EMTEC INC/NJ
Form 10-Q
July 16, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended May 31, 2012

OR

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

For the transition period from……….to……………

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.)

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 x 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 No x

As of July 9, 2012, there were outstanding 17,616,437 shares of the registrant’s common stock.

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EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED MAY 31, 2012

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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, 2012 (Unaudited)	August 31, 2011
Assets		
Current Assets		
Cash	$1,982	$4,039
Receivables:		
Trade, net of allowance for doubtful accounts	27,944	31,196
Other	730	2,223
Inventories, net	1,249	1,339
Prepaid expenses and other	3,298	3,440
Deferred tax asset - current	1,244	1,142
Total current assets	36,447	43,379
Property and equipment, net	3,807	4,284
Intangible assets, net	15,504	18,406
Goodwill	18,470	18,609
Deferred tax asset- long term	916	839
Other assets	1,751	1,090
Total assets	$76,895	$86,607
Liabilities, Put Options and Stockholders' Equity		
Current Liabilities		
Line of credit	$13,709	$17,222
Current portion of capital lease obligation	81	245
Accounts payable	16,030	17,847
Income taxes payable	241	310
Accrued liabilities	9,592	12,095
Due to former stockholders of acquired companies	-	727
Customer deposits	-	34
Current portion earn-out liabilities	1,470	1,616
Deferred revenue	1,933	2,113
Total current liabilities	43,056	52,209
Deferred tax liability	2,555	3,752
Earn-out liabilities, net of current portion	3,228	3,148
Warrant liabilities	2,279	1,452
Put option and restricted stock liability in connection with acquisition of Dinero	196	98
Capital lease obligation, net of current portion	189	189
Subordinated debt, net of original issue discount	12,527	9,520

Accrued liabilities	169	163
Total liabilities	64,199	70,531
Commitments and contingencies (Note 13)		
Put options in connection with SDI, Covelix and Emerging acquisitions	2,166	2,166
Stockholders' Equity		
Common stock $0.01 par value; 30,000,000 shares authorized; 17,616,437 and 17,619,813 shares issued and outstanding at May 31, 2012 and August 31, 2011, respectively	176	177
Additional paid-in capital	16,824	16,589
Accumulated deficit	(6,303)	(3,093)
Accumulated other comprehensive income (loss)	(167)	237
Total stockholders' equity	10,530	13,910
Total liabilities, put options and stockholders' equity	$76,895	$86,607

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

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2012	2011	2012	2011
Revenues				
Procurement services	$23,926	$24,652	$92,898	$113,389
Consulting and outsourcing	26,773	20,207	77,556	54,469
Total Revenues	50,699	44,859	170,454	167,858
Cost of Revenues				
Cost of procurement services	20,775	21,980	81,083	101,742
Cost of consulting and outsourcing	20,864	15,072	60,884	40,013
Total Cost of Revenues	41,639	37,052	141,967	141,755
Gross Profit				
Procurement services	3,151	2,672	11,815	11,647
Consulting and outsourcing	5,909	5,135	16,672	14,456
Total Gross Profit	9,060	7,807	28,487	26,103
Operating expenses:				
Selling, general, and administrative expenses	7,793	8,025	25,035	24,195
Stock-based compensation	93	144	332	437
Warrant liability adjustment	304	(49)	755	(478)
Earnout liability adjustment	(22)	-	434	-
Depreciation and amortization	1,314	856	3,995	2,296
Total operating expenses	9,482	8,976	30,551	26,450
Operating loss	(422)	(1,169)	(2,064)	(347)
Other expense (income):				
Interest income – other	(10)	(7)	(88)	(14)
Interest expense	848	184	2,482	521
Other	(53)	(2)	(56)	14
Loss before income tax benefit	(1,207)	(1,344)	(4,402)	(868)
Income tax benefit	(281)	(532)	(1,192)	(355)
Net loss	$(926)	$(812)	$(3,210)	$(513)

Net loss per common share				
Basic and diluted	$(0.06)	$(0.05)	$(0.19)	$(0.03)
Weighted Average Shares Outstanding				
Basic and diluted	16,636,441	15,824,147	16,636,441	15,701,185

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

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In Thousands)

	Three Months Ended May 31, 2012	Three Months Ended May 31, 2011	Nine Months Ended May 31, 2012	Nine Months Ended May 31, 2011
Net income (loss)	$(926)	$(812)	$(3,210)	$(513)
Foreign currency translation adjustment, net of taxes	(218)	105	(404)	178
Total other comprehensive income (loss)	$(1,144)	$(707)	$(3,614)	$(335)

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

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

	Nine Months Ended May 31, 2012	Nine Months Ended May 31, 2011
Cash Flows From Operating Activities		
Net loss	$(3,210)	$(513)
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities		
Depreciation and amortization	3,995	2,296
Amortization of original issue discount associated with subordinated debt	79	-
Deferred income tax benefit	(1,375)	68
Stock-based compensation	332	437
Earnout liability adjustment	434	-
Warrant liability adjustment	755	(478)
Changes In Operating Assets and Liabilities		
Receivables	4,745	14,701
Inventories	90	(124)
Prepaid expenses and other assets	(519)	(1,808)
Accounts payable	(1,816)	(7,308)
Customer deposits	(35)	(93)
Income taxes payable	(69)	(274)
Accrued liabilities	(2,415)	(1,648)
Due to former stockholders of acquired companies	(727)	2
Deferred revenue	(180)	454
Net Cash Provided by Operating Activities	84	5,712
Cash Flows From Investing Activities		
Purchases of property and equipment	(692)	(2,293)
Acquisition of businesses, net of cash acquired	-	(1,463)
Acquisitions related contingent earnout	(500)	-
Net Cash Used In Investing Activities	(1,192)	(3,756)
Cash Flows From Financing Activities		
Net decrease in line of credit	(3,513)	(1,492)
Repayments under capital lease	(164)	(63)
Proceeds from issuance of long term subordinated debt and warrants	3,000	-
Net Cash Used In Financing Activities	(677)	(1,555)
Effect of exchange rates on cash	(272)	110
Net Increase (decrease) in Cash	(2,057)	511
Beginning Cash	4,039	2,372
Ending Cash	$1,982	$2,883
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		

Income taxes	$77	$524
Interest	$2,364	$872

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.

In May 2011 and 2010, the Company increased goodwill by $-0- and $380, respectively. This increase was related to earnout paymentsassociated with the Luceo acquisition. As of May 31, 2012 and 2011, this earnout was not paid and are included in Accrued Liabilities of the Statements of Cash Flow.

In connection with the acquisitons of Covelix, March 2011, the Company recorded a put option liability embeddedin the stock issued as part of the purchase price consideration. As of May 31, 2011, this put option liabilty is included Accrued Liabilities of the Statements of Cash Flow. See Note 4 for additional information.

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

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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, 2011.

2. General

Description of Business

Emtec, Inc., a Delaware corporation ("Emtec"), 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 and schools and commercial businesses throughout the United States and Canada.

Principles of Consolidation

The consolidated financial statements in this report include the accounts of Emtec 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"), Covelix, Inc. ("Covelix"), Covelix's subsidiary Covelix Technologies Private Ltd. ("Covelix India") and GNUCO, LLC d/b/a Emerging Solutions, LLC ("Emerging"), 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 (collectively, the "Company"). Significant intercompany account balances and transactions have been eliminated in consolidation.

Segment Reporting

The Company divides its operating activity into two operating segments for reporting purposes: Emtec Systems Integration ("ESI") and Emtec Global Sourcing ("EGS"). The Company changed the names of these segments in 2010, however historical numbers associated with these segments remain the same. Our ESI segment provides clients a wide variety of services including outsourced consulting application services and infrastructure consulting and outsourcing. Our EGS segment provides our clients the opportunity to take advantage of our consulting resources and offshore resources when they are not specifically looking for us to manage their project. We will continue to reassess our segment reporting structure in accordance with Accounting Standards Codification Topic 280 Segment Reporting.

Reclassifications

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

FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles

The Company identifies the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC" or "ASC") as the authoritative source of generally accepted accounting principles in the United States of America ("GAAP"). Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative GAAP for SEC registrants.

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 valuations, impairment of goodwill and other long-lived assets, income taxes and valuations of put instruments and earnout obligations relating to acquisitions. 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.

Fair Value of Financial Instruments

The fair value of cash and cash equivalents and trade receivables approximates their carrying values due to their short maturities. The fair value of non-current financial instrument assets and liabilities approximate their carrying value unless otherwise stated. The carrying value of the PNC Credit Facility approximated its fair value due to its variable interest rate. In addition, the carrying value of the subordinated debt approximates its fair value as the issuance dates, August 15, 2011 and December 30, 2011, are close in proximity to the May 31, 2012 date of the financial statements. Furthermore, there have been no changes to the credit markets or the Company's financial position since the issuance dates that would impact the fair value of the subordinated debt in any material respect.

In accordance with FASB ASC Topic 820 Fair Value Measurement, the estimated fair values of amounts reported in the consolidated financial statements have been determined using available market information and valuation methodologies, as applicable. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Entities are required to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value based upon the following fair value hierarchy:

Level 1 — Quoted prices in active markets for identical assets or liabilities;

Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table summarizes the financial liabilities measured at fair value on a recurring basis as of May 31, 2012 and August 31, 2011 (in thousands):

	Level	May 31, 2012	August 31, 2011
Warrant liability	2	$ 2,279	$ 1,452
Earn-out liabilities	3	$ 4,698	$ 4,764

The warrant liabilities were recorded at fair value based on upon valuation models that utilize relevant factors such as expected life, volatility of the Company's stock price, and the risk free interest rate.

The following table summarizes the changes in earnout liabilities for the nine months ended May 31, 2012 (in thousands):

	Earnout Liabilities
Balance at August 31, 2011	$ 4,764
Valuation adjustments	434
Payments	(500)
Balance at May 31, 2012	$ 4,698

The earnout liabilities were recorded at fair value based on valuation models that utilize relevant factors such as expected life and estimated probabilities of the acquired companies achieving the performance targets throughout the earnout periods. Unobservable inputs used in the valuation of the earnout liabilities included discount rates, ranging from 19% to 21%, and probabilities, ranging from 10% to 95%, associated with the achievement of the earnout targets in future years.

A significant increase (decrease) in the discount rate, in isolation, would result in a significantly lower (higher) fair value measurement, and a significant increase (decrease) in any of the probabilities, in isolation, would result in a significantly higher (lower) fair value measurement.

Financing Costs

Financing costs incurred are amortized over the life of the associated financing arrangements. Amortization expense totaled approximately $97,000 and $-0- for the three months ended May 31, 2012 and 2011, respectively. During the nine months ended May 31, 2012 and 2011, amortization expense totaled approximately $238,000 and $-0-, respectively.

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, 2012 by reportable segment are as follows (in thousands):