

SOFTECH INC
Form 10-Q
January 13, 2009

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended	Commission File
	Number
November 30, 2008	0-10665

SOFTECH, INC.

State of Incorporation	IRS Employer Identification
Massachusetts	04-2453033

59 Composite Way Suite 401, Lowell, MA 01851

Telephone (978) 513-2700

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 S No £

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The number of shares outstanding of registrant's common stock at January 2, 2008 was 12,213,236 shares.

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 definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company S

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

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FINANCIAL STATEMENTS
SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

	(dollars in thousands)	
	(unaudited)	
	November 30, 2008	May 31, 2008
<u>ASSETS</u>		
Cash and cash equivalents	\$ 536	\$ 900
Accounts receivable, net	964	1,405
Prepaid and other assets	528	475
Total current assets	2,028	2,780
Property and equipment, net	155	157
Capitalized software costs, net	316	517
Goodwill	4,603	4,618
Other assets	136	137
TOTAL ASSETS	\$ 7,238	\$ 8,209
<u>LIABILITIES AND STOCKHOLDERS' DEFICIT</u>		
Accounts payable	\$ 489	\$ 368
Accrued expenses	719	784
Deferred maintenance revenue	2,317	3,341
Current portion of capital lease	31	31
Current portion of long term debt	1,829	1,646
Total current liabilities	5,232	6,170
Capital lease, net of current portion	35	51
Long-term debt, net of current portion	10,101	11,091
Total long-term liabilities	10,289	11,142
Stockholders' deficit	(8,283)	(9,103)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$	7,238	\$	8,209
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See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	(in thousands, except for per share data)	
	Three Months Ended	
	(unaudited)	
	November 30, 2008	November 30, 2007
Revenue		
Products	\$ 550	\$ 471
Services	1,923	2,022
Total revenue	2,473	2,493
Cost of products sold: materials	14	18
Cost of product sold: amortization of capitalized software costs and other intangible assets	101	354
Cost of services provided	370	415
Gross margin	1,988	1,706
Research and development expenses	460	460
Selling, general and administrative	903	1,119
Income from operations	625	127
Other expense	54	-
Interest expense	223	345
Net income (loss)	\$ 348	\$ (218)
Basic and diluted net income (loss) per common share	\$ 0.03	\$ (0.02)
Weighted average common shares outstanding-basic	12,213	12,213
Weighted average common shares outstanding-diluted	12,213	12,213

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	(in thousands, except for per share data)	
	Six Months Ended	
	(unaudited)	
	November 30, 2008	November 30, 2007
Revenue		
Products	\$ 1,090	\$ 948
Services	3,937	4,261
Total revenue	5,027	5,209
Cost of products sold: materials	30	32
Cost of product sold: amortization of capitalized software costs and other intangible assets	203	708
Cost of services provided	735	851
Gross margin	4,059	3,618
Research and development expenses	904	907
Selling, general and administrative	1,856	2,224
Income from operations	1,299	487
Other expense	79	-
Interest expense	453	704
Net income (loss)	\$ 767	\$ (217)
Basic and diluted net income (loss) per common share	\$ 0.06	\$ (0.02)
Weighted average common shares outstanding-basic	12,213	12,213
Weighted average common shares outstanding-diluted	12,213	12,213

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

	(dollars in thousands)	
	Six Months Ended	
	(unaudited)	
	November 30, 2008	November 30, 2007
Cash flows from operating activities:		
Net income (loss)	\$ 767	\$ (217)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	231	743
Provision for uncollectable accounts	25	-
Change in current assets and liabilities:		
Accounts receivable	416	379
Prepaid expenses and other assets	(52)	(78)
Accounts payable and accrued expenses	56	(114)
Deferred maintenance revenue	(1,024)	(948)
Total adjustments	(348)	(18)
Net cash provided by (used in) operating activities	419	(235)
Cash flows from investing activities:		
Capital expenditures	(33)	-
Net cash used in investing activities	(33)	-
Cash flows from financing activities:		
Repayments under debt agreements	(807)	(304)
Repayments under capital lease	(16)	(16)
Net cash used in financing activities	(823)	(320)
Effect of exchange rates on cash	73	(49)

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Decrease in cash and cash equivalents	(364)	(604)
Cash and cash equivalents, beginning of period	900	1,048
Cash and cash equivalents, end of period	\$ 536	\$ 444

See accompanying notes to consolidated condensed financial statements.

SOFTTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Continued)

(A)

The consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission from the accounts of SofTech, Inc. and its wholly owned subsidiaries (the Company) without audit; however, in the opinion of management, the information presented reflects all adjustments which are of a normal recurring nature and elimination of intercompany transactions which are necessary to present fairly the Company s financial position and results of operations. It is recommended that these consolidated condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company s fiscal year 2008 Annual Report on Form 10-K, as amended.

(B)

SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION

The Company follows the provisions of Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2) as amended by SOP No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions" (SOP 98-9) in recognizing revenue from software transactions. Revenue from software license sales is recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectability has been determined. The Company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the elements using the residual method set forth in SOP 98-9. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements, typically one year. Revenue from engineering, consulting and training services, primarily performed on a time and material basis, is recognized as those services are rendered.

CAPITALIZED SOFTWARE COSTS AND RESEARCH AND DEVELOPMENT

The Company capitalizes certain costs incurred to internally develop and/or purchase software that is licensed to customers. Capitalization of internally developed software begins upon the establishment of technological feasibility. Costs incurred prior to the establishment of technological feasibility are expensed as incurred. Purchased software is recorded at cost. The Company evaluates the realizability of capitalized costs and the related periods of amortization on a regular basis. Such costs are amortized over estimated useful lives ranging from three to ten years. The Company

did not capitalize any internally developed software during the three month periods ended November 30, 2008 and 2007. Substantially all of the recorded balance in Capitalized Software Costs, net, represents software acquired from third parties. Amortization expenses related to capitalized software costs for the three months ended November 30, 2008 and 2007 were \$101,000 and \$354,000, respectively.

ACCOUNTING FOR GOODWILL

The Company follows the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that goodwill existing at the date of adoption be reviewed for possible impairment and that impairment tests be periodically repeated, with impaired assets written down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified within the statement's criteria. Intangible assets with finite useful lives are amortized over such useful lives.

As of May 31, 2008, the Company conducted its annual impairment test of goodwill by comparing fair value to the carrying amount of its underlying assets and liabilities. The Company determined that the fair value exceeded the carrying amount of the assets and liabilities, therefore no impairment existed as of the testing date.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Continued)

LONG-LIVED ASSETS:

The Company periodically reviews the carrying value of all intangible assets with a finite life (primarily capitalized software costs) and other long-lived assets. If indicators of impairment exist, the Company compares the undiscounted cash flows estimated to be generated by those assets over their estimated economic life to the related carrying value of those assets to determine if the assets are impaired. If the carrying value of the asset is greater than the estimated undiscounted cash flows, the carrying value of the assets would be decreased to their fair value through a charge to operations. The Company does not have any long-lived assets it considers to be impaired.

STOCK BASED COMPENSATION

Effective June 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment (SFAS 123R), which requires all share-base payments to employees, including grants of employee stock options, to be recorded as expense in the statement of operations based on their fair value.

To adopt SFAS 123(R), we selected the modified prospective transition method. This method requires recording compensation expense prospectively over the remaining vesting period of the stock options on a straight-line basis using the fair value of the options on the date of the grant. It does not require restatement of financial results for the prior period expense related to stock option awards that were outstanding prior to adoption. The expense recorded in the current quarter was nominal. No stock options were granted during the six month period ended November 30, 2008.

The Company's 1994 Stock Option Plan provided for the granting of stock options at an exercise price not less than fair market value of the stock on the date of the grant and with vesting schedules as determined by the Board of Directors. No new options could be granted under the Plan after fiscal 2004 but options granted prior to that time continue to vest.

The following table summarizes information for stock options outstanding and exercisable at November 30, 2008:

	Weighted Average		Weighted Average	
	Number of Options	Exercise Price Per Share	Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at May 31, 2008	229,000	\$.28	3.73	\$10,860
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited or expired	-	-	-	-
Outstanding at November 30, 2008	229,000	\$.28	3.26	-
Exercisable at November 30, 2008	226,600	\$.28	3.23	-

SOFTECH, INC. AND SUBSIDIARIESNOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Continued)

The following table summarizes the information related to non-vested stock option awards outstanding as of November 30, 2008:

	Number of Options	Weighted Average Grant Date Fair Value Per Share
Non-vested at May 31, 2008	2,400	\$.04
Granted	-	-
Vested	-	-
Forfeited	-	-
Non-vested at November 30, 2008	2,400	\$.04

As of November 30, 2008, the remaining prospective pre-tax cost of non-vested stock option employee compensation is nominal and will be expensed on a pro rata basis going forward.

FOREIGN CURRENCY TRANSLATION:

The functional currency of the Company's foreign operations (France, Germany and Italy) is the Euro. As a result, assets and liabilities related to foreign operations are translated at period-end exchange rates and related revenues and expenses are translated at the average exchange rates. Adjustments resulting from translation of such financial accounts are classified in accumulated other comprehensive income (loss). Foreign currency gains and losses arising from transactions are included in the statement of operations. The Company recorded foreign currency transaction losses of approximately \$53,000 during the quarter ending November 30, 2008, which is included in other income (expense) in the Company's consolidated statement of operations.

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, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates included in the financial statements are the valuation of long term assets, including intangibles (goodwill, capitalized software and other intangible assets), deferred tax assets and the allowance for doubtful accounts. Actual results could differ from those estimates.

INCOME TAXES:

The provision for income taxes is based on the earnings or losses reported in the consolidated financial statements. The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. The Company provides a valuation allowance against deferred tax assets if it is more likely than not that some or all of the deferred tax assets will not be realized.

SOFTTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Continued)

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109" ("FIN 48"). This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. FIN 48 prescribes a recognition threshold of more likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. Effective June 1, 2007, the Company adopted the provisions of FIN 48. The Company believes that there are no uncertain tax positions or liabilities for interest and penalties associated with uncertain tax positions as of June 1, 2007 and May 31, 2008. The Company accounts for interest and penalties related to uncertain tax positions as part of its provision for federal and state income taxes. In accordance with the applicable statute of limitations, the Company's tax returns could be audited by the Internal Revenue Service and various states for the fiscal years ended 2002 to 2007.

NEW ACCOUNTING PRONOUNCEMENTS:

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*. This Statement establishes the disclosure requirements for derivative instruments and for hedging activities. It amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of derivative instruments and hedging activities. This Statement is effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company does not expect that the adoption of this standard will have a material impact on the Company's Consolidated Financial Statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. It will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendment to AU 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company does not expect the implementation of this standard to have a material impact on its Consolidated Financial Statements.

(C)

BALANCE SHEET COMPONENTS

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Details of certain balance sheet captions are as follows (000 s):

	November 30, 2008	May 31, 2008
Property and equipment	\$ 3,942	\$ 4,003
Accumulated depreciation and amortization	(3,787)	(3,846)
Property and equipment, net	\$ 155	\$ 157
Common stock, \$.10 par value	\$ 1,221	\$ 1,221
Capital in excess of par value	18,037	18,037
Accumulated deficit	(27,142)	(27,909)
Accumulated other comprehensive income	(399)	(452)
Stockholders' deficit	\$ (8,283)	\$ (9,103)

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Continued)

(D)

EARNINGS PER SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed by dividing net loss by the weighted-average number of common and equivalent dilutive common shares outstanding. Options to purchase shares of common stock have been excluded from the denominator for the computation of diluted earnings per share because their inclusion would be antidilutive.

The following depicts a reconciliation of earnings per share (unaudited) and weighted average shares outstanding):

	Three Month Periods Ended	
	November 30, 2008	November 30, 2007
(Amounts in thousands, except per share amounts)		
Net income (loss) available to common shareholders	\$ 348	\$ (218)
Weighted average number of common shares outstanding		
used in calculation of basic earnings per share	12,213	12,213
Incremental shares from the assumed exercise of dilutive stock options	-	-
Weighted average number of common shares outstanding used in calculating diluted earnings per share	12,213	12,213
Earnings (loss) per share:		
Basic	\$.03	\$ (.02)
Diluted	\$.03	\$ (.02)

	Six Month Periods Ended	
	November 30, 2008	November 30, 2007
(Amounts in thousands, except per share amounts)		

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Net income (loss) available to common shareholders	\$	767	\$	(217)
Weighted average number of common shares outstanding				
used in calculation of basic earnings per share		12,213		12,213
Incremental shares from the assumed exercise of dilutive stock options		-		-
Weighted average number of common shares outstanding used in calculating diluted earning per share		12,213		12,213
Earnings (loss) per share:				
Basic	\$.06	\$	(.02)
Diluted	\$.06	\$	(.02)

At November 30, 2008 and 2007, respectively, 229,000 and 238,000 options to purchase common shares were anti-dilutive and were excluded from the above calculation for both the three and six month periods.

SOFTECH, INC. AND SUBSIDIARIESNOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS(Continued)

(E)

COMPREHENSIVE INCOME

The Company's comprehensive income includes accumulated foreign currency translation adjustments and unrealized gain (loss) on marketable securities. The comprehensive loss was as follows (000's):

	Three Month Periods Ended	
	November 30, 2008	November 30, 2007
Net income (loss)	\$ 348	\$ (218)
Changes in:		
Foreign currency translation adjustment	10	(37)
Comprehensive Income	\$ 358	\$ (255)

	Six Month Periods Ended	
	November 30, 2008	November 30, 2007
Net income (loss)	\$ 767	\$ (217)
Changes in:		
Foreign currency translation adjustment	53	(39)
Comprehensive Income	\$ 820	\$ (256)

(F)

SEGMENT INFORMATION

The Company operates in one reportable segment and is engaged in the development, marketing, distribution and support of CAD/CAM and Product Data Management and Collaboration computer solutions. The Company's operations are organized geographically with foreign offices in Germany and Italy. Components of revenue and long-lived assets (consisting primarily of intangible assets, capitalized software and property, plant and equipment) by geographic location, are as follows (000 \$):

	Three Months Ended	Three Months Ended
	November 30,	November 30,
Revenue:	2008	2007
North America	\$ 1,717	1,761
Asia	399	236
Europe	543	554
Eliminations	(186)	(58)
Consolidated		
Total	\$ 2,473	2,493

SOFTTECH, INC. AND SUBSIDIARIESNOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS(Continued)

	Six Months Ended	Six Months Ended
	November 30,	November 30,
	2008	2007
Revenue:		
North America	\$ 3,673	3,840
Asia	637	516
Europe	1,175	1,135
Eliminations	(458)	(282)
Consolidated Total	\$ 5,027	5,209

	November 30,	May 31,
	2008	2008
Long Lived Assets:		
North America	\$ 5,096	5,259
Europe	114	170
Consolidated Total	\$ 5,210	5,429

SOFTTECH, INC. AND SUBSIDIARIES

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

This report may contain forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934 (including any statements regarding the Company's outlook for fiscal 2009 and beyond). Any forward looking statements are subject to a number of risks and uncertainties. These include, among other risks and uncertainties, whether we will be able to generate sufficient cash flow from our operations or other sources to fund our working capital needs, maintain our existing relationship with our lender, successfully introduce and attain market acceptance of any new products, attract and retain qualified personnel both in our existing markets and in new territories in an extremely competitive environment, and aging and potential obsolescence of our technologies.

In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, plans, anticipates, believes, estimates, projects, predicts, potential and similar expressions intended to describe forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as otherwise required by law, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this report to reflect any change in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. We qualify all of our forward-looking statements by these cautionary statements.

Critical Accounting Policies and Significant Judgments and Estimates

The Securities and Exchange Commission ("SEC") issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require the application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

Our significant accounting pol