SOFTECH INC
Form 10QSB
October 15, 2002

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, 2002	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 X No

The number of shares outstanding of registrant's common stock at September 30, 2002 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) August 31, 2002 (unaudited)	May 31, 2002 (audited)
ASSETS		
Cash and cash equivalents	$ 379	$ 708
Accounts receivable, net	1,140	1,671
Prepaid expenses and other assets	129	170
Total current assets	1,648	2,549
Property and equipment, net (Note B)	297	330
Capitalized software costs, net	8,986	9,371
Goodwill, net	2,197	2,197
Marketable securities	157	106
Other assets	146	143
TOTAL ASSETS	$ 13,431	$ 14,696

LIABILITIES AND STOCKHOLDERS' DEFICIT

Accounts payable	$ 418	$ 372
Accrued expenses	435	694
Deferred maintenance revenue	2,261	2,642
Current portion of capital lease obligations	79	79
Current portion of long term debt	714	714
Total current liabilities	3,907	4,501
Capital lease obligations, net of current portion	9	23
Non-current deferred revenue	459	459
Long-term debt, net of current portion	10,419	10,589
Total long-term debt	10,887	11,071
Stockholders' deficit (Note B)	(1,363)	(876)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 13,431	$ 14,696

See accompanying notes to consolidated condensed financial statements.

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

(in thousands, except for per
Three Months Ende

	August 31, 2002	A
Revenue		
Products	$ 298	$
Services	1,423	
Total revenue	1,721	
Cost of products sold	9	

Cost of services provided	67	
Gross margin	1,645	
Research and development expenses	334	
Selling, general and administrative	1,558	
Loss from operations before interest expense and income taxes	(247)	
Interest expense	285	
Loss from operations before income taxes	(532)	
Provision for income taxes	-	
Net loss	$ (532)	$
Basic and diluted net loss per common share	$ (0.04)	$
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 thousa Three Months End	
	August 31, 2002	A
Cash flows from operating activities:		
Net loss	$ (532)	$
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	469	
Change in current assets and liabilities:		
Accounts receivable	531	
Unbilled costs and fees	-	
Prepaid expenses and other assets	41	
Accounts payable and accrued expenses	(213)	
Deferred maintenance revenue	(381)	

Total adjustments	447	
Net cash used by operating activities	(85)	
Cash flows used by investing activities:		
Purchase of marketable securities	(29)	
Capital expenditures	(31)	
Net cash used by investing activities	(60)	
Cash flows from financing activities:		
Principal payments under capital lease obligations	(14)	
Repayments (proceeds) from line of credit agreements, net	(170)	
Net cash provided by financing activities	(184)	
Decrease in cash and cash equivalents	(329)	
Cash and cash equivalents, beginning of period	708	
Cash and cash equivalents, end of period	$ 379	$

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 2002 Annual Report on Form 10-K.

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

	August 31, 2002 (unaudited)	May 31, 2002
Property and equipment	$ 3,599	$ 3,568

Accumulated depreciation and amortization	(3,302)	(3,238)
Property and equipment, net	$ 297	$ 330

Common stock, $.10 par value	$ 1,274	$ 1,274
Capital in excess of par value	19,544	19,544
Accumulated deficit	(20,451)	(19,919)
Cumulative translation adjustment	(143)	(166)
Unrealized loss on marketable securities	(26)	(48)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	$ (1,363)	$ (876)

(C) 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 4,583 of common stock were excluded from the denominator for the computation of diluted earnings per share in the first quarter of fiscal 2002 because their inclusion would be antidilutive. There were no dilutive options outstanding for the first quarter of fiscal 2002.

	August 31, 2002 (unaudited)	August 31, 2001 (unaudited)
Basic weighted average shares outstanding during the quarter	12,205,236	10,741,784
Effect of employee stock options outstanding	--	--
Diluted	12,205,236	10,741,784

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(D) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments and unrealized loss on marketable securities. For the quarters ended at August 31, 2002 and 2001, the comprehensive loss was as follows (000's):

	Three Months Ended August 31, 2002	2001
Net loss	$ (532)	$ (421)
Changes in:		

Foreign currency translation adjustment	23	9
Unrealized gain on marketable securities	22	--
Comprehensive loss	$ (487)	$ (412)

(E) 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. The Company's operations are organized geographically with foreign offices in England, 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):

Revenue:	Three Months Ended August 31, 2002 (unaudited)	Three Months Ended August 31, 2001 (unaudited)
North America	$1,014	$1,592
Asia	225	282
Europe	505	669
Eliminations	(23)	(104)
Consolidated Total	$1,721	$2,439

Long-Lived Assets:	August 31, 2002 (unaudited)	May 31, 2002
North America	$11,616	$12,050
Europe	167	97
Consolidated Total	$11,783	$12,147

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(F) NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, FASB issued SFAS 141, "Business Combination", and SFAS No. 142, "Goodwill and Intangible Assets". SFAS 141 is effective for all business combinations initiated after June 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS 142. For the Company, SFAS No. 142 was adopted for the first quarter of fiscal 2003 which began on June 1, 2002. Major provisions of these Statements and their effective dates for the Company are as follows:

- All business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interests method of accounting is prohibited;
- Intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability;
- Goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized. Effective June 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization;
- Effective June 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator;
- All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

The Company adopted SFAS No. 142 prospectively on June 1, 2002. Accordingly, the Company ceased recording amortization of goodwill effective June 1, 2002. In addition, the Company is currently conducting the impairment testing required under SFAS No. 142. The following table presents the reported net loss and net loss per share data for the three months ended August 31, 2002 and 2001, as well as pro forma adjustments relating to the three months ended August 31, 2001, as if SFAS No. 142 had been adopted on June 1, 2001.

	Three Months Ended August 31 (000's)	
	2002	2001
Reported net loss	$(532)	$(421)
Add back: Goodwill amortization	--	254
Adjusted net earnings	$(532)	$(167)
Basic and diluted earnings per share, as reported	$(.04)	$(.04)
Basic and diluted earnings per share, pro forma	$(.04)	$(.02)

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

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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.

Management believes the adoption of SFAS No. 143 will not have a material effect on the financial position or results of operations of the Company.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. It replaces SFAS No. 121. The accounting model for long-lived assets to be disposed of by sale applies to all long-lived assets, including discontinued operations. SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The adoption of SFAS No. 144 did not have a material effect on the financial position or results of operations of the Company.

In April 2002, FASB issued Statement No. 145, "Rescission of FASB Statements No 4, 44, and 64, Amendment of FASB 13, and Technical Corrections", which is effective for fiscal years beginning after May 15, 2002. Upon adoption of SFAS 145, companies will be required to apply the criteria in APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions" in determining the classification of gains/losses resulting from the extinguishment of debt. Upon adoption, extinguishments of debt shall be classified under the criteria in APB Opinion No. 30. The adoption of SFAS No. 145 did not have a material effect on the financial position or results of operations or retained earnings.

In July 2002, FASB issued Statement No. 146 "Accounting for Costs Associated with Exit or Disposal Activities", which becomes effective January 2003. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment. Management believes the adoption of SFAS No. 146 will not have a material effect on the financial position or results of operations or retained earnings.

(G) RECLASSIFICATIONS:

Certain prior year amounts have been reclassified to conform to the current year presentation. Research and development expense for the prior period included $479,000 of amortization and allocation of overhead cost that have been reclassified to selling, general and administrative expense to conform to the current year presentation. These reclassifications have no effect on the previously reported results of operations or retained earnings.

(H) LIQUIDITY

The Company has incurred significant net losses of $2.7 and $6.8 million over the last two fiscal years and a net loss of $532,000 for the current quarter. While more than half the net losses incurred in fiscal 2001 were composed of non-cash expenses, the losses were significant and were far below the business plan. Fiscal year 2002's results were dramatically

improved with net losses of only $2.7 million but, more importantly, positive cash results of approximately $548,000 from operations. This represented the first cash positive result since fiscal 1997 and was in line with the budget adopted by the Board of Directors at the beginning of the year. During fiscal 2002 the Company was also successful in negotiating financial settlements to several long term office leases in Indiana, Michigan and the United Kingdom. These settlements have been fully provided for in the results for fiscal 2001 and 2002. Despite these recent events, the Company remains dependent on its debt facilities with Greenleaf Capital to fund operations.

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 2003, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable. The Company is continuing to seek out market opportunities both through new products and acquisitions to grow its revenue base and its product offerings to its customers.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

Total revenue for the three-month period ended August 31, 2002 was $1.7 million as compared to $2.4 million for the same period in the prior fiscal year. This represents a decrease from the first quarter of fiscal 2002 to fiscal 2003 of $718,000 or 29%. Product revenue decreased by approximately $394,000 in the first quarter of fiscal 2003 as compared to the same period in the prior year or about 57%. Service revenue decreased by about $324,000 or 19% in the first quarter of fiscal 2003 as compared to the first quarter of fiscal 2002.

Product revenue is composed of licensing our technology to end users. This decrease is the direct result of the ongoing extreme weakness in the worldwide manufacturing sector and the resulting impact on technology spending. This weakness in the current quarter was evident in all our geographic regions when compared to the prior year's Q1 license revenue with North America declining by 52%, Europe 69% and Asia 54%. Extreme weather conditions in Germany added to this downward pressure.

Service revenue is composed of software maintenance on our proprietary software and revenue generated from services performed by our engineers such as installation, training and consulting. For the quarter ended August 31, 2002 software maintenance revenue on our proprietary technology was $1.4 million as compared to $1.6 million for the same period in the prior fiscal year. Service revenue in the current quarter was about $100,000 lower than in the same period in fiscal 2002 due to a significant consulting project in the prior year that has not recurred.

Research and development expenditures for the first quarter of fiscal 2002 was approximately $334,000 as compared to $379,000 in fiscal 2002, a decrease of approximately 12%. R&D as a percent of revenue was 19% in the current fiscal quarter as compared to approximately 16% in the comparable quarter in fiscal 2002.

Selling, general and administrative expenses totaled approximately $1.6 million in the first quarter of fiscal year 2002 as compared to $2.0 million in fiscal 2002, a decrease of approximately 23%. The reduced spending in SG&A in the current quarter as compared to the same quarter in fiscal 2002 was due to headcount reductions which accounted for about $200,000 of savings and the cessation of goodwill amortization in the current year related to the adoption of FAS 142 which reduced current quarter expenses by $254,000.

Interest expense for the first quarter of fiscal year 2003 was $285,000 as compared to $308,000 for the same period in the prior fiscal year. The decrease in interest expense is due to lower average borrowings in the current quarter of approximately $250,000 as compared to the same period in the previous fiscal year and a lower average borrowing rate.

The net loss for the current fiscal year was $532,000 as compared to $421,000 in the same period in fiscal 2002. The number of shares outstanding increased to 12.2 million as compared to 10.7 million. The net loss per share for both periods was $.04.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAPITAL RESOURCES AND LIQUIDITY

The Company ended the first quarter of fiscal 2003 with cash of approximately $379,000, a decrease of $329,000 from year-end 2002. Operating activities used approximately $85,000 of cash during the first quarter. The net loss adjusted for non-cash expenditures related to amortization and depreciation used cash of $63,000. A net decrease in accounts receivable generated $531,000 and a slight reduction in other assets generated $41,000. The paydown of accounts payable and accrued expenses utilized $213,000 and the decrease in deferred revenue utilized $381,000.

During the quarter, the Company purchased $31,000 of capital equipment and an additional 33,952 shares of Workgroup Technology Corporation ("WTC") shares in open market transactions for approximately $29,000. The Company also utilized approximately $184,000 to paydown its debt obligations during the quarter.

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, 2002, the Company had available borrowings on its debt facilities of approximately $2.2 million.

The statements made above with respect to SofTech's outlook for fiscal 2003 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 CAD and CAM technologies, potential unfavorable outcome to existing litigation, maintaining existing relationships with the Company's lenders, remaining in compliance with debt covenants, 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.

ITEM 3. CONTROLS AND PROCEDURES

The Company's Chief Operating Officer is responsible for establishing and maintaining disclosure controls and procedures for the Company. Such officer has concluded (based upon their 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

(a) Exhibits

Exhibit 99.1 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the three-month period ended August 31, 2002.

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: OCTOBER 15, 2002

/s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph P. Mullaney, President and Chief Operating Officer of SofTech, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of SofTech, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: October 15, 2002

/s/ Joseph P. Mullaney

Joseph P. Mullaney
President and Chief Operating Officer