SOFTECH INC
Form 10QSB
April 14, 2004

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 February 29, 2004	Commission File Number 0-10665

SOFTECH, INC.

State of Incorporation	IRS Employer Identification
Massachusetts	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 X No ______

The number of shares outstanding of registrant's common stock at March 31, 2004 was 12,205,236 shares.

SOFTECH, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

	(dollars in Thousands) February 29, 2004 (unaudited)	May 31 2003 (audited
ASSETS		
Cash and cash equivalents	$ 539	$ 65
Restricted cash	-	6
Accounts receivable, net	1,576	2,05
Prepaid expenses and other assets	134	23
Total current assets	2,249	3,00
Property and equipment, net (Note B)	231	30
Capitalized software costs, net	7,560	9,11
Identifiable intangible purchased assets, net	642	91
Goodwill, net	4,601	4,59

Notes receivable.	134	13
Other assets.	160	16
TOTAL ASSETS.	$ 15,577	$ 18,23

LIABILITIES AND STOCKHOLDERS' DEFICIT

Accounts payable.	$ 198	$ 47
Accrued expenses.	1,468	2,04
Deferred maintenance revenue.	3,996	4,07
Current portion of capital lease obligations.	14	3
Current portion of long term debt	1,892	1,09
Total current liabilities	7,568	7,72
Non-current deferred revenue.	118	20
Long-term debt, net of current portion.	12,245	13,05
Total long-term liabilities	12,363	13,26
Stockholders' deficit	(4,354)	(2,74
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 15,577	$ 18,23

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

(in thousands, except f
share data)

Three Months Ende

February 29, Fe

	2004	
Revenue		
Products	$ 603	$
Services	2,165	
Total revenue	2,768	
Cost of products sold	15	
Cost of services provided	476	
Gross margin	2,277	
Research and development expenses	751	
Selling, general and administrative	1,406	
Amortization of capitalized software and other intangible assets	610	
Loss from operations before interest expense and income taxes	(490)	
Interest expense	255	
Loss from operations before income taxes	(745)	
Provision for income taxes	-	
Net loss	$ (745)	$
Basic and diluted net loss per common share	$ (0.06)	$
Weighted average common shares outstanding	12,205	

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

(in thousands, excep
for per share data)

Nine Months Ended

	February 29, 2004	Febr 2
Revenue		
Products	$ 2,054	$
Services	6,967	
Total revenue	9,021	
Cost of products sold	34	
Cost of services provided	1,460	
Gross margin	7,527	
Research and development expenses	2,292	
Selling, general and administrative	4,112	
Amortization of capitalized software and other intangible assets	1,835	
Loss from operations before interest expense and income taxes	(712)	
Interest expense	757	
Loss from operations before income taxes	(1,469)	
Provision for income taxes	-	
Net loss	$ (1,469)	$
Basic and diluted net loss per common share	$ (0.12)	$
Weighted average common shares outstanding	12,205	

See accompanying notes to consolidated condensed financial statements.

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

(dollars in thousands)
Nine Months Ended

	February 29, 2004	February 2003
Cash flows from operating activities:		
Net loss	$ (1,469)	$ (1
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,943	1
Change in current assets and liabilities:		
Accounts receivable	476	
Prepaid expenses and other assets	25	
Accounts payable and accrued expenses	(856)	
Deferred maintenance revenue	(164)	
Total adjustments	1,424	1
Net cash (used) provided by operating activities	(45)	
Cash flows used by investing activities:		
Payments for business acquisition, net of cash acquired	-	(3
Capital expenditures	(38)	
Net cash used by investing activities	(38)	(3
Cash flows from financing activities:		
Principal payments under capital lease obligations	(16)	
(Payments) proceeds from line of credit agreements, net	(16)	3
Net cash (used) provided by financing activities	(32)	3
(Decrease) increase in cash and cash equivalents	(115)	
Cash and cash equivalents, beginning of period	654	
Cash and cash equivalents, end of period	$ 539	$ 1
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	757	
Income Taxes Paid	10	

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 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 or nine month periods ended February 29, 2004 or February 28, 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 repeated annually, 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 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.

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

On December 31, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 148 (SFAS 148), Accounting for Stock-Based Compensation -- Transition and Disclosure, amending FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. This Statement amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. The Company has complied with the disclosure provisions in these financial statements.

The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and provides the required pro forma disclosures prescribed by SFAS 123 and SFAS 148.

The Company has adopted the disclosure-only provisions of SFAS 123. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market. No compensation expense was recognized during the three and nine month periods ended February 29, 2004 or February 28, 2003.

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. 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:

(in thousands, except per share data)	Three Month Periods Ended February 29, 2004 (unaudited)	Three Month Periods Ended February 28, 2003 (unaudited)
Net loss - as reported.	$ (745)	$ (494)
Net loss - pro forma.	(748)	(500)
Loss per share - diluted - as reported.	(0.06)	(0.04)
Loss per share - diluted - pro forma	(0.06)	(0.04)

(in thousands, except per share data)	Nine Month Periods Ended February 29, 2004 (unaudited)	Nine Month Periods Ended February 28, 2003 (unaudited)
Net loss - as reported.	$ (1,469)	$ (1,239)
Net loss - pro forma.	(1,478)	(1,256)
Loss per share - diluted - as reported.	(0.12)	(0.10)
Loss per share - diluted - pro forma. .	(0.12)	(0.10)

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 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 third quarter of fiscal 2004 with cash of $539,000. Operating activities utilized $45,000 of cash during the first nine 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 assets generated cash of $975,000. The reduction in accounts payable, accrued expenses and deferred revenue used cash of $1,020,000 during the first nine months of the fiscal year.

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 February 29, 2004, the Company had available borrowings on its debt facilities of approximately $3.3 million.

(D) BALANCE SHEET COMPONENTS

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

Property and Equipment

	February 29, 2004 (unaudited)	May 31, 2003 (audited)
Property and equipment. . .	$ 3,865	$ 3,827
Accumulated depreciation and amortization.	(3,634)	(3,521)
Property and equipment, net	$ 231	$ 306

Stockholders' Deficit

Common stock, $.10 par value. . .	$ 1,274	$ 1,274
Capital in excess of par value. .	19,544	19,544
Accumulated deficit	(23,240)	(21,771)
Cumulative translation adjustment	(371)	(234)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	$ (4,354)	$ (2,748)

The changes from May 31, 2003 in stockholders equity are due solely to the changes in the accumulated deficit resulting from the net loss for the first nine months of the fiscal year of $1,469 and the foreign currency translation adjustment of $137.

(E) LOSS 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 for all periods presented in fiscal 2004 and 2003 because their inclusion would be antidilutive. There were a total of 493,000 and 413,000 options outstanding at February 29, 2004 and February 28, 2003, respectively.

(F) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments and unrealized gain (loss) on marketable securities. For the three and nine month periods ended February 29, 2004 and February 28, 2003, the comprehensive loss was as follows (000's):

	Three Month Periods Ended	
	February 29, 2004 (unaudited)	February 28, 2003 (unaudited)
Net loss	$ (745)	$ (494)
Changes in:		
Foreign currency translation adjustment.	(58)	(67)
Unrealized loss on marketable securities	-	(4)
Comprehensive loss	$ (803)	$ (565)

	Nine Month Periods Ended	
	February 29, 2004 (unaudited)	February 28, 2003 (unaudited)
Net loss	$ (1,469)	$ (1,239)
Changes in:		
Foreign currency translation adjustment.	(137)	(56)
Unrealized gain on marketable securities	-	73
Comprehensive loss	$ (1,606)	$ (1,222)

(G) 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 computer solutions. Within that one reportable segment we offer several distinct product families and numerous modules for each of those product families. The three major product families are our two-dimensional CAD product family known as Cadra, our CAM product offerings by various trade names, and our data management and collaboration technology known as ProductCenter. The Company's operations are organized geographically with foreign offices in France, 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's):

	Three Month Periods Ended	
Revenue:	February 29, 2004 (unaudited)	February 28, 2003 (unaudited)
North America. . .	$ 2,035	$ 2,625
Asia	256	280
Europe	571	522
Eliminations . . .	(94)	(271)
Consolidated Total	$ 2,768	$ 3,156

	Nine Month Periods Ended	
Revenue:	February 29, 2004 (unaudited)	February 28, 2003 (unaudited)
North America. . .	$ 6,941	$ 4,925
Asia	705	749
Europe	1,741	1,931
Eliminations . . .	(366)	(502)
Consolidated Total	$ 9,021	$ 7,103

	February 29, 2004	May 31, 2003

Long Lived Assets:	(unaudited)	(audited)
North America. . .	$ 13,131	$ 15,017
Europe	197	212
Consolidated Total	$ 13,328	$ 15,229

(H) NEW ACCOUNTING PRONOUNCEMENTS:

On December 31, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 148 (SFAS 148), Accounting for Stock-Based Compensation -- Transition and Disclosure, amending FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. This Statement amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. The Company has complied with the disclosure provisions in these financial statements.

The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and provides the required pro forma disclosures prescribed by SFAS 123 and SFAS 148. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market. No compensation expense was recognized during the three and nine month periods ended February 29, 2004 or the same periods in the prior year.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, an entity capitalizes a cost by increasing the carrying amount of the long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 effective June 1, 2003 did not have a material effect on the financial position or results of operations of the Company.

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which is effective for contracts entered into or modified after June 30, 2003. This Statement amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities for the purpose of improving financial reporting by requiring contracts with comparable characteristics to be accounted for similarly. The adoption of SFAS No. 149 effective July 1, 2003 did not have a material impact on the Company's financial position or results of operations.

In May 2003, FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", which is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position or results of operations.

(I) ACQUISITION

On December 18, 2002, the Company closed its all cash tender offer ("Offer") for all of the outstanding shares of common stock of Workgroup Technology Corporation, a Delaware corporation ("WTC"), at a price of $2.00 per share. WTC was a publicly traded company listed on the Over the Counter Bulletin Board. WTC develops, supports and markets a software product to mechanical CAD ("Computer Aided Design") users that allows them to manage their design models. Its product offerings are compatible with SofTech's.

A total of 1,505,958 shares of WTC's common stock were tendered in the Offer, which, together with shares beneficially owned by SofTech prior to commencement of the Offer, represented approximately 88.8% of WTC's outstanding common stock.

Subsequent to the 2003 fiscal year end, the Company exercised an option to purchase an additional 220,000 shares of WTC thereby bringing its ownership of WTC to 90.02%. On June 18, 2003, the Company filed a short-form merger with the State of Delaware thereby acquiring the 205,662 WTC shares that had not been tendered in the Offering. This action provides the beneficial owners of those 205,662 shares the right to present them to the Company and to receive $2.00 per share in cash.

The operating results of WTC have been included in the Company's results since the acquisition date. Therefore the results of operations shown below for the three and nine month periods ended February 29, 2004 are the actual results reported in this Form 10-QSB. The unaudited pro forma results of operations for the three and nine month periods ended February 28, 2003 assume that the WTC acquisition had occurred as of the beginning of each of those periods.

The following unaudited pro forma comparative information is presented for illustrative purposes only and is not necessarily indicative of the consolidated results of operations for future periods or that actually would have been realized had the Company and WTC been a consolidated entity as of the beginning of the three and nine month periods ended February 28, 2003 (in thousands, except per shared data). The pro forma results for the three and nine month periods ended February 28, 2003 have been prepared by combining the Company's actual results for those periods with the adjusted results of WTC prior to the acquisition and making certain adjustments to increase expenses for the amortization of intangible assets and interest expense and eliminate all transaction related expenses incurred by WTC during those periods.

	Three Months Ended, (unaudited)	
	February 29, 2004	February 28, 2003
Revenue	$ 2,768	$ 3,464
Net loss.	(745)	(519)

Net loss per share:		
Basic	(.06)	(. 04)
Diluted	(.06)	(.04)

	Nine Months Ended, (unaudited)	
	February 29, 2004	February 28, 2003
Revenue	$ 9,021	$10,714
Net loss.	(1,469)	(2,739)
Net loss per share:		
Basic	(.12)	(.22)
Diluted	(.12)	(.22)

(J) SUBSEQUENT EVENT

Subsequent to the end of the quarter, the Board of Directors approved the following actions at the regularly scheduled meeting:

- Established June 30, 2004 as the 2003 Annual Meeting of the Stockholders;
- Approved a resolution to amend the Company's Amended Articles of Incorporation to authorize a class of Preferred Shares and to provide the Board of Directors with the authority to issue Preferred Shares in an amount and under such terms as deemed appropriate; and
- Approved the conversion to Preferred Shares of the Company's outstanding debt to Greenleaf Capital, Inc., subject to approval of the Amendment described above.

Management and the Board of Directors will recommend that the stockholders approve the Amendment.

Subject to stockholder approval of the amendment to the Articles of Incorporation described above, the Company has also reached a tentative agreement with Greenleaf Capital, Inc. whereby the Company would issue up to $14 million in Preferred Shares to Greenleaf Capital in exchange for up to $14 million of debt.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

The statements made below with respect to SofTech's outlook for fiscal 2004 and beyond represent "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 and are subject to a number of risks and uncertainties. These include, among other risks and uncertainties, general business and economic conditions, generating sufficient cash flow from operations to fund working capital needs, continued integration of acquired entities, potential obsolescence of the Company's technologies, maintaining existing relationships with the Company's lenders, successful introduction and market acceptance of planned new products and the ability of the Company to attract and retain qualified personnel both in our existing markets and in new territories in an extremely competitive environment.

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.

The Company's significant accounting policies are described in Note B to these financial statements. The Company believes that the following accounting policies require the application of management's most difficult, subjective or complex judgments:

Valuation of Long-lived and Intangible Assets

We assess the recoverability of long-lived assets and intangible assets whenever we determine that events or changes in circumstances indicate that their carrying amount may not be recoverable. Our assessment is primarily based upon our estimate of future cash flows associated with these assets. These valuations contain certain assumptions concerning estimated future revenues and future expenses for each of our two reporting units. We have determined that there is no indication of impairment of any of our assets. However, should our operating results deteriorate, we may determine that some portion of our long-lived assets or intangible assets are impaired. Such determination could result in non-cash charges to income that could materially affect our financial position or results of operations for that period.

Valuation of Goodwill

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 repeated annually, 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 and intangible assets with indeterminable lives ceased as of June 1, 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. As a result, the second step of the transitional goodwill impairment test was not required to be completed. The Company tested the goodwill for impairment at 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. The Company will be required to continue to perform a goodwill impairment test on an annual basis.

Estimating Allowances for Doubtful Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. A significant change in the liquidity or financial position of any of our significant customers could have a material adverse effect on the collectibility of our accounts receivable and our future operating results.

Valuation of Deferred Tax Assets

We regularly evaluate our ability to recover the reported amount of our deferred income taxes considering several factors, including our estimate of the likelihood of the Company generating sufficient taxable income in future years during the period over which temporary differences reverse. The Company's deferred tax assets are currently fully reserved.

Results of Operations

The WTC Acquisition

On December 18, 2002, the Company closed its all cash tender offer ("Offer") for all of the outstanding shares of common stock of Workgroup Technology Corporation as more fully described above and in our previous SEC filings. The operating results of WTC have been included in the Company's results since the acquisition date.

WTC represented a significant acquisition for the Company. Its technology, known as ProductCenter, is complementary to our technology offerings, its revenue was comparable and its physical proximity made it possible to quickly combine our headquarter locations within one facility. Redundant administrative and management positions were also eliminated at or near the acquisition date. Most of the significant changes in results of operations for the periods presented herein are a direct result of this acquisition.

The results of operations for WTC are included in their entirety in the three and nine month periods ended February 29, 2004. For the three month period ended February 28, 2003, WTC's results of operations are included for all but the first 18 days of that period. For the nine months ended February 28, 2003, WTC's results of operations are included for the last two and a half months of that period.

Overview

Our revenues derive from three distinct product families that serve different functions within what has become known as the Product Lifecycle Management ("PLM") industry. These product families were acquired by the Company in three separate and unrelated business transactions over the last six years. Two of those product families, Cadra and our CAM technologies, serve mature markets and are primarily focused on catering to the needs of our installed base. These product families make up about half of our revenue. The ProductCenter product line is a product data management and collaboration technology. Essentially, it allows users to capture critical corporate product data, control that data and share it with authorized users throughout the company's extended enterprise. This product offering serves a portion of the PLM industry that is forecasted by industry analysts to grow at approximately 15% per year for the next four years. ProductCenter is integrated with proprietary CAD tools that make up a majority of the installed base of CAD users including Parametric Technology Corporation's Pro/Engineer, Dassault Systems' Solidworks and AutoDesk's products including AutoCad, Inventor and Mechanical Desktop.

Over the last several months, we have experienced an increase in pre-sales activity surrounding our ProductCenter offering. We attribute this increased pre-sales activity to several factors including:

- the increased sales presence of the Company's sales force and indirect distribution channel marketing the ProductCenter offering post acquisition;
- the translation of ProductCenter for non-English speaking users;
- a cautiously improving economic outlook which has begun to remove the spending restraints that were most certainly in place for a large portion of our targeted customers over the last several years; and
- a steadily growing transition from 2D CAD tools to 3D CAD tools which greatly increase the demand for data management solutions.

However, while we have experienced an increase in pre-sales activity over the last several months, there continues to be a hesitancy on the part of companies to make that final decision to issue a purchase order. This hesitation has caused a certain unpredictability to our license revenue although the pipeline of identified business from both our installed base and newly identified customers has grown. Our current quarter product revenue decreased 27% from the immediately preceding second quarter and 37% from the same quarter in the prior year. These negative comparisons were due almost entirely to our ProductCenter offering which is exactly where we see the increasing pre-sale activity and the greatest market opportunity.

Detailed Analysis

Revenue for the three month period ended February 29, 2004 was $2.8 million as compared to $3.2 million for the same period in the prior fiscal year, a decrease of $(.4) million or (12.3)%. This decrease was primarily due to the decrease in product revenue from our ProductCenter offering (acquired in the WTC transaction). See discussion under product revenue below.

Revenue for the nine month period ended February 29, 2004 was $9.0 million as compared to $7.1 million for the same period in the prior fiscal year, an increase of $1.9 million or 27.0%. The inclusion of WTC for the entire nine month period of the current year while being included in the prior year for only about two and a half months of the nine month period accounted for $2.5 million of the increase. The revenue generated from the Company's CAD and CAM product lines declined by approximately 11% during the nine month period ended February 29, 2004 as compared to the same period in the prior year.

Product revenue for the three month period ended February 29, 2004 was approximately $603,000 as compared to $989,000 for the same period in the prior fiscal year, a decrease of $(386,000) or (39%). This decrease was due primarily to the decline in our ProductCenter offering. As detailed in the Overview above, the pre-sale activity related to this product line has steadily increased over the last several months but there is a pronounced and wide spread final hesitation on the part of our customers to make that final purchase decision. This has caused a hesitation and certain unevenness to our order flow especially for the ProductCenter offering. It is our view that this hesitation is the result of the recession-like economic environment in the world-wide manufacturing marketplace over the last several years. While the economy has shown signs of improvement over the last several quarters, our customers seem to be cautiously evaluating purchase decisions.

Product revenue for the nine month period ended February 29, 2004 was approximately $2,054,000 as compared to $2,124,000 for the same period in the prior fiscal year, a decrease of $(70,000) or (3.3)%. WTC generated product revenue of $913,000 in the nine month period ended February 29, 2004 as compared to $564,000 for the same period in fiscal 2003 when WTC contributed to product revenue only for the third quarter of that year. This increase was more than offset by a decline of approximately 26% in product revenue from the Company's CAD and CAM product lines.

Service revenue for the three month periods ended February 29, 2004 and February 28, 2003 was $2.2 million for both periods. However, if WTC was included for the first 18 days of the quarter ended February 28, 2003, service revenue would have decreased by about 14% in the quarter to quarter comparison.

Service revenue for the nine month period ended February 29, 2004 was $7.0 million as compared to $5.0 million for the same period in fiscal 2003, an increase of $2.0 million or 39.9%. WTC generated service revenue of $3.0 million for the nine month period ended February 29, 2004 as compared to $826,000 for the nine month period ended February 28, 2003 (due to the December 18, 2002 acquisition date) thereby accounting for all of the increase in service revenue. Despite the difficult economic situation noted above, generally our customers continue to purchase maintenance support contracts. This is the reason that SofTech's non-WTC service revenue remained flat despite the declines noted above for product revenue.

Gross margin as a percentage of revenue was 82.2% for the three month period ended February 29, 2004 as compared to 89.0% for the same period in fiscal 2003. Gross margin as a percentage of revenue was 83.4 % for the nine month period ended February 29, 2004 as compared to 92.3% for the same periods in fiscal 2003. This decrease in gross margin as a percent of revenue in fiscal 2004 as compared to the same period in fiscal 2003 is due to WTC's consulting services which make up between 8% and 9% of total revenue in the three and nine month periods ended February 29, 2004. The consulting revenue generated is a labor intensive effort and therefore has a much lower margin as compared to the margin on software maintenance revenue. It is the Company's expectation that consulting revenue will be an important element of our business in the future and that the gross margin experience of the current year is expected to be the norm.

Research and development expenses ("R&D") were $751,000 for the three month period ended February 29, 2004 as compared to $706,000 for the same period in the prior year. Research and development expenses were $2.3 million for the nine month period ended February 29, 2004, as compared to $1.4 million for the same period in the prior fiscal year. This represents an increase of $45,000 or 6.4% for fiscal 2004 Q3 as compared to the same period in fiscal 2003 and an increase of $890,000 or 63.5% for the nine month period ended February 29, 2004 as compared to the same period in fiscal 2003. The increase in R&D expenditures is due primarily to the addition of WTC's development engineering group on December 18, 2002 which increased our R&D staff from 14 to 28.

Selling, general and administrative ("SG&A") expenses were $1.4 million for the three month period ended February 29, 2004 as compared to $1.6 million for the same period in the prior fiscal year. SG&A expenses were $4.1 million for both the nine month periods ended February 29, 2004 and February 28, 2003. As the WTC acquisition was integrated in the third quarter of fiscal 2003 we have been able to realize cost synergies through consolidation of office locations and reduction of redundant functions. This has resulted in no growth in SG&A costs for the current year nine month period as compared to the prior year despite the 27% growth in revenue.

The non-cash expenses related to the amortization of capitalized software and other intangible assets were $.6 million for both the three month periods ended February 29, 2004 and February 28, 2003. The non-cash expenses related to the amortization of capitalized software and other intangible assets was $1.8 million for the nine month period ended February 29, 2004 as compared to $1.4 million for the same periods in fiscal 2003. The increase of approximately $.4 million for the nine months ended February 29, 2004 as compared to the same period in fiscal 2003 is related to the capitalized software and other identifiable intangible assets of WTC totaling approximately $2.7 million that are being amortized on a straight line basis over 3 years. These amortized costs related to the WTC acquisition were included in the current year nine month period for all three quarters but for only one quarter in the same period in fiscal 2003.

Interest expense for the three month period ended February 29, 2004 was approximately $255,000 as compared to $314,000 for the same period in fiscal 2003. This represents a decrease of $(59,000) or (18.8)% for the third quarter of fiscal 2004 compared to the same period in the previous fiscal year. Interest expense for the nine month period ended February 29, 2004 was approximately $757,000 as compared to $890,000 for the same period in fiscal 2003, a decrease of $(133,000) or (14.9)% for the nine month period ended February 29, 2004 as compared to the same period in the prior fiscal year. The average borrowings increased to approximately $14.3 million during the current quarter as compared to $14.5 million for the same period in fiscal 2003 and the average interest rate on those borrowings decreased to about 7.0% in the current quarter from 8.6% for the same period in fiscal 2003. The average borrowings increased to approximately $14.2 million during the first nine months of fiscal 2004 as compared to $12.9 million for the same period in fiscal 2003 and the average interest rate on those borrowings decreased to about 7.0% during the first nine months of fiscal 2004 as compared to 9.2% for the same period in fiscal 2003. The increase in average borrowings is a direct result of the funds borrowed to complete the WTC acquisition. The decrease in average interest rate is due to a reduction in the prime rate.

Capital Resources and Liquidity

The Company ended the third quarter of fiscal 2004 with cash of $539,000. Operating activities utilized $45,000 of cash during the first nine 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 assets generated cash of $975,000. The reduction in accounts payable, accrued expenses and deferred revenue used cash of $1,020,000 during the first nine months of the fiscal year.

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 February 29, 2004, the Company had available borrowings on its debt facilities of approximately $3.3 million.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company's business is subject to many uncertainties and risks. This Form 10-QSB also contains certain forward-looking statements within the meaning of the Private Securities Reform Act of 1995. The Company's future results may differ materially from its current results and actual results could differ materially from those projected in the forward looking statements as a result of certain risk factors, including but not limited to those set forth below, other one-time events and other important factors disclosed previously and from time to time in the Company's other filings with the SEC.

Our quarterly results may fluctuate. The Company's quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Our quarterly revenue may fluctuate significantly for several reasons, including: the timing and success of introductions of our new products or product enhancements or those of our competitors; uncertainty created by changes in the market; difficulty in predicting the size and timing of individual orders; competition and pricing; and customer order deferrals as a result of general economic conditions. Furthermore, the Company has often recognized a substantial portion of its product revenues in the last month of a quarter, with these revenues frequently concentrated in the last weeks or days of a quarter. As a result, product revenues in any quarter are substantially dependent on orders booked and shipped in the latter part of that quarter and revenues from any future quarter are not predictable with any significant degree of accuracy. We typically do not experience order backlog. For these reasons, we believe that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

We may not generate positive cash flow in the future. During fiscal years 1998 through 2001 we generated significant cash losses from operations. The Company took aggressive cost cutting steps and reorganized its operations at the beginning of fiscal 2002. These actions have greatly reduced our fixed costs and resulted in positive cash flow from operations for the last two full fiscal years. It is our expectation that we can continue to improve on our recent success, however, there can be no assurances that the Company will continue to generate positive cash in the future.

Continued decline in business conditions and Information Technology (IT) spending could cause further decline in revenue. The level of future IT spending remains very uncertain as does the prognosis for an economic recovery in the manufacturing sector. If IT spending continues to decline and the manufacturing sector continues to experience economic difficulty, the Company's revenues could be adversely impacted.

The Company is dependent on its lender for continued support. We have a very strong relationship with our sole lender, Greenleaf Capital. They currently represent our sole source of financing and it is our belief that it would be difficult to find alternative financing sources in the event whereby the relationship with Greenleaf changed.

The continued integration of WTC may experience difficulty. Since acquiring WTC in December 2002, much progress has been made in integrating our operations, reducing redundant functions and consolidating our facilities. The strategy includes more closely integrating our technologies and offering our combined customer base these solutions. The strategy also includes translating ProductCenter for users other than the U.S. English speaking market. There can be no assurance that this continued integration of our technologies or offering ProductCenter outside the U.S. will be successful.

NEW ACCOUNTING PRONOUNCEMENTS:

On December 31, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 148 (SFAS 148), Accounting for Stock-Based Compensation -- Transition and Disclosure, amending FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. This Statement amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. The Company has complied with the disclosure provisions in these financial statements.

The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and provides the required pro forma disclosures prescribed by SFAS 123 and SFAS 148. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market. No compensation expense was recognized during the three and nine month periods ended February 29, 2004 or the same periods in the prior year.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, an entity capitalizes a cost by increasing the carrying amount of the long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 effective June 1, 2003 did not have a material effect on the financial position or results of operations of the Company.

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which is effective for contracts entered into or modified after June 30, 2003. This Statement amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities for the purpose of improving financial reporting by requiring contracts with comparable characteristics to be accounted for similarly. The adoption of SFAS No. 149 effective July 1, 2003 did not have a material impact on the Company's financial position or results of operations.

In May 2003, FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", which is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position or results of operations.

SOFTECH, INC. AND SUBSIDIARIES

Item 3. Controls and Procedures

The Company's President and Chief Operating Officer is responsible for establishing and maintaining disclosure controls and procedures for the Company. Such officer has concluded (based upon his evaluation of these controls and procedures as of a date within 90 days of the filing of this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in this report is accumulated and communicated to the Company's management, including its principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officer also has indicated that there were no significant changes in the Company's internal controls or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K

None.

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.

SOFTECH, INC.

Date: April 14, 2004

/s/ Joseph P. Mullaney

Joseph P. Mullaney
President and
Chief Operating Officer