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SOFTECH INC
Form 10QSB
October 15, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

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

For the Quarter Ended
August 31, 2003

Commission File Number
0-10665

SOFTECH, INC.

State of Incorporation
Massachusetts

IRS Employer
Identification
04-2453033

2 Highwood Drive, Tewksbury, MA 01876
Telephone (978) 640-6222

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

The number of shares outstanding of registrant's common stock at September 30, 2003 was 12,205,236 shares.

SOFTECH, INC.

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August 31, 2003 (unaudited) and
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Consolidated Condensed Statements of Operations

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

| | August 31, 2003 (unaudited) | May 31, 2003 (audited) |
|-------------------------------------|-----------------------------------|------------------------------|
| | ----- (dollars in thousands) | |
| ASSETS ----- | | |
| Cash and cash equivalents | \$ 438 | \$ 654 |
| Restricted cash | - | 65 |
| Accounts receivable, net | 1,455 | 2,052 |
| Prepaid expenses and other assets | 130 | 235 |
| | ----- | ----- |
| Total current assets | 2,023 | 3,006 |
| | ----- | ----- |
| Property and equipment, net | 265 | 306 |
| Capitalized software costs, net | 8,596 | 9,114 |
| Identifiable intangible assets, net | 825 | 917 |
| Goodwill, net | 4,598 | 4,598 |

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| | | |
|----------------------------------------------|-----------|-----------|
| Notes receivable | 134 | 134 |
| Other assets | 161 | 160 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 16,602 | \$ 18,235 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| ----- | | |
| Accounts payable | \$ 314 | \$ 474 |
| Accrued expenses | 1,680 | 2,048 |
| Deferred maintenance revenue | 3,561 | 4,074 |
| Current portion of capital lease obligations | 20 | 30 |
| Current portion of long term debt | 1,095 | 1,095 |
| | ----- | ----- |
| Total current liabilities | 6,670 | 7,721 |
| | ----- | ----- |
| Non-current deferred revenue | 117 | 204 |
| Long-term debt, net of current portion | 13,075 | 13,058 |
| | ----- | ----- |
| Total long-term debt | 13,192 | 13,262 |
| | ----- | ----- |
| Stockholders' deficit | (3,260) | (2,748) |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 16,602 | \$ 18,235 |
| | ===== | ===== |

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

Three Months Ended

August 31, August
2003 200

(in thousands, except for per

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| | | | |
|------------------------------------------------------------------|----|--------|-------|
| Revenue | | | |
| Products | \$ | 583 | \$ |
| Services | | 2,360 | 1 |
| | | ----- | ----- |
| Total revenue | | 2,943 | 1 |
| Cost of products sold | | 8 | |
| Cost of services provided | | 493 | |
| | | ----- | ----- |
| Gross margin | | 2,442 | 1 |
| Research and development expenses | | 773 | |
| Selling, general and administrative | | 1,279 | 1 |
| Amortization of capitalized software and other intangible assets | | 615 | |
| | | ----- | ----- |
| Loss from operations before interest expense and income taxes | | (225) | |
| Interest expense | | 253 | |
| | | ----- | ----- |
| Loss from operations before income taxes | | (478) | |
| Provision for income taxes | | - | |
| | | ----- | ----- |
| Net loss | \$ | (478) | \$ |
| | | ===== | ===== |
| Basic and diluted net loss per common share | \$ | (0.04) | \$ |
| Weighted average common shares outstanding | | 12,205 | 12 |

See accompanying notes to consolidated condensed financial statements.

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

| | Three Months Ended | |
|---------------------------------------|--------------------|------------------------|
| | August 31, | August |
| | 2003 | 2002 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| | | (dollars in thousands) |

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| | | | | |
|-----------------------------------------------------------------------------|----|-------|----|-----|
| Net loss | \$ | (478) | \$ | (5) |
| ----- | | | | |
| Adjustments to reconcile net loss to net cash used by operating activities: | | | | |
| Depreciation and amortization | | 663 | | 4 |
| Change in current assets and liabilities: | | | | |
| Accounts receivable | | 597 | | 5 |
| Prepaid expenses and other assets | | 70 | | |
| Accounts payable and accrued expenses | | (528) | | (2) |
| Deferred maintenance revenue | | (600) | | (3) |
| ----- | | | | |
| Total adjustments | | 202 | | 4 |
| ----- | | | | |
| Net cash used by operating activities | | (276) | | (|
| ----- | | | | |
| Cash flows used by investing activities: | | | | |
| Purchase of marketable securities | | 0 | | (|
| Capital expenditures | | (12) | | (|
| ----- | | | | |
| Net cash used by investing activities | | (12) | | (|
| ----- | | | | |
| Cash flows from financing activities: | | | | |
| Principal payments under capital lease obligations | | (10) | | (|
| Proceeds (repayments) from line of credit agreements, net | | 17 | | (1 |
| ----- | | | | |
| Net cash provided (used) by financing activities | | 7 | | (1 |
| ----- | | | | |
| Decrease in cash and cash equivalents | | (281) | | (3 |
| Cash and cash equivalents, beginning of period | | 719 | | 7 |
| ----- | | | | |
| Cash and cash equivalents, end of period | \$ | 438 | \$ | 3 |
| ===== | | | | |

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(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

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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 2003 Annual Report on Form 10-KSB.

(B) SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION:

The Company has adopted the provisions of Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2) as amended by SOP No. 98-9, in recognizing revenue from software transactions. Revenue from software license sales are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility has been determined. To the extent that obligations exist for other services, the Company allocates revenue between the license and the services based upon their relative fair value. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements. Revenue from engineering, consulting and training services 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. The Company evaluates the realizability 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 August 31, 2002 or 2003.

ACCOUNTING FOR GOODWILL AND OTHER INTANGIBLE ASSETS

Effective June 1, 2002, the Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. This statement affects the Company's treatment of goodwill and other intangible assets. This statement 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 will continue to be amortized over those periods. Amortization of goodwill ceased as of May 31, 2002.

The Company completed the first step of the transitional goodwill impairment test during the three months ended November 30, 2002 based on the amount of goodwill as of the beginning of fiscal year 2003, as required by SFAS No. 142. Based on the results of the first step of the transitional goodwill impairment test, the Company has determined that the fair value of each of the reporting units exceeded their carrying amounts and, therefore, no goodwill impairment existed as of June 1, 2002.

The Company tested the goodwill for impairment as of May 31, 2003 and concluded, based on actual results for fiscal 2003 and projected cash flows from each of the reporting units, that no impairment existed as of May 31, 2003.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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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. The Company has determined that all of its intangible assets (other than goodwill) have finite lives and, therefore, the Company has continued to amortize its intangible assets.

STOCK BASED COMPENSATION

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock option plans. Because the number of shares is known and the exercise price of options granted has been equal to fair value at date of grant, no compensation expense has been recognized in the statements of operations. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards under these plans, consistent with the methodology prescribed under SFAS 123, the Company's net loss and loss per share would have approximated the pro forma amounts indicated below:

| Three Month Periods Ended August 31, | 2003 | 2002 |
|----------------------------------------|---------------------------------------|----------|
| ----- | ----- | ----- |
| | (in thousands, except per share data) | |
| Net income (loss) - as reported | \$ (478) | \$ (532) |
| Net income (loss) - pro forma | (482) | (537) |
| Loss per share - diluted - as reported | (.04) | (.04) |
| Loss per share - diluted - pro forma | (.04) | (.04) |

FOREIGN CURRENCY TRANSLATION:

The functional currency of the Company's foreign operations (France, Germany and Italy) is the local currency. As a result, assets and liabilities are translated at period-end exchange rates and revenues and expenses are translated at the average exchange rates. Adjustments resulting from translation of such financial statements are classified in accumulated other comprehensive income (loss). Foreign currency gains and losses arising from transactions are included in the 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

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liabilities and 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.

(C) LIQUIDITY

The Company ended the first three months of fiscal 2004 with cash of approximately \$.4 million. Operating activities utilized approximately \$276,000 of cash during the first three months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation together with a decrease in accounts receivable and other

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

assets generated cash of \$852,000. The reduction in accounts payable and accrued expenses used cash of \$528,000 and the cyclical reduction in deferred revenue utilized an additional \$600,000 during the first quarter.

Although the Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow in fiscal 2004, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable.

The Company believes that the cash on hand together with cash flow from operations and its available borrowings under its credit facility will be sufficient for meeting its liquidity and capital resource needs for the next year. At August 31, 2003, the Company had available borrowings on its debt facilities of approximately \$3.5 million.

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

| | August 31, 2003 (unaudited) | May 31, 2003 (audited) |
|--------------------------------------------------------|--------------------------------|---------------------------|
| | ----- | ----- |
| Property and equipment | \$ 3,839 | \$ 3,827 |
| Accumulated depreciation and amortization | (3,574) | (3,521) |
| | ----- | ----- |
| Property and equipment, net. | \$ 265 | \$ 306 |
| | ----- | ----- |
| Common stock, \$.10 par value | \$ 1,274 | \$ 1,274 |

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| | | |
|------------------------------------|------------|------------|
| Capital in excess of par value . . | 19,544 | 19,544 |
| Accumulated deficit | (22,249) | (21,771) |
| Cumulative translation adjustment. | (268) | (234) |
| Less treasury stock | (1,561) | (1,561) |
| | ----- | ----- |
| Stockholders' deficit | \$ (3,260) | \$ (2,748) |
| | ----- | ----- |