EMTEC INC/NJ
Form 10-Q
July 15, 2011

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, 2011

Commission file number: 0-32789

EMTEC, INC.
(Exact name of registrant as specified in its charter)

Delaware	87-0273300
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11 Diamond Road
Springfield, New Jersey 07081
(Address of principal executive offices, including zip code)

(973) 376-4242
(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 x No o

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 o No o

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)

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

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

As of July 10, 2011, there were outstanding 16,507,313 shares of the registrant's common stock.

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED MAY 31, 2011

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	May 31, 2011 (Unaudited)	August 31, 2010
Assets		
Current Assets		
Cash	$ 2,883	$ 2,372
Receivables:		
Trade, less allowance for doubtful accounts	23,528	36,262
Other	994	2,019
Inventories, net	1,639	1,515
Prepaid expenses and other	5,010	2,977
Deferred tax asset - current	961	898
Total current assets	35,015	46,043
Property and equipment, net	4,284	2,211
Intangible assets, net	12,337	11,522
Goodwill	15,903	13,979
Deferred tax asset- long term	485	411
Other assets	205	106
Total assets	$ 68,229	$ 74,272
Liabilities, Put Options and Stockholders' Equity		
Current Liabilities		
Line of credit	$ 14,531	$ 16,023
Current portion of capital lease obligation	63	-
Accounts payable	17,535	24,666
Warrant liability	432	910
Income taxes payable	278	341
Accrued liabilities	7,798	8,027
Due to former stockholders	493	6
Customer deposits	108	202
Current portion earn-out liabilities	252	202
Deferred revenue	2,661	2,150
Total current liabilities	44,151	52,325
Deferred tax liability	3,873	3,063
Earn-out liabilities, net of current portion	1,554	474
Put option and restricted stock liability in connection with acquisition of Dinero	52	-
Capital lease obligation, net of current portion	343	-
Accrued liabilities	179	183
Total liabilities	50,152	56,247

Commitments and contingencies (Note 12)						
Put options in connection with SDI and Covelix acquisitions		1,114			738	
Stockholders' Equity						
Common stock $0.01 par value; 25,000,000 shares authorized; 19,471,902 and 18,984,520 shares issued and 16,607,313 and 16,119,931, outstanding at May 31, 2011 and August 31, 2010, respectively		194			190	
Additional paid-in capital		21,353			21,346	
Retained earnings		645			1,158	
Accumulated other comprehensive income		367			189	
		22,559			22,883	
Less: treasury stock, at cost, 2,864,589 shares		(5,596	)		(5,596	)
Total stockholders' equity		16,963			17,287	
Total liabilities, put options and stockholders' equity	$	68,229		$	74,272	

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

1

EMTEC, INC. AND SUBSIDIARIES
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,	
	2011	2010	2011	2010
Revenues				
Procurement services	$24,652	$39,536	$113,389	$122,193
Service and consulting	20,207	13,970	54,469	40,994
Total Revenues	44,859	53,506	167,858	163,187
Cost of Sales				
Cost of procurement services	21,980	35,140	101,742	109,348
Cost of service and consulting	15,072	10,285	40,013	29,310
Total Cost of Sales	37,052	45,425	141,755	138,658
Gross Profit				
Procurement services	2,672	4,396	11,647	12,845
Service and consulting	5,135	3,685	14,456	11,684
Total Gross Profit	7,807	8,081	26,103	24,529
Operating expenses:				
Selling, general, and administrative expenses	8,025	7,287	24,195	21,043
Stock-based compensation	144	118	437	392
Warrant liability adjustment	(49)	-	(478)	-
Depreciation and amortization	856	551	2,296	1,718
Total operating expenses	8,976	7,956	26,450	23,153
Operating income (loss)	(1,169)	125	(347)	1,376
Other expense (income):				
Interest income – other	(7)	(3)	(14)	(18)
Interest expense	184	124	521	428
Other	(2)	(4)	14	(12)
Income (loss) before income tax expense (benefit)	(1,344)	8	(868)	978
Income tax expense (benefit)	(532)	43	(355)	456
Net income (loss)	$(812)	$(35)	$(513)	$522

Net income (loss) per common share				
Basic and Diluted	$(0.05)	$-	$(0.03)	$0.03
Weighted Average Shares Outstanding				
Basic	15,824,147	15,071,515	15,701,185	15,071,515
Diluted	15,824,147	15,071,515	15,701,185	15,258,822

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

2

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

	For the Nine Months Ended May 31, 2011	2010
Cash Flows From Operating Activities		
Net income (loss)	$(513)	$522
Adjustments to Reconcile Net Income (loss) to Net Cash Provided By Operating Activities		
Depreciation and amortization	2,296	1,718
Deferred income tax benefit	68	(331)
Stock-based compensation	437	392
Warrant liability adjustment	(478)	-
Changes In Operating Assets and Liabilities		
Receivables	14,701	(2,562)
Inventories	(124)	196
Prepaid expenses and other assets	(1,808)	(631)
Accounts payable	(7,308)	(275)
Customer deposits	(93)	312
Income taxes payable	(274)	(548)
Accrued liabilities	(1,648)	(1,781)
Due to former stockholders	2	-
Deferred revenue	454	183
Net Cash Provided By (used in) Operating Activities	5,712	(2,805)
Cash Flows From Investing Activities		
Purchases of property and equipment	(2,293)	(563)
Acquisition of businesses, net of cash acquired	(1,463)	(294)
Net Cash Used In Investing Activities	(3,756)	(857)
Cash Flows From Financing Activities		
Net increase (decrease) in line of credit	(1,492)	4,809
Repayment of debt	-	(1,146)
Repayments under capital lease	(63)	-
Net Cash Provided By (Used in) Financing Activities	(1,555)	3,663
Effect of exchange rates on cash	109	59
Net Increase in Cash	511	60
Beginning Cash	2,372	1,713
Ending Cash	$2,883	$1,773
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		

Income taxes	$524	$2,094
Interest	$872	$713

Supplemental Disclosures of Non Cash Investing and Financing Activities

In January 2011, the Company entered into a capital lease for computer equipment and related hardware with a value of $468. See Note 10 for additional information.

In May 2011 and 2010, the Company increased goodwill by $380 and $606, respectively. These increases were related to earnout payments associated with the Luceo and KOAN-IT acquisitions. As of May 31, 2011 and 2010, these earnouts were not paid and were included in Accrued Liabilities of the Statements of Cash Flow.

In connection with the acquisition of Covelix, March 2011, the Company recorded a put option liability embedded in the stock issued as part of the purchase price consideration. As of May 31, 2011, this put option liability is included in Accrued Liabilities of the Statements of Cash Flow.

EMTEC, INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited 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 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, 2010.

2. General

Description of Business

Emtec, Inc., a Delaware corporation (the “Company”), is an information technology (“IT”) services provider delivering consulting, application services, and infrastructure services to public sector and commercial clients. The Company’s client base is comprised of departments of the United States and Canada’s federal, state/provincial and local governments, schools, and commercial businesses throughout the United States and Canada.

Principles of Consolidation

The consolidated financial statements in this report 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 LLC”), EGS LLC’s wholly-owned subsidiaries Luceo, Inc. (“Luceo”), eBusiness Application Solutions, Inc. (“eBAS”), Aveeva, Inc. (“Aveeva”), Emtec Services Mauritius (“Emtec Mauritius”), Emtec Mauritius’s subsidiary Emtec Software India Private Limited (“Emtec India”), formerly Aviance Software India Private Limited, Dinero Solutions, LLC (“Dinero”) (effective February 3, 2011), Covelix, Inc. (“Covelix”) and Covelix’s subsidiary Covelix Technologies Private Ltd. (“Covelix India”) (effective March 1, 2011), 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, KOAN-IT (US) Corp. (“KOAN-IT (US)”) and Secure Data, Inc. (“SDI”) a subsidiary of Emtec Federal. Significant intercompany account balances and transactions have been eliminated in consolidation.

On February 3, 2011, EGS LLC acquired all of the outstanding equity interests of Dinero. Dinero’s results of operations are included in the Company’s consolidated financial statements for the period February 3, 2011 through February 28, 2011.

On March 1, 2011, EGS LLC acquired all of the outstanding stock of Covelix. Covelix's results of operations are included in the Company's consolidated financial statements for the period March 1, 2011 through May 31, 2011.

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 includes Emtec NJ, Emtec LLC, Emtec Federal, the Federal application services business from SDI, the business service management solutions offered by the Information Technology Service Management ("ITSM") practice, Dinero, our Oracle Consulting Practice, effective February 3, 2011, and Covelix, our Offshore Development practice, effective March 1, 2011. Because of our continued cross-selling of applications services into our EIS client base, in 2010, we redefined the services offered by our EGS segment as training and staffing business for enterprise applications services. We may rename these segments in the future.

Reclassifications

Certain reclassifications have been made to prior year balances in order to conform to current presentations.

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, 2011 by reportable segments are as follows (in thousands):

		EIS		EGS		Total
Balance at August 31, 2010	$	11,685	$	2,294	$	13,979
Foreign currency translation effect of Canadian and Indian goodwill		75		12		87
Increase in goodwill arising from to Luceo and Koan-IT acquisitions related earnout payments		110		270		380
Increase in goodwill due to Dinero and Covelix acquisitions		1,458		-		1,458
Balance at May 31, 2011	$	13,328	$	2,575	$	15,903

In accordance with Accounting Standard Codification ("ASC") Topic 350 "Intangibles- Goodwill and Other," goodwill is not amortized but is 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 reporting unit) in accordance with the guidance of ASC Topic 350. These reporting units are comprised of Systems Division, KOAN-IT, Luceo, eBAS/Aveeva, SARK, SDI, Dinero (effective February 3, 2011) and Covelix (effective March 1, 2011.) 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 Topic 805 "Business Combinations." The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

At May 31, 2011, Emtec's market capitalization was less than its total stockholders' equity. However, the Company's stock does not trade frequently and thus management believes the inherent value of the Company is not and has not been accurately reflected by the current or historical stock market valuation of the Company. Accordingly, the Company continues to believe that the income and market-based approaches are the most appropriate valuation methods.

In accordance with ASC Topic 350, the Company performed its annual impairment testing as of June 1, 2010. Based on its annual impairment testing at June 1, 2010 and continued monitoring of market conditions and the operating performance of its reporting units, the Company does not currently believe that there is an indication of goodwill impairment at May 31, 2011. However, if current market conditions change and the Company's estimated value(s) under the income and/or market-based approaches is/are affected, then it is possible that the Company would have to take a goodwill impairment charge against earnings in a future period.

Identifiable Intangible Assets

At May 31, 2011 and August 31, 2010, the components of identifiable intangible assets are as follows (in thousands):

	May 31, 2011	August 31, 2010
Customer relationships	$ 17,158	$ 15,768
Noncompete agreements	938	449
Software technology	14	14
Trademarks	169	169
Trade names	623	203
Foreign currency translation adjustment	169	52
	19,071	16,655
Accumulated amortization	(6,718)	(5,128)
Foreign currency translation adjustment	(16)	(5)
Balance, ending	$ 12,337	$ 11,522

6

Customer relationships represent the fair value ascribed to customer relationships purchased in 2005, the acquisitions of Luceo and eBAS/Aveeva in fiscal 2008, the acquisition of KOAN-IT in fiscal 2009, the acquisition of SDI in fiscal 2010, the acquisition of Dinero in February 2011 and Covelix in March 2011. The amounts ascribed to customer relationships are being amortized on a straight-line basis over 5-15 years.

Noncompete agreements represent the value ascribed to covenants not to compete in employment and acquisition agreements with certain members of Luceo, eBAS/Aveeva, KOAN-IT, SDI, Dinero and Covelix's management entered into at the time of the respective acquisitions. The amounts ascribed to noncompete agreements are being amortized on a straight-line basis over 3-5 years.

Software technology represents the value ascribed to software developed by SARK that was acquired in fiscal 2010. The amount ascribed to software technology is being amortized on a straight-line basis over 3 years.

Trademarks represent the value ascribed to trademarks owned by KOAN-IT. The amount ascribed to trademarks is being amortized on a straight-line basis over 5 years.

Trade names represent the value ascribed to trade names owned by SDI, Dinero and Covelix. The amount ascribed to trade name is being amortized on a straight-line basis over 5 years.

Amortization expense related to intangible assets was $593,000 and $410,000 for the three months ended May 31, 2011 and 2010, respectively. For the nine months ended May 31, 2011 and 2010, amortization expense related to intangible assets was $1.6 million and $1.2 million, respectively. We currently expect future amortization of definite lived intangible assets to be as follows (in thousands):

Years ending August 31,	
2011	$2,138
2012	$2,344
2013	$2,296
2014	&