, which were recorded as due to related parties (current portion). Subsequent to December, Enerfund advanced additional monies to the Company. The Company repaid all advances to Enerfund (\$905,317) on March 6, 2012 that were made between December 31, 2011 and March 6, 2012.

See Note 15 for information regarding notes payable entered into subsequent to March 31, 2012.

#### NOTE 10. COMMITMENTS AND CONTINGENCIES

Openfilm has completed two "Get it Made" competitions. The first contest completed in September 2010, awarded \$250,000 in cash (\$50,000) and services (\$200,000) to produce a film suitable for distribution. The services are provided once the winner provides a screenplay in acceptable form to Openfilm. The second contest winner was announced in June 2011 and \$500,000 was awarded in cash (\$50,000) and services (\$450,000) to produce a feature film suitable for distribution. The terms of this contest require the winner to submit an acceptable screenplay within six months. The Company has recorded \$100,000 in expense relating to the cash prizes awarded. The services will be charged to operations over the expected time it takes to produce the films beginning once acceptable screenplays have been submitted to and approved by Openfilm.

The Company has been developing a concept called BMA (Brand Marketing Alliance) whereby the Company will aggregate content and sell advertising. A consultant has been retained that is responsible for building the business and has the opportunity to earn equity based compensation once the project becomes cash flow positive. On March 26, 2012, the Board of Directors approved five year, stock option grants totaling 3,625,000 options to purchase the Company's common stock at \$0.18 per share subject to the BMA project becoming cash flow positive.

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

#### NOTE 11. STOCKHOLDERS' EQUITY

On February 1, 2011, our Board of Directors adopted a resolution recommending an amendment to the Certificate of Incorporation to increase the number of authorized shares of our capital stock to an aggregate of 2,600,000,000 shares, with 2,500,000,000 shares designated common stock, \$.001 par value, and 100,000,000 shares designated preferred stock, \$.001 par value per share, which may be divided into series with the designations, powers, preferences, and relative rights and any qualifications, limitations or restrictions as determined by the Board of Directors. Our majority stockholders approved the amendment to our Certificate of Incorporation through action taken by written consent without a meeting, as authorized by Section 228 of the Delaware General Corporation Law. The actions recommended by the Board of Directors and approved by the Company's majority stockholders became effective upon the filing of a certificate of amendment relating thereto with the Secretary of State of the State of Delaware on March 4, 2011.

Effective as of March 29, 2011, we entered into a joint venture arrangement with Curtis Wolfe in connection with the formation of LegalGuru LLC, a Florida limited liability company. The Company owns a 70% interest in LegalGuru LLC and Mr. Wolfe, through Lobos Advisors, LLC, owns a 30% interest in LegalGuru LLC. Mr. Wolfe has the right, for 36 months from March 29, 2011, to convert his interest in LegalGuru LLC into 3,000,000 shares of our common stock.

On May 3, 2011, the Company entered into an agreement with Roger Elliot to purchase content for cash and stock. The Company agreed to provide Roger with 60,000 shares of common stock for every 300 hours of content provided plus a 25,000 stock bonus for performance. Roger has provided over 300 hours of content and the Company recorded a charge of \$14,182 for the three months ended March 31, 2012 to reflect the value of the 85,000 shares provided to Roger.

On May 16, 2011 we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$2,000,000. The annual interest rate is 5.0% and principal and interest is due on or before April 27, 2014. The loan may be pre-paid at any time without penalty. Outstanding principal may be converted by Enerfund at any time into shares of common stock of the Company at a conversion price of \$0.11 per share, the market price at the date of issuance.

On June 16, 2011, we entered into a Subscription Agreement pursuant to which we sold a 15% ownership interest in our subsidiary Yapik LLC in exchange for a \$100,000 investment in Yapik LLC, which was received on June 20, 2011. The investor has an option, which is exercisable for 36 months, to convert the 15% ownership interest in Yapik LLC into 1,500,000 shares of common stock of the Company.

On August 9, 2011, we entered into a Stock Purchase Agreement pursuant to which we were to acquire 100% of the outstanding equity interests in Stratuscore, Inc., a State of Washington corporation, from its selling shareholder in exchange for the issuance of up to 10 million shares of common stock of the Company. On November 10, 2011, the Company and the selling shareholder mutually agreed to terminate and unwind the Stock Purchase Agreement.

On January 10, 2012, the Company, Motorsport, LLC and the Sellers named therein entered into an amendment (the "Amendment") to the Stock Purchase Agreement dated December 17, 2010 pursuant to which Motorsport, LLC acquired its 80% interest in Motorsport.com, Inc. Pursuant to the Amendment, the Company's and Motorsport's remaining obligations to pay an aggregate of \$450,000 to the Sellers in four quarterly installments beginning on December 1, 2013 were amended to provide that: (i) Motorsport must pay to the Sellers \$300,000 in cash in four equal annual installments of \$75,000 each beginning on January 10, 2012, with each subsequent installment payable on each annual anniversary thereafter until such \$300,000 is paid in full; and (ii) the Company must issue to the Sellers an aggregate of 1,333,333 shares of its common stock on January 10, 2012. The initial \$75,000 installment was paid by the Company and the Company issued such 1,333,333 shares of its common stock to the Sellers. In addition, pursuant to the Amendment, Motorsport exercised its option to acquire the remaining 20% interest in Motorsport.com, Inc. for a purchase price consisting solely of the Company's issuance to the Sellers of an aggregate of 3,333,333 shares of its common stock.

On February 2, 2012, the Company 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) 666,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.25 per share; (iii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.50 per share; and (iv) a three-year warrant to purchase up to an additional 666,666 shares of common stock of the Company with an exercise price of \$1.00 per share.

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On February 10, 2012, the board approved a stock option grant to key employees awarding 1,600,000 fully-vested options with a strike price of \$0.16 and a life of five years

On February 23, 2012, the Company entered into a Subscription Agreement pursuant to which it sold 13,333,334 newly issued shares of common stock of the Company to Kenges Rakishev for an aggregate purchase price of \$2,000,000.10, or \$0.15 per share.

On March 7, 2012, the Company entered into a consulting agreement with CSFG1 who agreed to provide certain investor relations services in exchange for \$3,000 in cash and 25,000 restricted shares of the Company's common stock per month. This agreement was terminated by the Company effective May 31, 2012.

On March 26, 2012, the Company granted 460,000 shares of common stock to Michael Waltrip in exchange for his participation on the Motorsport Advisory Board and his participation in building the Motorsport.com business in general. The agreement is for two years and the Company recorded \$7,667 in non-cash compensation expense from the date of agreement (January 26, 2012) to March 31, 2012.

### NOTE 12. STOCK OPTIONS, WARRANTS AND STOCK BASED COMPENSATION

#### Stock Options and Warrants

On March 6, 2011, the Board of Directors approved the grant of options to purchase an aggregate of 3,971,500 shares of common stock at an exercise price of \$0.10 per share to certain employees and consultants under our 2004 Stock Option Plan. The Company valued the options using a Black-Scholes model and recorded a compensation charge of \$39,715. The options vest over three years at 33.3% per year with vesting for a particular year occurring on the anniversary date of the grant. At March 31, 2012, 1,184,400 of the 3,971,500 options were forfeited by employees that are no longer with the Company.



On June 28, 2011, the Board of Directors approved the 2011 Equity Incentive Plan with 150,000,000 shares authorized. The Company's majority stockholder approved the plan pursuant to a written consent also dated June 28, 2011. The Board of Directors serves as administrator of the plan. The new plan is designed to attract and retain the services of directors, employees and consultants by offering ability to make awards of unrestricted stock, stock options or both in order to create incentives. The plan limits the strike price of incentive options issued to 100% (110% if the optionee is a 10% or more shareholder) of current market and terms can be no longer than 10 years (5 years if the optionee is a 10% or more shareholder). The Company has registered the shares issuable under this plan on a registration statement on Form S-8 filed with the SEC. This plan became effective on July 20, 2011.

On August 9, 2011, we issued incentive stock options to purchase 1,500,000 shares of our common stock under our 2011 Equity Incentive Plan to our Chief Revenue Officer at an exercise price of \$0.06 per share with a term of 5 years, subject to a three-year vesting schedule. The Chief Revenue Officer's employment was terminated in November 2011 and he has one year to exercise vested options or they will terminate.

On August 9, 2011, the Board of Directors approved the issuance of five-year stock options to purchase shares of common stock of the Company to employees taking salary reductions. These options were immediately vested upon issuance. Accordingly, the Company recorded a compensation charge, using a Black-Scholes model for the following issuances in 2011 of fully vested options.

Date Range	# Options Issued	Strike Price of Options	Grant Expiration Date	2011 Compensation Charge
6/15/11-7/31/11	555,207	\$0.06	08/07/16	\$76,645
August, 2011	62,052	\$0.20	08/29/16	\$22,959
September, 2011	350,494	\$0.15	09/28/16	\$52,574
October, 2011	342,223	\$0.15	10/29/16	\$51,333
November, 2011	179,306	\$0.21	11/30/16	\$37,654
December, 2011	52,591	\$0.60	12/29/16	\$31,555
Totals	1,541,873			\$272,720

Effective as of March 29, 2011, we entered into a joint venture arrangement with Curtis Wolfe in connection with the formation of LegalGuru LLC, a Florida limited liability company. The Company owns a 70% interest in LegalGuru LLC and Mr. Wolfe, through Lobos Advisors, LLC, owns a 30% interest in LegalGuru LLC. Mr. Wolfe has the right, for 36 months from March 29, 2011, to convert his interest in LegalGuru LLC into 3,000,000 shares of our common stock.

On May 16, 2011 we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$2,000,000. The annual interest rate is 5.0% and principal and interest is due on or before April 27, 2014. The loan may be pre-paid at any time without penalty. Outstanding principal may be converted by Enerfund at any time into shares of common stock of the Company at a conversion price of \$0.11 per share.

On June 16, 2011, we entered into a Subscription Agreement pursuant to which we sold a 15% ownership interest in our subsidiary Yapik LLC in exchange for a \$100,000 investment in Yapik LLC, which was received on June 20, 2011. The related party investor, who is employed by Yapik, has an option, which is exercisable for 36 months, to convert the 15% ownership interest in Yapik LLC into 1,500,000 shares of common stock of the Company.

On February 2, 2012, the Company 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) 666,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.25 per share; (iii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.50 per share; and (iv) a three-year warrant to purchase up to an additional 666,666 shares of common stock of the Company with an exercise price of \$1.00 per share.

On February 10, 2012, the Board of Directors approved the issuance of 1,600,000, five-year stock options to purchase shares of common stock of the Company for \$0.16 per share to certain employees. These options were immediately vested upon issuance. Accordingly, the Company recorded a compensation charge of \$256,000, using a Black-Scholes model for the issuance of fully vested options.

On March 31, 2012, the Company issued five-year stock options to purchase shares of common stock of the Company to employees taking salary reductions for the first quarter of 2012. These options were immediately vested upon issuance. Accordingly, the Company recorded a compensation charge for \$95,899, using a Black-Scholes model for the issuance of 550,340 fully vested options.

At March 31, 2012, the Company had options to purchase 9,124,241 shares of common stock outstanding under its stock option plans, of which options to purchase 7,256,884 shares of common stock are vested, with a weighted average exercise price of \$0.15 per share and with a remaining weighted average contractual term of 5.86 years. We also had warrants to purchase 200,000,000 shares of common stock outstanding at March 31, 2012 with a strike price of \$0.05 per share and a remaining contractual term of 3.31 years and warrants to purchase an addition 47,272,727 shares if notes are converted pursuant to Subscription Agreements with TGR Energy and Enerfund, LLC.

At March 31, 2012, we had outstanding options to purchase 5,237,141 shares of common stock under our 2011 Equity Incentive Plan, of which options to purchase 5,237,141 shares of common stock are vested, with a weighted average exercise price of \$0.16 per share and with a remaining weighted average contractual term of 4.77 years.

Additionally, at March 31, 2012, we had outstanding options to purchase 3,887,100 shares of common stock under our 2004 Stock Option Plan, of which options to purchase 2,019,743 shares of common stock are vested, with a weighted average exercise price of \$0.14 per share and with a remaining weighted average contractual term of 7.33 years.

#### Stock Based Compensation

On February 18, 2011, the Company's Board of Directors approved the hiring of Richard Lappenbusch as President and Chief Operating Officer. In addition to salary and benefits, Mr. Lappenbusch was granted 6,100,000 shares of our common stock with vesting as follows: 100,000 shares on February 15, 2012; 4,000,000 shares vesting semi-annually over a three year period from the date of the grant; and 2,000,000 shares upon the Company achieving \$20,000,000 in gross revenues (other than through acquisitions), subject to the terms and conditions of a restricted stock agreement. Accordingly, the fair value of the restricted shares issued of \$33,549 will be amortized over the vesting periods.

The remaining 2,000,000 restricted shares of common stock vest upon the Company's attainment of \$20 million in aggregate gross revenues. For the three months ended March 31, 2012, we amortized \$4,217 of this amount as an expense to operations.

Also on February 18, 2011, our Board of Directors approved a grant of 100,000 shares of our common stock to a consultant as compensation for marketing and investor relations services. We recorded a charge of \$4,000 based on the fair market value of shares issued.

On March 6, 2011, our Board of Directors approved the issuance of 100 shares of our common stock to certain employees and consultants located in the U.S., Russia and Ukraine. This resulted in an issuance of 5,800 shares of common stock and a corresponding compensation charge of \$580 to reflect the fair market value of the shares issued.

On April 4, 2011, we entered into a public relations contract with Roar Media, LLC to provide press related services and assist with community outreach and strategic alliances. The term of this agreement was for six months and provided for monthly remuneration of \$14,000 and 5,000 shares of our common stock, with an option by the Company to renew for successive six-month periods. This agreement was modified to provide remuneration in July of \$7,000 and 5,000 shares. August and September were revised to \$6,500 per month plus 5,000 shares per month. Beginning in October, we have agreed to the same terms, as revised, on a month to month basis. For the three months ended March 31, 2012, the Company issued Roar 15,000 shares of the Company's common stock and recorded a charge of \$3,750 based on the fair value of stock provided.

On May 3, 2011, the Company entered into an agreement with a consultant to purchase content for cash and stock. The Company agreed to provide Roger with 60,000 shares of common stock for every 300 hours of content provided plus a 25,000 stock bonus for performance. Roger has provide over 300 hours of content and the Company recorded a charge of \$14,182 for the three months ended March 31, 2012 to reflect the value of the 85,000 shares provided to Roger.

As partial consideration for certain consulting services pursuant to an Advisor Agreement entered into on July 19, 2011 among the Company, Motorsport.com, Inc. and Emerson Fittipaldi, the Company granted Mr. Fittipaldi 5 million shares of the Company's common stock. In addition, pursuant to the Advisory Agreement, Mr. Fittipaldi has the opportunity to earn a bonus of up to 1 million additional shares of common stock of the Company based upon his success in promoting motorsport.com through his social networking activities, which bonus is in the sole discretion of the Board of Directors of the Company. If Mr. Fittipaldi terminates the Advisor Agreement, he is required to forfeit a pro rata amount of the 5 million shares of the Company's common stock that were granted to him in accordance with the terms of the Advisor Agreement.

On December 13, 2011, the board of directors appointed Felix Vulis as a director of the Company. In connection with his service as board member, Mr. Vulis was granted 800,000 restricted common shares of the Company. These shares vest over two years and the Company recorded a compensation charge of \$12,000 for the three months ended March 31, 2012. Our total charge will be \$96,000 over two years based on the fair value of shares provided.

On January 26, 2012, the Company entered into an Advisory Board Agreement with Michael Waltrip for a term of two years. Mr. Waltrip will help develop the Company's motorsport business by participating in Motorsport Advisory Board meetings and attending industry functions to help promote Motorsport.com. For his service, Mr. Waltrip was granted 460,000 shares of the Company's common stock and recorded a charge for \$7,667 representing two months of a twenty-four month agreement. Our total charge for this grant will be \$92,000 based on the fair value of the stock provided on the date of grant.

On March 7, 2012, the Company entered into a consulting agreement with CSFG1 who agreed to provide certain investor relations services in exchange for \$3,000 in cash and 25,000 restricted shares of the Company's common stock per month. This agreement was cancelled effective May 31, 2012.

Motorsport.com appointed Pietro Fittipaldi, a junior Nascar race car driver and grandson of the Chairman of Motorsport.com, to its Advisory Board. On March 26, 2012, the Company's board of directors approved the issuance 500,000 stock options pursuant to the Company's 2011 Equity Incentive Plan, as part of an Advisory Agreement. Additionally, Motorsport.com entered into a Consulting Agreement with Dan Goodstadt, an advisor to Emerson Fittipaldi, Motorsport.com's Chairman, pursuant to which the board of directors approved the issuance of stock options to purchase 1,000,000 shares of the Company's common stock pursuant to the Company's 2011 Equity Incentive Plan. Our charge for this grant will be \$270,000 over two years beginning April 1, 2012.

#### NOTE 13. RELATED PARTY TRANSACTIONS

The Company is party to a \$1,666,667 loan from Enerfund, LLC to Openfilm with a two-year term dated December 10, 2010. The interest rate is 5% per year, payable on December 31 of each year. See Note 9.

On January 31, 2011, Motorsport, LLC entered into a three-year, 5% \$184,592 loan agreement with Enerfund, LLC. On February 1, 2011, the Company acquired the equity of Motorsport from Enerfund. The loan was repaid on February 24, 2011. See Note 9.

On January 31, 2011, Music1, LLC entered into a three-year, 5% \$128,890 loan agreement with Enerfund, LLC. On February 1, 2011, the Company acquired the equity of Music1 from Enerfund. The loan was repaid on February 24, 2011. See Note 9.

On February 1, 2011, we purchased all of the equity interests in each of Motorsport, LLC and Music1, LLC from Enerfund, LLC. See Note 4.

During February 2011, Enerfund, LLC agreed to transfer 1,000,000 of our common shares held by Enerfund to a consultant in consideration for services performed on our behalf. We recorded a compensation charge in the amount of the value of the services (\$10,000) during the quarter ended March 31, 2011.

On March 17, 2011, we formed a wholly-owned subsidiary, Splinx, LLC, a Florida limited liability company. Splinx, LLC is intended to develop 3D technology for use in our products and services and certain other licensed applications. As of April 12, 2011, an aggregate 15% ownership interest in Splinx, LLC was issued to certain of our employees and consultants.

Effective as of March 29, 2011, we entered into a joint venture arrangement with Curtis Wolfe in connection with the formation of LegalGuru LLC. The Company owns a 70% interest in LegalGuru LLC and Mr. Wolfe, who is a director and Secretary of the Company and Chief Executive Officer and Chairman of LegalGuru LLC, through Lobos Advisors, LLC (a company of which Mr. Wolfe is the President and managing member), owns a 30% interest in LegalGuru LLC. On April 24, 2012, we entered into with Curtis Wolfe an amended and restated joint venture agreement, dated as of December 31, 2011, which amends and restates the joint venture agreement originally entered into as of March 29, 2011. In addition, on April 24, 2012, we entered into the Limited Liability Company Operating Agreement of LegalGuru LLC, dated effective as of March 31, 2011, with Lobos Advisors, LLC, a company of which Curtis Wolfe is the President and managing member, and LegalGuru LLC. See Note 5.

On May 16, 2011, the Company issued a three-year, 5% unsecured convertible promissory note in the amount of \$2,000,000 to Enerfund, LLC. See Note 9.

On August 9, 2011, we entered into a Stock Purchase Agreement pursuant to which we were to acquire 100% of the outstanding equity interests in Stratuscore, Inc., a State of Washington corporation, from its selling shareholder, Denise Muyco (who is the spouse of our President and Chief Operating Officer, Richard Lappenbusch), in exchange for the issuance of 10 million shares of our common stock. On November 10, 2011, the Company and the selling shareholder mutually agreed to terminate and unwind that transaction. The 10 million shares of our common stock issuable pursuant to that transaction were not delivered to the selling shareholder. Amounts advanced and costs incurred by the Company through March 31, 2012 (\$201,557), are reflected as advances in our consolidated balance sheets. As consideration for amounts advanced to Stratuscore, Stratuscore agreed to issue the Company a convertible promissory note convertible into equity in Stratuscore at the same rate as Ms. Muyco agrees to accept investment from a bona fide third party in the next investment round or lender terms. In the event that there is no further investment in Stratuscore, then the amount invested in Stratuscore by the Company would be based on the Company's original valuation of Stratuscore.

On October 24, 2011, the Company issued a three-year unsecured convertible promissory note in the amount of \$1,600,000 to Enerfund, LLC. See Note 9.

On February 2, 2012, the Company 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) 666,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.25 per share; (iii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.50 per share; and (iv) a three-year warrant to purchase up to an additional 666,666 shares of common stock of the Company with an exercise price of \$1.00 per share.

On February 24, 2012, the Company entered into a Shareholder Rights Agreement (the "Shareholder Rights Agreement") with Mark Global Corporation, Kenges Rakishev, Mike Zoi, TGR Capital, LLC, MZ Capital, LLC (Delaware), MZ Capital, LLC (Florida) and Enerfund, LLC (collectively, the "Shareholders"). The companies TGR Capital, LLC, MZ Capital, LLC (Delaware), MZ Capital, LLC (Florida) and Enerfund, LLC are directly or indirectly owned and controlled by Mike Zoi. As further described below, pursuant to the Shareholder Rights Agreement, the Shareholders agreed to certain corporate governance matters pertaining to the Company and the Company granted registration rights to each of Mark Global Corporation, Kenges Rakishev, TGR Capital, LLC, Mike Zoi and certain of their assignees (collectively, the "Holders").

The Shareholder Rights Agreement is not effective until 12:01 a.m. (New York time) on the first business day immediately following the date on which Mark Global Corporation, together with its affiliates, has beneficial ownership (as determined under Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of greater than 10% of the Company's common stock.

The Shareholders agreed to cause the Board of Directors of the Company to be comprised of not less than four and not more than eight directors. For so long as TGR Capital, LLC, together with its affiliates, has beneficial ownership (as determined under Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of greater than 5% of the Company's common stock, TGR Capital, LLC is entitled to nominate one director. For so long as Mark Global Corporation, together with its affiliates, has beneficial ownership (as determined under Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of greater than 5% of the Company's common stock, Mark Global Corporation is entitled to nominate one director. For so long as the Shareholder Rights Agreement remains in effect, TGR Capital, LLC and Mark Global Corporation are entitled to nominate two independent directors mutually acceptable to TGR Capital, LLC and Mark Global Corporation. In the event that Mark Global Corporation's director nominee is unable to attend any meeting of the Board of Directors, Mark Global Corporation is entitled to have another representative attend such meeting in a non-voting observer capacity. In addition, so long as Mark Global Corporation, together with its affiliates, has beneficial ownership (as determined under Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of greater than 10% of the Company's common stock, the Shareholders agreed to cause Mark Global Corporation's director nominee to be a member of any compensation committee, nominating committee and audit committee that the Board of Directors may establish, in each case to the extent such directors are permitted to serve on such committees under applicable Securities and Exchange Commission rules.

Additionally, the Company agreed to obtain customary director and officer indemnity insurance and the Shareholders agreed to cause the Company's bylaws to be amended, in a manner acceptable to Mark Global Corporation, to provide mandatory indemnification and advancement of expenses for directors of the Company.



Upon demand by any of the Holders, the Company agreed to register from time to time with the Securities and Exchange Commission for resale (i) all shares of common stock of the Company from time to time owned by Mark Global Corporation, Kenges Rakishev or any other person or entity controlled by Kenges Rakishev, and (ii) all shares of common stock of the Company from time to time owned by TGR Capital, LLC, Mike Zoi or any other person or entity controlled by Mike Zoi. The Company also granted the Holders piggyback registration rights with respect to all of such shares. The Company agreed to bear substantially all expenses incidental to the registration rights granted pursuant to the Shareholder Rights Agreement.

On May 14, 2012, the Company entered into a \$500,000 principal amount Promissory Note and Loan Agreement with Enerfund maturing November 1, 2012. The interest rate is 5% per annum.

#### NOTE 14. UNCERTAIN TAX POSITION

In the past, we have been delinquent in the filing of our federal tax returns for several years. Although we did not owe tax due to a lack of profits, we incurred penalties and interest in the amount of \$60,000 for the failure to file returns. We are in the process of appealing this assessment.

#### NOTE 15. SUBSEQUENT EVENTS

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 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 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 (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 5 million 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.

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.

The Joint Venture Agreement also provides that Mr. Krutoy will enter into a Subscription Agreement to purchase 13,333,333 shares of common stock of the Company for an aggregate purchase price of \$2 million. The Company expects to close this transaction in the second quarter.

On April 24, 2012, we entered into an amended and restated joint venture agreement with an effective date of December 31, 2011, which amends and restates the joint venture agreement originally entered into with Mr. Wolfe as of March 29, 2011 in connection with the formation of LegalGuru LLC. In addition, on April 24, 2012, we entered into the Limited Liability Company Operating Agreement of LegalGuru LLC, dated effective as of March 31, 2011, with Lobos Advisors, LLC, a company of which Curtis Wolfe is the President and managing member, and LegalGuru LLC. See Note 5.

On May 14, 2012, the Company entered into a \$500,000 principal amount Promissory Note and Loan Agreement with Enerfund maturing November 1, 2012. The interest rate is 5% per annum.

## 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, as amended, for the fiscal year ended December 31, 2011.*

### Overview; Recent Developments

Net Element, Inc. (OTCQB: NETE) is a developer and publisher of Internet websites and mobile application services for the Business to Business (B2B) and Business to Consumer (B2C) software services market. Net Element products are optimized for the media & entertainment, barter & trading, and professional industry market sectors. The company also develops and licenses intellectual property around graphics, HD and 3D video, web hosted business services, subscription-based and mobile-based services.

There are five core website services in the Net Element portfolio including:

**A&R Music Live** ([www.arlive.com](http://www.arlive.com)) – an artist discovery and music review service that educates aspiring talent and connects them with music record company A&R (i.e., record company divisions that are responsible for talent scouting and overseeing the artistic development of recording artists) and music supervisors through webinars for entertainment contracts and employment.

**Motorsport.com** ([www.motorsport.com](http://www.motorsport.com)) – a motorsport racing news site for fans and teams with industry award winning editorial content and unique multimedia capabilities.

**Openfilm** ([www.openfilm.com](http://www.openfilm.com)) – an independent film hosting site that operates two content management service platforms – one for the Business to Consumer market and the other for the Business to Business market (Launchpad).

**LegalGuru** ([www.legalguru.com](http://www.legalguru.com)) – intended to be a resource for consumers with potential legal issues that would offer attorneys and other professionals compelling ways to showcase their talents and specialties and find new clients. LegalGuru is still under development stage and its website was launched in April.

**Yapik** ([www.yapik.com](http://www.yapik.com)) – a set of mobile and web applications that enable college students to barter, buy, sell, or trade goods or services in a digital environment tailored for the campus experience.

The Company's platform enables the rapid development, production and distribution of rich media content (including high definition (HD) and three-dimensional (3D) formats), services (Software as a Service (SaaS)) and branded content in entertainment and news. The Company owns and publishes Internet properties and creates social and business communities in collegiate, legal, motorsport, music, film and entertainment. Net Element was formed in 2004 as Splinx Technology, Inc., a spin-off of Ener1, Inc.

We believe that our technology platforms and development expertise will enable us to enhance the digital distribution of content in a variety of industries. Accordingly, we are exploring the possibility of acquiring other Internet portal properties and companies with similar goals of connecting people in various vertical markets, such as the medical, educational and sports markets. From time to time, we may be engaged in various discussions to acquire businesses or formulate joint venture or other arrangements. Our policy is not to disclose discussions or potential transactions until definitive agreements have been executed. Where appropriate, acquisitions will be financed with our equity securities, which may result in substantial dilution to existing stockholders.

### **Results of Operations for the Three-Month Periods Ended March 31, 2012 and 2011**

We reported a net loss of \$2,383,995, or \$(0.00) per share, for the three months ended March 31, 2012, as compared with a net loss of \$20,314,897, or \$(0.03) per share, for the three months ended March 31, 2011. Basic and diluted weighted average shares outstanding were 752,792,562 and 668,410,995 for the quarters ended March 31, 2012 and 2011, respectively.

Net revenues consist of license fees, advertising fees, membership fees and other service fees. Net revenues for the three months ended March 31, 2011 were \$74,810, which related primarily to fees generated by Music (\$34,031), Motorsport (\$31,960) and Openfilm (\$8,238), as compared with \$78,146 in revenue for the three months ended March 31, 2011, which related primarily to fees generated by Openfilm (\$50,689), Music (\$17,633) and Motorsport (\$6,758). Music revenues are primarily services fees while Motorsport revenues are primarily advertising. Openfilm revenues are a mix of license fees, advertising and subscription fees.

Operating expenses totaled \$2,046,994 for the three months ended March 31, 2012, as compared to total operating expenses of \$20,364,254 for the three months ended March 31, 2011. Most of total operating expenses in each of such periods consisted of general and administrative expenses. For the three months ended March 31, 2012, general and administrative expenses were \$1,641,516, or 80.2% of total operating expenses during that period. For the three months ended March 31, 2011, general and administrative expenses were \$20,198,892, or 99.2% of total operating expenses during that period. The components of our general and administrative expenses are discussed below.

Cost of revenues represents direct costs of generating revenues, including commissions, content acquired and created and certain payroll expense that is directly related to revenue creation. Cost of revenues for the three months ended March 31, 2012 was \$100,585 as compared to \$86,823 for the three months ended March 31, 2011, which represents an increase of \$13,762, or 15.9%. Motorsport cost of revenues of \$60,106 for the three months ended March 31, 2012, increased \$8,907 over \$51,199 for the three months ended March 31, 2011. This increase was due to increased hosting & streaming costs, higher costs for content acquisition and commissions as well as higher costs for web development efforts during the quarter ended March 31, 2012 as compared to the quarter ended March 31, 2011.

Business development expenses consist of direct costs associated with developing our brand and developing revenue opportunities. Business development expenses increased by \$153,235, or 475%, to \$185,519 for the three months ended March 31, 2012 as compared with \$32,284 for the three months ended March 31, 2011. For the quarter ended March 31, 2012, business development expenses were primarily attributable to corporate activities (\$175,748), and LegalGuru (\$8,979). Business development expenses for the three months ended March 31, 2011 were primarily attributable to Motorsport (\$24,158) and other corporate activities (\$6,790). Business development expenses attributable to corporate activities related primarily to business development of new website and services opportunities. LegalGuru business development expenses related primarily to marketing efforts. Motorsport business development expenses related primarily to branding through the use of paid marketing professionals at race events and the purchase of promotional items. The primary reasons for the increase in business development expense for the three months ended March 31, 2012 was \$132,953 of expense related to promotion at Ferrari North American Challenge and \$37,385 increase in travel relating to business development, partially offset by decreases in Motorsport of \$15,179 as we did not have paid marketing professionals or promotional items at race events during 2012.

General and administrative expenses were \$1,641,516 for the three months ended March 31, 2012 as compared to \$20,198,892 for the three months ended March 31, 2011, representing a decrease of \$18,557,376. General and administrative expenses for the three months ended March 31, 2012 and 2011 consisted of operating expenses not otherwise delineated in our Unaudited Condensed Consolidated Statements of Operations, including certain salaries, benefits, professional fees, travel, rent, Internet expenses and other expenses required to run our business. General and administrative expenses for the three months ended March 31, 2012 and 2011 were attributable to the properties or subsidiaries of the Company as follows:

Property or Entity

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	Three months ended March 31, 2012	Three months ended March 31, 2011
Net Element Corporate	\$995,207	\$19,783,591
Openfilm / Launchpad	35,703	119,253
Music1 / A&R Live (purchased 2/1/11)	107,561	52,002
Motorsport (purchased 2/1/11)	120,373	41,531
Social Networking (Yapik) (formed in 2011)	39,210	7,625
Legal Guru (formed in March, 2011)	54,804	9,885
Netlab Systems / Splinx	288,658	185,005
Total general and administrative	\$1,641,516	\$20,198,892

General and administrative expenses for Net Element Corporate were \$995,207 for the three months ended March 31, 2012 as compared to \$19,783,591 for the three months ended March 31, 2011. For the three months ended March 31, 2012, general and administrative expenses for Corporate consisted primarily of \$521,497 in non-cash compensation expense relating to the issuance of stock, options and warrants, \$220,933 of payroll expenses, \$191,870 of professional fees and \$46,816 of recruiting expense.

Of the \$19,783,591 in general and administrative expenses for corporate for the three months ended March 31, 2011, \$18,945,384 is attributable to non-cash compensation expense relating primarily to charges for stock and options provided under a subscription agreement with Enerfund during the period. Of the \$838,207 remaining in general and administrative expenses for the three months ended March 31, 2011, \$455,184 consisted of payroll expense, \$99,928 was for recruiting expenses, \$69,464 in professional fees, \$50,000 for accrual of disputed tax penalties (see Note 14 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements), \$41,879 in travel, \$41,313 in rent and \$80,439 of other general and administrative expenses.

Motorsport and Music were both purchased on February 1, 2011 so the three months ended March 31, 2011 only includes two months of operating expenses for each of those subsidiaries. Additionally, subsequent to acquisition, the Company increased its development efforts for both consolidated entities, which contributed to higher general and administrative expenses in the three months ended March 31, 2012 as compared to the three months ended March 31, 2011. Legal Guru and Yapik both started accumulating expenses in March of 2011 as start-up businesses, which explains the variance between general and administrative expenses for the three months ended March 31, 2012 versus the three months ended March 31, 2011.

Product development expense was \$50,711 for the three months ended March 31, 2012 as compared to \$5,000 for the three months ended March 31, 2011 when the Company had more limited product development efforts. Product development expense consists of research and development on new ideas for existing and to be formed websites and services as well as work that may result in the Company seeking patents for particular technology or business processes.

Depreciation and amortization expense consists of depreciation expense on fixed assets used by the Company and the amortization of capitalized website development, intellectual property and deferred compensation expenses. Depreciation and amortization expense was \$68,663 for the three months ended March 31, 2012 as compared with \$41,255 for the three months ended March 31, 2011. Additionally, capitalized costs related to website development and intangible assets were \$735,043, net at March 31, 2012 as compared with \$608,823 at March 31, 2011. Capitalized website development and intangible assets of \$735,043 at March 31, 2012 includes \$542,314 of capitalized web development, \$28,393 for the direct costs of acquiring patents and \$164,336 related to website content, customer lists and domain names (Motorsport, LLC (\$143,125) and Music1, LLC (\$21,211)).

Interest expense was \$72,674 for the three months ended March 31, 2012 as compared with \$24,915 for the three months ended March 31, 2011. Interest expense for the three months ended March 31, 2012 includes interest on convertible loans from Enerfund to Net Element (\$49,025 in interest expense at 5% per annum) with principal balances totaling \$3,600,000 and a loan from Enerfund to Openfilm with a principal balance of \$1,667,762 (\$20,790 in interest expense at 5% per annum). The interest expense in 2011 was primarily attributable to the loan from Enerfund to Openfilm, LLC (\$20,559 in interest expense) with a principal balance of \$1,667,762 and an interest rate of 5% per annum.

Other expenses totaled \$411,225 for the three months ended March 31, 2012 compared to other expenses of \$45,942 for the three months ended March 31, 2011. Other expenses for three months ended March 31, 2012 related primarily to the amendment of amounts payable to old Motorsport.com owners and other expense for the three months ended March 31, 2011 related primarily to adjusting our carrying value of Korlea-TOT to fair value on January 1, 2011.

The net loss attributable to non-controlling interests relating to Yapik, LLC, LegalGuru, LLC, A&R Music Live, LLC, and Splinx, LLC was \$72,088 for the three months ended March 31, 2012 as compared with \$42,068 for the three

months ended March 31, 2011. Non-controlling interest for the three months ended March 31, 2012 were primarily attributable to LegalGuru (\$37,687) and Yapik (\$28,479). The non-controlling interest reflects the results of operations of subsidiaries that are allocable to equity owners other than the Company.

### **Liquidity and Capital Resources**

At March 31, 2012, we had an accumulated deficit of \$53,658,028, negative working capital of \$2,071,946 and cash of \$635,145. We had a net loss of \$2,383,995 for the three months ended March 31, 2012, a net loss of \$20,314,897 for the three months ended March 31, 2011, and further losses are anticipated. We had negative cash flows from operations of \$1,322,504 for the three months ended March 31, 2012 and negative cash flows from operations of \$1,556,801 for the three months ended March 31, 2011.

We have historically been primarily dependent upon TGR Capital, LLC, Enerfund, LLC or Mike Zoi (as a result of his controlling interest in TGR and Enerfund) to fund our operations.

On December 14, 2010, the Company assumed a \$1,667,020 loan to Openfilm from Enerfund when the Company purchased Openfilm on that date. The loan agreement is dated December 10, 2010 and matures two years from this date. The annual interest rate is 5% payable annually on December 31.



On February 1, 2011, we purchased all of the equity interests in Motorsport, LLC from Enerfund, LLC. As consideration for that acquisition, we paid to Enerfund \$130,000 (excluding a \$20,000 contingent payment relating to the purchase of certain domain names) and agreed to take over responsibility for the obligations of Motorsport, LLC under a Stock Purchase Agreement dated December 17, 2010 pursuant to which Motorsport, LLC would acquire all of the equity interests in Motorsport.com, Inc. At the time of our acquisition of Motorsport, LLC, pursuant to the December 17, 2010 Stock Purchase Agreement, Motorsport, LLC had already acquired 80% of the outstanding common stock of Motorsport.com, Inc., although Motorsport, LLC remained obligated under the Stock Purchase Agreement to pay an aggregate of \$450,000 to the sellers in four quarterly installments beginning on December 1, 2013. Pursuant to an amendment to the Stock Purchase Agreement dated January 10, 2012, that payment obligation was amended to provide that: (i) Motorsport, LLC must pay to the sellers \$300,000 in cash in four equal annual installments of \$75,000 each beginning on January 10, 2012, with each subsequent installment payable on each annual anniversary thereafter until such \$300,000 is paid in full; and (ii) the Company must issue to the sellers an aggregate of 1,333,333 shares of its common stock. The initial \$75,000 installment was paid by the Company and the Company issued such 1,333,333 shares of its common stock to the sellers. The sellers have a security interest in the Internet domain names of Motorsport.com, Inc. as collateral for the Company's and Motorsport's remaining payment obligations.

The December 17, 2010 Stock Purchase Agreement provided Motorsport, LLC an option until December 16, 2018 to purchase the remaining 20% of the outstanding common stock of Motorsport.com, Inc. for a price per share of between \$0.1075 and \$0.1435 (or an aggregate of between \$400,330 and \$534,394) depending upon when the option was exercised, payable in either cash or shares of preferred stock of Motorsport.com, Inc. having an equivalent value. If the option were exercised before December 17, 2015, then the purchase price for the remaining 20% interests would have been \$0.1075 per share, or an aggregate of \$400,330. Pursuant to the January 10, 2012 amendment to the Stock Purchase Agreement, Motorsport, LLC exercised its option to acquire the remaining 20% interests for a purchase price consisting solely of the Company's issuance to the sellers of an aggregate of 3,333,333 shares of its common stock.

On January 31, 2011, Motorsport, LLC entered into a loan agreement with Enerfund, LLC in the principal amount of \$184,592. The annual interest rate is 5% payable annually on December 31. The loan matures on the third anniversary of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued interest due at that time. This loan was repaid in full on February 24, 2011 for an aggregate of \$186,808.

On February 1, 2011, we purchased all of the equity interests in Music1, LLC from Enerfund, LLC for an aggregate purchase price of \$15,000. We were required to invest at least \$500,000 in Music1 by December 31, 2012, which requirement was met during the fourth quarter of 2011.

On January 31, 2011, Music1, LLC entered into a loan agreement with Enerfund, LLC in the principal amount of \$128,890. The annual interest rate is 5% payable annually on December 31. The loan matures on the third anniversary

of each funding under the loan agreement, which fundings occurred from October 2010 through January 2011, with accrued and unpaid interest due at that time. This loan was repaid in full on February 24, 2011 for an aggregate of \$131,827.

On April 24, 2012, we entered into an amended and restated joint venture agreement with an effective date of December 31, 2011, which amends and restates the joint venture agreement originally entered into with Mr. Wolfe as of March 29, 2011 in connection with the formation of LegalGuru LLC. The Company owns a 70% interest in LegalGuru LLC and Mr. Wolfe, who is a director and Secretary of the Company and Chief Executive Officer and Chairman of LegalGuru LLC, through Lobos Advisors, LLC (a company of which Mr. Wolfe is the President and managing member), owns a 30% interest in LegalGuru LLC. The amended and restated joint venture agreement requires the Company and Mr. Wolfe to invest up to an aggregate of \$900,000 in LegalGuru LLC, with Mr. Wolfe investing up to an aggregate of \$100,000 and the Company investing up to an aggregate of \$800,000. As noted above, the original joint venture agreement required the Company and Mr. Wolfe to invest up to an aggregate of \$1,000,000 in LegalGuru LLC, with Mr. Wolfe investing up to an aggregate of \$200,000 and the Company investing up to an aggregate of \$800,000. In connection with the \$100,000 reduction in the amount required to be invested in LegalGuru LLC by Mr. Wolfe, Mr. Wolfe agreed to maintain his current salary of \$10,000 per month, with \$8,000 of such amount paid in cash and \$2,000 paid in stock options of the Company, until LegalGuru LLC generates at least \$500,000 in revenue. As of March 31, 2012, Mr. Wolfe had invested \$71,279 in LegalGuru LLC and the Company had invested \$830,983 in LegalGuru LLC. For additional information, see Note 5 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

On April 4, 2011, we entered into a public relations contract with Roar Media, LLC to provide press related services and assist with community outreach and strategic alliances. The term of this agreement was for six months and provided for monthly remuneration of \$14,000 and 5,000 shares of our common stock with an option by the Company to renew for successive six-month periods. This agreement was modified to provide for monthly remuneration in July 2011 of \$7,000 and 5,000 shares. August and September 2011 were revised to \$6,500 per month plus 5,000 shares per month. Beginning in October 2011, we agreed to same terms, as revised, on a month to month basis.

On April 15, 2011, we entered into a two-year cross advertising transaction with Ferrari North America, Inc. whereby we contracted to pay \$50,000 per year in cash and provide \$200,000 within two years in advertising value on our websites in exchange for a Platinum Sponsorship for the Ferrari Challenge over two race seasons. This arrangement provides us with marketing outreach and exposure to potential investors. The agreement stipulates that the Ferrari Challenge must advertise on any Net Element website within one year from date of execution. Accordingly, we will recognize \$200,000 in advertising revenue as Ferrari utilizes the advertisements. Of the total cash expense of the sponsorship (\$100,000 over two years), \$50,000 was recognized as a charge to operations over the five month period May to September 2011 during the Ferrari Challenge. Additionally, the Company recorded a \$200,000 expense during 2011 for the value of website services provided in exchange for the sponsorship.

On May 16, 2011 we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$2,000,000. The annual interest rate is 5.0% and principal and interest is due on or before April 27, 2014. The loan may be pre-paid at any time without penalty. Outstanding principal may be converted by Enerfund at any time into shares of common stock of the Company at a conversion price of \$0.11 per share. Enerfund has funded the full amount of this note and the balance at March 31, 2012 was \$2,000,000.

On June 16, 2011, we entered into a Subscription Agreement pursuant to which we sold a 15% ownership interest in our subsidiary Yapik LLC in exchange for a \$100,000 investment in Yapik LLC, which was received on June 20, 2011. The related party investor, who is employed by Yapik, has an option, which is exercisable for 36 months, to convert the 15% ownership interest in Yapik LLC into 1,500,000 shares of common stock of the Company.

On August 9, 2011, we entered into a Stock Purchase Agreement pursuant to which we were to acquire 100% of the outstanding equity interests in Stratuscore, Inc., a State of Washington corporation, from its selling shareholder, Denise Muyco (who is the spouse of our President and Chief Operating Officer, Richard Lappenbusch), in exchange for the issuance of 10 million shares of our common stock. On November 10, 2011, the Company and the selling shareholder mutually agreed to terminate and unwind that transaction. The 10 million shares of our common stock issuable pursuant to that transaction were not delivered to the selling shareholder. Amounts advanced and costs incurred by the Company through March 31, 2012 (\$201,557), are reflected as advances in our consolidated balance sheets. As consideration for amounts advanced to Stratuscore, Stratuscore agreed to issue the Company a convertible promissory note convertible into equity in Stratuscore at the same rate as Ms. Muyco agrees to accept investment from a bona fide third party in the next investment round or lender terms. In the event that there is no further investment in Stratuscore, then the amount invested in Stratuscore by the Company would be based on the Company's original valuation of Stratuscore.

On October 24, 2011, we entered into a three-year, unsecured convertible promissory note and loan agreement with Enerfund, LLC in the principal amount of \$1,600,000. The annual interest rate under the note is 5% and principal and interest is due on or before October 24, 2014. The note may be pre-paid at any time without penalty. Outstanding principal under the note may be converted by Enerfund, LLC at any time into shares of common stock of the Company at a conversion price of \$0.11 per share. Upon conversion of the note, the Company is required to issue to Enerfund, LLC a five-year warrant to purchase a number of shares of common stock of the Company equal to the number of shares issued upon such conversion with an exercise price of \$0.11 per share. Enerfund has funded the full amount of this note and the balance at March 31, 2012 was \$1,600,000.

On February 2, 2012, the Company into a Subscription Agreement with one of its directors, Felix Vulis, pursuant to which Mr. Vulis purchased from the Company for \$100,000: (i) 666,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.25 per share; (iii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.50 per share; and (iv) a three-year warrant to purchase up to an additional

666,666 shares of common stock of the Company with an exercise price of \$1.00 per share.

On February 23, 2012, the Company entered into a Subscription Agreement pursuant to which it sold 13,333,334 newly issued shares of common stock of the Company to Kenges Rakishev for an aggregate purchase price of \$2,000,000.10, or \$0.15 per share.

On February 24, 2012, the Company entered into a Shareholder Rights Agreement (the "Shareholder Rights Agreement") with Mark Global Corporation, Kenges Rakishev, Mike Zoi, TGR Capital, LLC, MZ Capital, LLC (Delaware), MZ Capital, LLC (Florida) and Enerfund, LLC. The companies TGR Capital, LLC, MZ Capital, LLC (Delaware), MZ Capital, LLC (Florida) and Enerfund, LLC are directly or indirectly owned and controlled by Mike Zoi. Pursuant to the Shareholder Rights Agreement, the Shareholders agreed to certain corporate governance matters pertaining to the Company and the Company granted registration rights to each of Mark Global Corporation, Kenges Rakishev, TGR Capital, LLC, Mike Zoi and certain of their assignees (collectively, the "Holders"). Upon demand by any of the Holders, the Company agreed to register from time to time with the Securities and Exchange Commission for resale (i) all shares of common stock of the Company from time to time owned by Mark Global Corporation, Kenges Rakishev or any other person or entity controlled by Kenges Rakishev, and (ii) all shares of common stock of the Company from time to time owned by TGR Capital, LLC, Mike Zoi or any other person or entity controlled by Mike Zoi. The Company also granted the Holders piggyback registration rights with respect to all of such shares. The Company agreed to bear substantially all expenses incidental to the registration rights granted pursuant to the Shareholder Rights Agreement. The Shareholder Rights Agreement is not effective until 12:01 a.m. (New York time) on the first business day immediately following the date on which Mark Global Corporation, together with its affiliates, has beneficial ownership (as determined under Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder) of greater than 10% of the Company's common stock. For additional information, see Note 13 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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 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 (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 5 million 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 Joint Venture Agreement also provides that Mr. Krutoy will enter into a Subscription Agreement to purchase 13,333,333 shares of common stock of the Company for an aggregate purchase price of \$2 million. For additional information, see Note 15 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

On May 14, 2012, the Company entered into a \$500,000 principal amount Promissory Note and Loan Agreement with Enerfund maturing November 1, 2012. The interest rate is 5% per annum.

As a result of our history of recurring losses and our accumulated deficit and stockholders’ deficiency, the audit report of our independent registered public accounting firm as of December 31, 2011 contains a statement expressing substantial doubt as to our ability to continue as a going concern. Management recognizes that we must raise capital sufficient to fund business activities until such time as we can generate sufficient revenues and net cash flows in amounts necessary to enable us to continue contemplated operations, of which there can be no assurance. We have historically been dependent upon TGR Capital, LLC, Enerfund, LLC or Mike Zoi (as a result of his controlling interest in TGR and Enerfund) to fund our operations and we are exploring additional sources of financing in order to meet our financial requirements. As of the date this Report was filed with the Commission, management expects that our cash flows from operations and additional borrowings available under the May 14, 2012 loan agreement with Enerfund described above and the anticipated \$2 million subscription agreement with Krutoy will be sufficient to meet our financial requirements through most of the second fiscal quarter of 2012. Management currently believes that we will require an additional \$4 million in financing to continue operations as currently conducted and to pay for anticipated capital expenditures over the next 12 months. 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 prospects, financial condition and results of operations and may ultimately require us to suspend or cease operations.

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

At March 31, 2012, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

### **Recently Issued Accounting Pronouncements**

None.

#### **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 carried out 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) of 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 there are a limited number of personnel employed and we cannot have an adequate segregation of duties, and due to material weaknesses in internal control over financial reporting as discussed in our Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2011. Accordingly, management cannot provide reasonable assurance of achieving the desired control objective. Management works to mitigate these risks by being personally involved in all substantive transactions and attempts to obtain verification of transactions and accounting policies and treatments involving our operations, including those overseas. We are in the process of reviewing and, where necessary, modifying controls and procedures throughout the Company, particularly in light of our recent acquisitions and joint ventures and the continued integration of these businesses. We have contracted to install new financial systems and that process is currently expected to be completed by December 31, 2012. We will continue to address deficiencies as resources permit.

During the quarter ended March 31, 2012, there were no changes in our internal control over financial reporting 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**

On August 30, 2011, NueMeta LLC filed a demand for arbitration against the Company to be conducted in Chicago, Illinois in accordance with the Commercial Dispute Resolution Procedures of the American Arbitration Association.

The claimant alleged that it was owed \$152,400 under an agreement pursuant to which it was to perform certain software development and other services for the Company. On January 12, 2012, the Company entered into a Settlement Agreement with NueMeta LLC pursuant to which the Company paid to NueMeta LLC \$5,000 and the arbitration proceeding was terminated and the agreement between the Company and NueMeta LLC was terminated.

Neither the Company nor any of its subsidiaries is currently a party to any pending legal proceeding, nor is any of their respective property the subject of a currently pending legal proceeding, the outcome of which would have a material effect on our business, financial condition or results of operations.

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

There have been no material changes in risk factors during 2012 through the date of this Report from those previously discussed in Part I, Item 1A of our Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2011. 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, as amended, for the fiscal year ended December 31, 2011.

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

During the fiscal quarter ended March 31, 2012, the Company issued 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 made pursuant to the exemption from registration requirements provided by Section 4(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 substantive preexisting 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 February 1, 2011, we purchased all of the equity interests in Motorsport, LLC from Enerfund, LLC. As consideration for that acquisition, we paid to Enerfund \$130,000 (excluding a \$20,000 contingent payment relating to the purchase of certain domain names) and agreed to take over responsibility for the obligations of Motorsport, LLC under a Stock Purchase Agreement dated December 17, 2010 pursuant to which Motorsport, LLC would acquire all of the equity interests in Motorsport.com, Inc. At the time of our acquisition of Motorsport, LLC, pursuant to the December 17, 2010 Stock Purchase Agreement, Motorsport, LLC had already acquired 80% of the outstanding common stock of Motorsport.com, Inc., although Motorsport, LLC remained obligated under the Stock Purchase Agreement to pay an aggregate of \$450,000 to the sellers in four quarterly installments beginning on December 1, 2013. Pursuant to an amendment to the Stock Purchase Agreement dated January 10, 2012, that payment obligation was amended to provide that: (i) Motorsport, LLC must pay to the sellers \$300,000 in cash in four equal annual installments of \$75,000 each beginning on January 10, 2012, with each subsequent installment payable on each annual anniversary thereafter until such \$300,000 is paid in full; and (ii) the Company must issue to the sellers an aggregate of 1,333,333 shares of its common stock. The initial \$75,000 installment was paid by the Company and the Company issued such 1,333,333 shares of its common stock to the sellers. The sellers have a security interest in the Internet domain names of Motorsport.com, Inc. as collateral for the Company's and Motorsport's remaining payment obligations.

The December 17, 2010 Stock Purchase Agreement provided Motorsport, LLC an option until December 16, 2018 to purchase the remaining 20% of the outstanding common stock of Motorsport.com, Inc. for a price per share of between \$0.1075 and \$0.1435 (or an aggregate of between \$400,330 and \$534,394) depending upon when the option was exercised, payable in either cash or shares of preferred stock of Motorsport.com, Inc. having an equivalent value. If the option were exercised before December 17, 2015, then the purchase price for the remaining 20% interests would have been \$0.1075 per share, or an aggregate of \$400,330. Pursuant to the January 10, 2012 amendment to the Stock Purchase Agreement, Motorsport, LLC exercised its option to acquire the remaining 20% interests for a purchase price consisting solely of the Company's issuance to the sellers of an aggregate of 3,333,333 shares of its common stock.

On February 2, 2012, the Company 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) 666,667 shares of common stock of the Company; (ii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.25 per share; (iii) a three-year warrant to purchase up to an additional 666,667 shares of common stock of the Company with an exercise price of \$0.50 per share; and (iv) a three-year warrant to purchase up to an additional 666,666 shares of common stock of the Company with an exercise price of \$1.00 per share.

On February 23, 2012, the Company entered into a Subscription Agreement pursuant to which it sold 13,333,334 newly issued shares of common stock of the Company to Kenges Rakishev for an aggregate purchase price of \$2,000,000.10, or \$0.15 per share. Mr. Rakishev was appointed as a director of the Company on April 23, 2012.

**Item 5. Other Information**

On May 14, 2012, the Company entered into a \$500,000 principal amount Promissory Note and Loan Agreement (the "Note") with Enerfund, LLC. The loan matures on November 1, 2012 and has an annual interest rate of 5%. The Note may be pre-paid at any time without penalty. The required repayment date of the outstanding principal under the Note may be accelerated if an event of default occurs under the terms of the Note, including in certain circumstances if the Company or its assets becomes the subject of certain voluntary or involuntary bankruptcy or insolvency proceedings or if the Company fails to timely pay principal and/or interest under the Note and such failure continues for 60 calendar days. Enerfund, LLC is owned and controlled by Mike Zoi, a director and Chief Executive Officer of the Company.

**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 30 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, Inc.

Date: May 15, 2012 By: /s/ Jonathan New  
Name: Jonathan New  
Title: Chief Financial Officer

**EXHIBIT INDEX**

Exhibit Number	Description
2.1	Membership Interest Purchase Agreement (Motorsport) dated as of February 1, 2011 between Enerfund, LLC and the Company (incorporated by reference to Exhibit 10.29 to the Company's Transition Report on Form 10-KT/A filed with the Commission on February 3, 2011)
2.2	Amendment dated as of January 10, 2012 among Motorsport, LLC, Tom Haapanen, Jack Durbin, Nancy Schilke and Eric Gilbert (incorporated by reference to Exhibit 2.3 to the Company's Annual Report on Form 10-K filed with the Commission on March 30, 2012)
3.1	Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 filed with the Commission on June 24, 2004 (Registration No. 333-116817))
3.2	Certificate of Merger of the Company (incorporated by reference to Exhibit 3.2 to Amendment No. 3 to the Company's Registration Statement on Form S-1 filed with the Commission on December 27, 2004 (Registration No. 333-116817))
3.3	Certificate of Amendment of Certificate of Incorporation of the Company filed with the Secretary of State of the State of Delaware on March 13, 2008 (incorporated by reference to Exhibit A to the Company's Schedule 14C filed with the Commission on February 15, 2008)
3.4	Certificate of Amendment of Certificate of Incorporation of the Company filed with the Secretary of State of the State of Delaware on March 13, 2009 (incorporated by reference to Appendix A to the Company's Schedule 14C filed with the Commission on February 11, 2009)
3.5	Amendment to Certificate of Incorporation of the Company filed with the Secretary of State of the State of Delaware on October 13, 2010 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on October 15, 2010)
3.6	Articles of Amendment to Certificate of Incorporation of the Company filed with the Secretary of State of the State of Delaware on March 4, 2011 (incorporated by reference to Exhibit A to the Company's Schedule 14C filed with the Commission on February 4, 2011)
3.7	Bylaws of the Company, as amended and restated on April 24, 2012 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on April 25, 2012)
4.1	Shareholder Rights Agreement, dated February 24, 2012, among Mark Global Corporation, Kenges Rakishev, Mike Zoi, TGR Capital, LLC, MZ Capital, LLC (Delaware), MZ Capital, LLC (Florida), Enerfund, LLC and the Company (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the Commission on February 29, 2012)
4.2	

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Consulting Agreement dated October 12, 2009 between Openfilm, LLC and James Caan, as amended by the letter agreement dated October 12, 2009 signed by Mike Zoi and the letter agreement dated September 28, 2010 among Enerfund, LLC, Dmitry Kozko, James Caan and Mike Zoi (incorporated by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-K filed with the Commission on March 30, 2012)

- 10.1 Subscription Agreement dated February 2, 2012 between the Company and Felix Vulis (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on February 6, 2012)
- 10.2 Form of Warrant, dated February 2, 2012, with an exercise price of \$0.25 per share, issued to Felix Vulis (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on February 6, 2012)
- 10.3 Form of Warrant, dated February 2, 2012, with an exercise price of \$0.50 per share, issued to Felix Vulis (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on February 6, 2012)
- 10.4 Form of Warrant, dated February 2, 2012, with an exercise price of \$1.00 per share, issued to Felix Vulis (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the Commission on February 6, 2012)
- 10.5 Subscription Agreement, dated February 23, 2012, between the Company and Kenges Rakishev (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on February 29, 2012)
- 10.6 Joint Venture Agreement, dated April 6, 2012, between Net Element, Inc. and Igor Yakovlevich Krutoy (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on April 12, 2012)
- 10.7 First Amendment, effective as of the 19th day of April, 2012, to the Subscription Agreement by and between Net Element, Inc., a Delaware corporation, and Kenges Rakishev, dated as of February 23, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on April 25, 2012)
- 10.8 Amended and Restated Guru Joint Venture Agreement dated as of December 31, 2011 between Net Element, Inc. and Curtis Wolfe (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on April 30, 2012)
- 10.9 Limited Liability Company Operating Agreement of LegalGuru LLC dated effective as of March 31, 2011 among LegalGuru LLC, Net Element, Inc. and Lobos Advisors, LLC (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on April 30, 2012)
- 10.10\* Promissory Note and Loan Agreement dated May 14, 2012 between Enerfund, LLC and Net Element, Inc.
- 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 March 31, 2012, formatted in XBRL (Extensible Business Reporting Language), is furnished electronically herewith: (i) the Unaudited Condensed Consolidated Balance Sheets; (ii) the Unaudited Condensed Consolidated Statements of Operations; (iii) the Unaudited Condensed Consolidated Statements of Cash Flows; and (iv) the Notes to Unaudited Condensed Consolidated Financial Statements tagged as blocks of text.

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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 Sections 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.

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