

EMTEC INC/NJ
Form 10-Q
July 15, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended May 31, 2010

Commission file number: 0-32789

EMTEC, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	87-0273300 (I.R.S. Employer Identification No.)
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525 Lincoln Drive
5 Greentree Center, Suite 117
Marlton, New Jersey 08053
(Address of principal executive offices, including
zip code)

(856) 552-4204
(Registrant's telephone number, including area code)

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

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

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

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

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

As of July 6, 2010, there were outstanding 16,054,931 shares of the registrant's common stock.

EMTEC, INC.

FORM 10-Q FOR THE QUARTER ENDED MAY 31, 2010

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

EMTEC, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In Thousands, Except per Share and Share Data)

	May 31, 2010 (Unaudited)	August 31, 2009
Assets		
Current Assets		
Cash	\$1,773	\$1,713
Receivables:		
Trade, less allowance for doubtful accounts	32,467	29,463
Other	1,805	2,184
Inventories, net	4,214	4,410
Prepaid expenses and other	2,875	2,184
Deferred tax asset - current	707	680
Total current assets	43,841	40,634
Property and equipment, net	1,474	1,390
Intangible assets, net	10,072	11,235
Goodwill	12,327	11,424
Deferred tax asset- long term	436	459
Other assets	95	131
Total assets	\$68,245	\$65,273
Liabilities and Stockholders' Equity		
Current Liabilities		
Line of credit	\$13,844	\$9,035
Accounts payable	25,128	25,390
Current portion of long term debt - related party	82	1,213
Income taxes payable	42	590
Accrued liabilities	5,643	6,723
Customer deposits	312	-
Deferred revenue	2,311	2,103
Total current liabilities	47,362	45,054
Deferred tax liability- long term	2,503	2,816
Accrued liabilities	176	180

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Total liabilities	50,041	48,050
Commitments and contingencies		
Stockholders' Equity		
Common stock \$0.01 par value; 25,000,000 shares authorized; 18,744,520 and 18,059,679 shares issued and 15,879,931 and 15,195,090, outstanding at May 31, 2010 and August 31, 2009, respectively	187	181
Additional paid-in capital	21,180	20,794
Retained earnings	2,194	1,671
Accumulated other comprehensive income	239	173
	23,800	22,819
Less: treasury stock, at cost, 2,864,589 shares	(5,596)	(5,596)
Total stockholders' equity	18,204	17,223
Total liabilities and stockholders' equity	\$68,245	\$65,273

The accompanying notes are integral parts of these consolidated financial statements.

EMTEC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except per Share and Share Data)

	For the Three Months Ended May 31,		For the Nine Months Ended May 31,	
	2010	2009	2010	2009
Revenues				
Procurement services	\$39,536	\$35,321	\$122,193	\$121,094
Service and consulting	13,970	13,898	40,994	40,106
Total Revenues	53,506	49,219	163,187	161,200
Cost of Sales				
Cost of procurement services	35,140	31,204	109,348	107,967
Service and consulting	10,285	10,369	29,310	30,666
Total Cost of Sales	45,425	41,573	138,658	138,633
Gross Profit				
Procurement services	4,396	4,117	12,845	13,127
Service and consulting	3,685	3,529	11,684	9,440
Total Gross Profit	8,081	7,646	24,529	22,567
Operating expenses:				
Selling, general, and administrative expenses	7,243	6,198	20,962	18,134
Rent expense – related parties	162	147	473	452
Depreciation and amortization	551	632	1,718	1,734
Total operating expenses	7,956	6,977	23,153	20,320
Operating income	125	669	1,376	2,247
Other expense (income):				
Interest income – other	(3) (5) (18) (16
Interest expense	124	169	428	693
Other expense	(4) 17	(12) 21
Income before income taxes	8	488	978	1,549
Provision for income taxes	43	215	456	655
Net income (loss)	\$(35) \$273	\$522	\$894
Net income (loss) per common share				
Basic and Diluted	\$0.00	\$0.02	\$0.03	\$0.06

Weighted Average Shares Outstanding				
Basic	15,071,515	14,629,231	15,071,515	14,629,231
Diluted	15,071,515	14,888,272	15,258,822	14,883,734

The accompanying notes are integral parts of these consolidated financial statements.

EMTEC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	For the Nine Months Ended May 31,	
	2010	2009
Cash Flows From Operating Activities		
Net income	\$522	\$894
Adjustments to Reconcile Net Income to Net Cash Provided By Operating Activities		
Depreciation and amortization	493	626
Amortization related to intangible assets	1,225	1,108
Deferred income taxes (benefit)	(331)	(240)
Stock-based compensation	393	87
Indemnification of professional fees	-	(270)
Changes In Operating Assets and Liabilities		
Receivables	(2,562)	8,017
Inventories	196	(6,978)
Prepaid expenses and other assets	(631)	(174)
Accounts payable	(275)	1,291
Customer deposits	312	(1)
Income taxes payable	(548)	(93)
Accrued liabilities	(1,175)	(855)
Deferred revenue	182	(36)
Net Cash Provided By (Used In) Operating Activities	(2,199)	3,376
Cash Flows From Investing Activities		
Purchases of property and equipment	(563)	(795)
Acquisition of businesses, net of cash acquired	(294)	(1,129)
Acquisitions related contingent earnout/tax settlement	(606)	(165)
Net Cash Used In Investing Activities	(1,463)	(2,089)
Cash Flows From Financing Activities		
Net increase in line of credit	4,809	2,198
Repayment of debt	(1,146)	(2,723)
Net Cash Provided By Financing Activities	3,663	(525)
Effect of rate changes on cash	59	200
Net Increase in Cash	60	962
Beginning Cash	1,713	2,025
Ending Cash	\$1,773	\$2,987
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Income taxes	\$2,094	\$697

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Interest	\$713	\$780
Supplemental Schedule of Non Cash Investing and Financing Activities		
Indemnification receivable due from former shareholders settled by the amounts due to former shareholders	\$-	\$631
Note payable issued, acquisition of Capital Stock of Koan-IT	\$-	\$397

The accompanying notes are integral parts of these consolidated financial statements.

EMTEC, INC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included in the accompanying unaudited condensed consolidated financial statements. Quarterly results are not necessarily indicative of results for the full year. For further information, refer to the annual financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2009.

2. General

Description of Business

Emtec, Inc. a Delaware corporation (the "Company") established in 1964, is a systems integrator providing information technology ("IT") services and products to the federal, state, and local governments, and education and commercial markets. Emtec helps clients identify and prioritize areas for improvement and then implements process, technology and business application improvements that reduce costs, improve service and align the delivery of IT with the needs of their organizations. The Company's value-based management methods, coupled with IT technology, consulting and development services, allow us to address a wide range of specific client needs, as well as support broader IT transformation initiatives. The Company's client base is comprised of departments of federal, state and local governments in the United States and Canada, and schools and commercial businesses throughout the United States and Canada.

Principles of Consolidation

The consolidated financial statements for the three and nine months ended May 31, 2010 include the accounts of the Company and its wholly-owned subsidiaries, Emtec, Inc., a New Jersey Corporation ("Emtec NJ"), Emtec Viasub LLC ("Emtec LLC"), Emtec LLC's wholly-owned subsidiary Emtec Federal, Inc. ("Emtec Federal"), Emtec Global Services LLC ("EGS"), EGS' wholly-owned subsidiaries Luceo, Inc. ("Luceo"), eBusiness Application Solutions, Inc. ("eBAS"), Aveeva, Inc. ("Aveeva"), Emtec Services Mauritius ("Emtec Mauritius"), and Emtec Mauritius's subsidiary Emtec Software India Private Limited ("Emtec India"), formerly Aviance Software India Private Limited ("Aviance"), Emtec Infrastructure Services Corporation ("EIS-US"), and EIS-US's wholly-owned subsidiaries Emtec Infrastructure Services Canada Corporation ("EIS-Canada"), which is referred to in this report as KOAN-IT, and KOAN-IT (US) Corp. ("KOAN-IT (US)"). Significant intercompany account balances and transactions have been eliminated in consolidation.

On June 4, 2010, Emtec Federal acquired all of the outstanding stock of Secure Data, Inc. ("SDI"). SDI's accounts will be included in future consolidated financial statements of the Company.

Segment Reporting

The Company divides its operating activity into two operating segments for reporting purposes: Emtec Infrastructure Services Division (“EIS”) and Emtec Global Services Division (“EGS”). EIS consists of the Company’s historical business (“Systems Division”) which includes Emtec NJ, Emtec LLC, Emtec Federal and the business service management solutions offered by the Information Technology Service Management (“ITSM”) practice. EGS is the Company’s enterprise applications services solutions and training business including its Enterprise Resource Planning (“ERP”) and Application Development practice and its Business Analysis and Quality Assurance Practice.

Accounting 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 financial statements and the reported amounts of revenues and expenses during the reporting period, including, but not limited to, receivable and inventory valuations, impairment of goodwill and other long-lived assets and income taxes. Management’s estimates are based on historical experience, facts and circumstances available at the time and various other assumptions that are believed to be reasonable under the circumstances. The Company reviews these matters and reflects changes in estimates as appropriate. Actual results could differ materially from those estimates.

Goodwill

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired companies. The changes in the carrying amount of goodwill for the nine months ended May 31, 2010, by reportable segments are as follows (in thousands):

	EIS	EGS	Total
Balance at August 31, 2009	\$9,683	\$1,741	\$11,424
Foreign currency translation effect of Canadian goodwill	20	-	20
Increase in goodwill arising due to Luceo and Koan-IT acquisition related earnout payments	316	290	606
Goodwill acquired during the year	-	277	277
Balance at May 31, 2010	\$10,019	\$2,308	\$12,327

KOAN-IT Corp: The contingent payment of \$316,000 for the first year anniversary of closing to the former shareholders of KOAN-IT was accrued in the three months ended May 31, 2010, and paid in June 2010. This contingent payment is treated as additional purchase price and increased goodwill.

Luceo, Inc.: The contingent payment of \$290,000 for the second year anniversary of closing to Mr. Natarajan was accrued in the three months ended May 31, 2010, and paid in June 2010. This contingent payment is treated as additional purchase price and increased goodwill.

SARK Infotech Private Limited: On April 1, 2010, Emtec India acquired certain assets of SARK Infotech Private Limited (“SARK”), a software consulting company based in Mumbai, India. The Company recorded \$277,000 in goodwill during this quarter from this acquisition.

In accordance with Accounting Standard Codification (“ASC”) 350 “Intangibles- Goodwill and Other,” goodwill is not amortized but tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. Goodwill is tested for impairment at one level below an operating segment (also known as a component) in accordance with the guidance of FASB ASC Topic 350. These reporting units are comprised of Systems Division, KOAN-IT, Luceo and eBAS/Aveeva. The Company has set an annual impairment testing date of June 1.

An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount. The impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of the reporting unit and compares it to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit’s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with ASC 805 “Business Combinations.” The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

The following table presents a summary of the Company’s goodwill by reporting unit at May 31, 2010, as well as critical assumptions used in the valuation of the reporting units at June 1, 2009, the Company’s annual testing date:

		Goodwill						
Reporting Unit	\$'000	% of total	Discount Rate	Terminal Growth Rate	Years of Cash Flow before Terminal Value	% By Which Reporting Unit Fair Value Exceeds its Carrying Value*		
Systems Division	8,817	71.5%	15.6 %	4.0 %	10	68.8	%	
Luceo	1,961	15.9%	17.5 %	4.0 %	10	992.3	%	
eBAS/Aveeva	70	0.6%	17.1 %	4.0 %	10	887.7	%	
KOAN-IT	1,202	9.8%	17.5 %	4.0 %	10	4652.0	%	
SARK**	277	2.2%	n/a	n/a	n/a	n/a		
Total	12,327	100.0%						