

EMTEC INC/NJ
Form 10-K
November 29, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended August 31, 2007**

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 of Incorporation or Organization)

87-0273300
(I.R.S. Employer Identification No.)

**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)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock \$0.01 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes NO

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a larger accelerated filer, an accelerated filer, or non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of February 28, 2007 was approximately \$3,397,004 computed by reference to the closing price of the common stock for that date.

As of November 5, 2007, there were outstanding 14,385,286 shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following document are incorporated by reference in the Part of this report indicated below:

Part III Registrant's Proxy Statement for the 2008 Annual Meeting of Stockholders.

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References in this Annual Report to we, us, or our are to Emtec, Inc. and its subsidiaries, unless the context specifies or requires otherwise.

Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Annual Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Annual Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, expects, plans, anticipates, believes, predicts, potential, or continue or the negative of those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks discussed in this Annual Report for the year ended August 31, 2007 and other reports or documents that we file from time to time with the SEC. Those factors may cause our actual results to differ materially from any of our forward-looking statements. All forward-looking statements attributable to us or a person acting on our behalf are expressly qualified in their entirety by this cautionary statement.

Assumptions relating to budgeting, marketing, and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our marketing, capital expenditure, or other budgets, which may in turn affect our business, financial position, results of operations, and cash flows.

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PART I

Item 1. Business

Introduction

Emtec, Inc. (the Company) is an information technology company, providing consulting, services and products to commercial, U.S. Federal Government, education, U.S. state and local clients. Our services and products address the technology needs of our clients including communications, data management, enterprise computing, managed services, storage and data center planning and development. Our solutions are crafted to enable our clients to become more efficient and effective, thereby making them more profitable and giving them a competitive advantage. To date, the most significant portion of our revenues has been derived from our activities as a reseller of IT products, such as workstations, servers, microcomputers, application software and networking and communications equipment. However, we are actively endeavoring to increase the portion of our revenues that are derived from IT services.

Our primary business objective is to become a leading single-source provider of high quality and innovative IT consulting, services and products. Through our strategic partners, we have an expanded array of products and technology solutions to offer our clients.

Over the past two decades, we have built strong relationships with leading manufacturers, such as Cisco, HP, LENOVO, Microsoft, Sun Microsystems, Dell, Samsung and Symantec, thereby enabling us to provide cutting-edge, scalable, reliable and secure solutions. This development along with our background in information technology, positions us as a single-source provider of information systems and network solutions.

Our clients are primarily large business organizations, federal, state and local governments, local school districts, and

other large and mid-sized companies located principally in the New York/New Jersey Metropolitan area and the Southeastern United States. We service our client base from leased facilities in New Jersey, New York, Virginia, Georgia, and Florida as well as five sales offices in the South and Western United States. We provide IT products to federal government civilian and military locations throughout the United States.

Our executive offices are located at 525 Lincoln Drive, 5 Greentree Center, Suite 117, Marlton, New Jersey; telephone: (856) 552-4204. Our website is *www.emtecinc.com*. We have made available free of charge through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after such material was electronically filed with, or furnished to, the SEC. The information on our website is not part of this Annual Report.

The Merger

On August 5, 2005, we completed our merger pursuant to the Agreement and Plan of Merger dated as of July 14, 2005 (the Merger Agreement), by and among Emtec, Inc., a Delaware corporation (Old Emtec), Emtec Viasub LLC, a Delaware limited liability company and a wholly-owned subsidiary of Old Emtec (MergerCo), and Darr Westwood Technology Corporation, a Delaware corporation (Darr). Prior to the Merger, Darr was a holding company formed in April 2004 in order to effectuate the purchase of all of the outstanding capital stock of Westwood Computer Corporation (Westwood). Darr's acquisition of Westwood's capital stock was completed on April 16, 2004 (the Westwood Acquisition). In March 2007, we changed Westwood's name to Emtec Federal, Inc. (Emtec Federal). Pursuant to the terms of the Merger Agreement, Darr merged with and into MergerCo (the Merger) and became a part of the consolidated entity that retained the name Emtec, Inc.

The Merger has been accounted for as a capital transaction followed by a recapitalization. Our management concluded that the transaction resulted in a change in control of the Company and that the Merger should be accounted for as a reverse acquisition. Accordingly, Darr was deemed to be the acquiring company for financial reporting purposes and its financial statements became our historical financial statements. In conjunction with the Merger, we changed our fiscal year end from March 31 to August 31.

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Upon completion of the Merger, all of the shares of Darr common stock issued and outstanding immediately prior to the Merger were exchanged for 9,528,110 shares of our common stock and the former Darr stockholders were issued warrants to purchase an additional 10% of our common stock calculated on a fully diluted basis for an aggregate exercise price of \$3,695,752, measured on a post-exercise basis.

Accounting Treatment

The issuance of our common stock in connection with the Merger gave the former Darr shareholders shares equal to approximately 55.7% of our total outstanding common stock post-merger and resulted in a change in control of the Company and determination that the transaction should be accounted for as a reverse merger, whereby Darr was considered the accounting acquirer of Old Emtec for financial reporting purposes. In what was regarded as a recapitalization, the historical stockholders' equity of Darr, the accounting acquirer, prior to the merger, was retroactively restated for the equivalent number of shares received in the merger after giving effect to any difference in the par value of Old Emtec's and Darr's stock with an offset to paid-in capital. Retained earnings of Darr are carried forward after the merger. Operations prior to the merger are those of Darr. Earnings per share for periods prior to the

merger were restated to reflect the equivalent number of shares. The consolidated financial statements and related footnotes for the year ended August 31, 2005 includes the amounts and transactions of Darr for the year ended August 31, 2005 and Old Emtec for the period from August 6, 2005 to August 31, 2005.

Industry Background

The broad market in which we compete is the provision of IT services and products. This marketplace consists of traditional IT services such as hardware and software procurement, life-cycle services, and network consulting, as well as internet services such as web enablement, remote network monitoring, help desk services, and information security.

As the market for IT products has matured over the past several years, price competition has intensified. That factor, combined with abbreviated product lifecycles, has forced IT product manufacturers to pursue lower cost manufacturing and distribution strategies. Resellers who were able to serve the needs of corporate end users requiring diverse brands of products and related IT services were initial beneficiaries of this heightened competition. More recently, however, continuing competition and manufacturers renewed efforts to improve their cost structures have led to both consolidations and business failures among resellers. Manufacturers have shifted from exclusive distribution partners to open sourcing and some have begun direct selling efforts with a view toward capturing market share from resellers.

At the same time that the market for IT products is consolidating, the market for IT services is expanding. Many companies have become increasingly dependent on the use of IT as a competitive tool in today's business environment. The need to distribute and access data on a real-time basis throughout an organization and between organizations has led to the rapid growth in network computing infrastructures that connect numerous and geographically dispersed end users through local and wide area networks. This growth has been driven by the emergence of industry standard hardware, software, and communications tools, as well as the significant improvement in the performance, capacity, and utility of such network-based equipment and applications.

The decision-making process that confronts companies when planning, selecting, and implementing IT infrastructure and services continues to grow more complex. Organizations are continually faced with technology obsolescence and must design new networks, upgrade, and migrate to new systems. As a result of the rapid changes in IT products and the risks associated with the commitment of large capital expenditures for products and services whose features and perceived benefits are not within the day-to-day expertise of operating management, many businesses increasingly are outsourcing some or all of their network management and support functions and are seeking the expertise of independent providers of IT products and services.

Regarding the federal government business, the U.S. federal government is one of the largest purchasers of IT products and services in the world and one of the largest users of outside contractors. The use of outside contractors is driven primarily by an effort to address specific skills needed by the federal government. There is a high demand requirement for certain service capabilities such as security, storage, networking and integration. Engagements support mission-specific goals rather than routine and deferrable office automation efforts.

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While the government will likely always support small and disadvantaged businesses, efforts toward shared data and IT functions across agencies should increase the need for vendors with scale as prime contractors. Federal IT spending growth is expected to outpace the growth of private sector spending.

Our Strategy

Our primary business objective is to become a leading single-source provider of high quality and innovative IT consulting, services and products. With the Merger, we believe we have created a strong, stable platform for growth and management depth. Through our strategic partners, we have an expanded array of products and technology solutions to offer our clients. We believe that by working with a single-source provider, organizations will be able to adapt more quickly to technological changes and reduce their overall IT costs. To this end, we are pursuing the following strategies:

Pursuing Strategic Acquisitions

We are seeking to expand our service offerings. We plan to enhance our base of technical and sales personnel, and to nurture and expand client relationships by means of acquisitions of companies whose businesses complement our businesses and, in particular, expand into the area of software consulting services. We intend to focus on companies with management teams who are willing to commit to long-term participation in our organization and who share our vision of continued growth.

Capitalizing on Existing Relationships

We have invested in training and committed resources to obtain company certifications from key industry manufacturers, and have entered into agreements with most of these manufacturers, such as Sun Microsystems, IBM, LENOVO, HP, Dell, CISCO, Microsoft, Novell and Citrix. These agreements grant us a nonexclusive right to purchase the manufacturer's hardware and license its software for our internal business use and for commercial integration and resale. Typically, our agreements with such manufacturers, such as those with Sun Microsystems, IBM, LENOVO, CISCO, Microsoft, Novell and Citrix, provide for a one-year term, renewable by the parties for successive one-year terms and are terminable by either party on prior written notice ranging from 30 to 45 days. They generally do not contain financial terms for resale of the manufacturer's products, which terms are separately governed by purchase orders.

Moreover, we believe that our history of satisfying the IT product requirements of our larger customers is facilitating the marketing of our broad range of services to this important segment of our clientele.

Our Business

IT Reseller

We are an authorized reseller of the products of many leading IT manufacturers, such as 3Com, CISCO, HP, Lenovo, IBM, Intel, Microsoft, NEC, Symantec, Novell, Dell, and Sun Microsystems. Such products include workstations, servers, networking and communications equipment, enterprise computing products, and application software. Our business depends in large part upon our ongoing access to well established aggregators, as well as directly with manufacturers to enable us to acquire IT products at competitive prices and on reasonable terms for resale to our customers. Typically, we have not entered into any long-term supply contacts with any of our suppliers, as we purchase computers, computer systems, components, and parts on a purchase order basis. In general, our agreements with any of our suppliers including manufacturers can be terminated by such companies at any time upon 30 to 45 days prior notice.

Through our vendor alliances, we provide our customers with competitive pricing and value-added services such as electronic product ordering, product configuration, testing, warehousing, and delivery. Our relationships with our suppliers allow us to minimize inventory risk by ordering products primarily on an as-needed basis. We believe that in

most cases our ability to acquire products on a cost-plus basis affords us the opportunity to avail ourselves of prices lower than those that could be obtained independently from manufacturers or other vendors. We utilize electronic ordering and pricing systems that provide real-time status checks on the aggregators' inventories and maintain electronic data interchange links to other suppliers. Our sales team is thereby able to schedule shipments more accurately and to provide electronically-generated client price lists.

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We receive manufacturer rebates resulting from certain equipment sales. In addition, we receive volume discounts and other incentives from various suppliers. Our accounting policy is to reduce cost of revenues for rebates, discounts, and other incentives received from these suppliers. Except for products in transit or products awaiting configuration at our facility, we generally do not maintain large inventory balances. Our primary vendors limit price protection to that provided by the manufacturer (generally less than 30 days) and they restrict product returns, other than defective returns, to a percentage (the percentage varies depending on the vendor and when the return is made) of products purchased. Those returns must occur during a defined period, at the lower of the invoiced price or the current price, subject to the specific manufacturer's requirements and restrictions.

Our IT reseller activities accounted for approximately for 87.4%, 87.6% and 89.9% of our total revenues for the twelve months ended August 31, 2007, 2006 and 2005, respectively.

IT Services

Enterprise Computing Solutions: We offer a full spectrum of IT product acquisition and support services needed to support client/server environments, including product sourcing, network design and implementation, technical support, server consolidation, virtualization, and clustering and load balancing for high availability.

Managed Services and Staff Augmentation Solutions: We manage and support customers' networks through the utilization of help desk and network monitoring services as well as through our own on-site engineering resources. This allows organizations to focus the majority of their efforts on their businesses' not on managing their IT infrastructures.

Data Communications Solutions: We offer Local Area Network / Wide Area Network and data wireless connectivity, voice over IP and structured cabling solutions that are designed to enhance communication capabilities, while decreasing costs.

Data Access Solutions: We enable on-demand access to information from anywhere over any network; our mobility, messaging, and management solutions provide secure data access, increased business productivity, and reduced IT costs for any organization.

Data Storage Solutions: We offer storage needs assessments, solution recommendations with hardware, software and implementation project requirements, implementation and integration services, post-sales training, maintenance and support services.

Data Center: We consult and design a Data Center plan that addresses facility needs. We organize servers and workstations with modular universal racking systems that take into consideration long-term needs for air flow, security, power distribution and cable management.

Lifecycle Management Services: Our lifecycle management services are designed to provide customers with continuous availability of service and support throughout the lifecycle of their IT investments, including the full spectrum of IT product acquisition and support services needed to support server environments. Our services include:

Evaluation and prioritization of business objectives to determine the best course of action for our customers;
Consultation with customers to identify the right IT products and services for their needs;
Leveraging our vendor relationships to quickly source the right combination of products;
Providing logistical support needed to deploy a major technology roll out; and
Providing continuous support to enable a client to improve end-user satisfaction, minimize downtime, and lower the total cost of ownership.

K-12 Specialized Services for Student and Faculty Needs: We integrate top-quality curriculum software and computer products into the classroom. We have significant experience in building local area networks that link many campuses together. We also provide district-wide support and sustain Internet access to educational resources worldwide. We tailor our array of services to make the best use of limited funds.

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Manufacturers Support Services Contracts: We offer manufacturer support service contracts that provide our clients with extended technical support, onsite hardware service and access to new software releases at a fixed price.

Our IT services activities accounted for approximately 12.6%, 12.4% and 10.1% of our total revenues for the twelve months ended August 31, 2007, 2006 and 2005, respectively.

Backlog

Since the majority of our sales are on a purchase order basis, we do not have a significant backlog of business. Accordingly, backlog is not material to our business or indicative of future sales.

Distribution

Through our vendor alliances, we provide our customers with competitive pricing and value-added services such as electronic product ordering, product configuration, testing, warehousing, and delivery. Our relationships with our suppliers allow us to minimize inventory risk by ordering products primarily on an as-needed basis. We believe that in most cases our ability to acquire products on a cost-plus basis affords us the opportunity to avail ourselves of prices lower than those that could be obtained independently from manufacturers or other vendors. We utilize electronic ordering and pricing systems that provide real-time status checks on the aggregators' inventories and maintain electronic data interchange links to other suppliers. Our sales team is thereby able to schedule shipments more accurately and to provide electronically-generated client price lists. Typically, our agreements with any of our suppliers including manufacturers can be terminated by such companies at any time upon 30 days prior notice.

Marketing

Our marketing efforts are focused on:

Broadening our public image as an IT service provider;
Promoting our offerings to current customers, prospects, partners, and investors;
Maintaining a constant flow of marketing communications to increase and maintain our market presence;

Driving prospects to our web site; and
Increasing overall inquiries and sales from all sources.

Our marketing division is charged with sales lead generation. Through diverse efforts that include seminars, tradeshow, direct mail, telemarketing, a bi-monthly newsletter, and through our website we create multiple and frequent touches of our prospective customers. The primary goal is to increase the number of face to face meeting opportunities between our account team and prospective clients, and to drive additional opportunities through our sales pipeline.

Customers

Our clients are primarily large business organizations, federal, state and local governments, local school districts, and other large and mid-sized companies located principally in the New York/New Jersey Metropolitan area and the Southeastern United States. The majority of our sales are drawn from various civilian and military U.S. governmental departments and agencies. We service our client base from leased facilities in New Jersey, New York, Virginia, Georgia, and Florida as well as five sales offices in the South and Western United States. We provide IT products to federal government civilian and military locations throughout the United States.

Our governmental agency customers include the Department of Defense, Department of Justice, Department of Homeland Security, Department of Health and Human Services, Department of Commerce and the GSA. Our state local government customers include various agencies in the State of New Jersey and other local government units. Education customers primarily include k-12 school districts in GA and FL.

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The government utilizes a variety of contracting methods, including negotiated bids, pre-negotiated blanket purchase agreement contracts and open-market procurements when purchasing from us. We participate in formal government bids for all contract types, and also processes orders received on existing contracts on an ongoing basis.

Substantially all of these bids are awarded on a best value to the government basis (which depending on the bid can be a combination of price, technical expertise, past performance on other government and commercial contracts and other factors). We seek to use partner contacts, purchasing power, distribution strength, value-added services and procurement expertise to compete successfully on these bids. These major procurements can generate millions of dollars in annual revenue, span multiple years and provide government personnel with an expedited method of purchasing from us.

We hold a GSA-designated Schedule 70 contract for the sale of IT products and services. Schedule 70 contracts are multi-award schedule contracts managed by the GSA IT Acquisition Center. The current contract is valid through December 31, 2007 with two five-year renewals. Additionally, we hold three Indefinite Delivery Indefinite Quantity (IDIQ) contracts that are valid for all federal government agencies. An Electronic Commodity Store III (ECS III) prime contract issued to us by the National Institute of Health provides various governmental agencies with an efficient cost-effective means for buying commercial products. The ECS III contract is valid through December 2011. An ADMC-2 prime contract issued to us by the Army Small Computer Program provides all military departments (and other authorized government agencies) the ability to purchase desktops, laptops, thin clients/server-based computing, ruggedized computers, peripheral devices and related accessories. The ADMC-2 contract is valid thru April 2016. A National Aeronautics and Space Administration Solutions for Enterprise-Wide Procurement IV (SEWP IV) prime contract issued to us by NASA provides all governmental agencies with the means to purchase a wide variety of IT products and related integration and installation services. Specifically for the SEWP IV contract, we are considered a Large Business, and the SEWP IV contract is valid through April 2014.

Our subsidiary, Emtec Federal, maintains a small-business designation with the federal government under its GSA Schedule, ECS III, ADMC-2 and all current BPAs held based upon our size status (headcount based) at the time of the contract's original award date. As a small business, Emtec Federal enjoys a number of benefits, including being able to compete for small business orders, qualifying as a small business subcontractor, bidding pursuant to small purchase procedures directed to non-manufacturer small business, and offering government agencies an avenue to meet their internal small business purchase goals.

It is expected that federal government business revenues will continue to represent a large portion of our total revenues as we continue to strive to penetrate wider and deeper into various civilian and military agencies. During the last three fiscal years ended on August 31, 2007, 2006 and 2005, U.S. governmental department and agency related sales accounted for approximately 52.3%, 52.6%, and 76.1% of our total revenues, respectively. The federal government business typically experiences increased activity during the months of August through November.

Government Contracts Potentially Subject to Termination

Our contracts with the U.S. Federal Government, U.S. state and local clients are generally subject to termination, in whole or part, at the convenience of the government parties or if funding becomes unavailable.

Competition

The IT services industry is highly competitive. Our competitors include established computer product manufacturers (some of which supply products to us), distributors, computer resellers, systems integrators, and other IT service providers. In addition, many computer product manufacturers also sell to customers through their direct sales organizations and certain of them have announced their intention to enhance such direct sales efforts.

Many of our current and potential competitors have longer operating histories and financial, sales, marketing, technical, and other resources substantially greater than we do. As a result, our competitors may be able to adapt more quickly to changes in client needs or to devote greater resources than we can to the sales of IT products and the provision of IT services. Such competitors could also attempt to increase their presence in our markets by forming strategic alliances with our other competitors or with our customers, offering new

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or improved products and services to our customers or increasing their efforts to gain and retain market share through competitive pricing. Although, we hold a GSA designated Schedule 70 contract, an ECS-III prime contract, an ADMC-2 prime contract, a SEWP IV prime contract, and have contracts with the State of New Jersey, State of New York, Gwinnett County School System, Duval County School System and Tiffany & Co., we typically have no ongoing written commitments from any customers to purchase products, and all product sales are made on a purchase-order basis.

We are also in direct competition with local, regional, and national distributors of microcomputer products and related services as well as with various IT consulting companies. These competitors run the gamut from consulting companies to the established consulting arms of nationwide accounting and auditing firms. Several of these competitors offer most of the same basic products as we do. We also encounter competition from microcomputer suppliers that sell their products through direct sales forces, rather than through resellers such as ourselves, and from manufacturers and distributors that emphasize mail order and telemarketing sales.

Depending on the customer, the principal areas of competition may include price, pre-sale and post-sale technical support and service, availability of inventory, and breadth of product line. We have an insignificant market share of sales in the microcomputer industry and of the service markets that we serve. Most of our competitors at the regional and national levels are substantially larger, have more personnel, have materially greater financial, technological and marketing resources, and operate within a larger geographic area than we do.

Employees

As of November 14, 2007, we employed 213 individuals, including 74 sales, marketing and related support personnel, 82 service and support employees, 35 operations and administration personnel, and 22 employees in accounting, finance, and human resources. We believe that our ability to recruit and retain highly skilled technical and other management personnel will be critical to our ability to execute our business model and growth strategy. We believe that our relations with our employees are good.

Available Information

The public may read and copy any materials filed by us with the SEC at the SEC's public reference room at 100 F Street, N.E., Washington D.C. 20549. The public may obtain information about the operation of the SEC's public reference rooms by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements and other information about issuers such as us that file electronically with the SEC.

In addition, we make available free of charge on our website at www.emtecinc.com our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) under the Exchange Act as soon as reasonably practical after we electronically file such material with, or furnish it to, the SEC.

Item 1A. Risk Factors

We cannot assure you that we can successfully increase the portion of our revenues derived from IT services. If we are unsuccessful our future results may be adversely affected.

Our transition from an emphasis on reselling IT products to an emphasis on providing IT services has placed significant demands on our managerial, administrative, and operational resources. Our ability to manage this transition effectively is dependent upon our ability to develop and improve operational, financial, and other internal systems, as well as our business development capabilities, and to attract, train, retain, motivate, and manage our employees. If we are unable to do so, our ability to effectively deliver and support our services may be adversely affected. Further, our transitional efforts to access higher-margin services and consulting revenues may result in reduced IT product sales. If we successfully expand our IT services offerings, periods of variability in utilization may continue to occur. In addition, we are likely to incur greater technical training costs during such periods. Historically, our IT reseller activities accounted for approximately 87.4%, 87.6% and 89.9% of our total revenues for the year ended August 31, 2007, 2006 and 2005, respectively. In contrast, our IT services activities accounted for approximately 12.6%, 12.4% and 10.1% of our total revenues for the year ended August 31, 2007, 2006 and 2005, respectively.

Our new services have not achieved widespread client acceptance. If they do not achieve market acceptance, our profit potential may be adversely affected.

We have limited experience in developing, marketing, or providing these services. We cannot assure you that we will be able to successfully market such services to either new or existing customers, that our services will achieve market acceptance, or that we will be able to effectively hire, integrate, and manage additional technical personnel to enable us to perform these services to our customers' expectations.

We may not be able to compete effectively in the highly competitive IT services industry.

The IT services business is highly competitive. Our competitors include established computer product manufacturers, some of which supply products to us, distributors, computer resellers, systems integrators and other IT service providers.

Many computer product manufacturers also sell to customers through their direct sales organizations and certain of them have announced their intentions to enhance such direct sales efforts. Many of our current and potential competitors have longer operating histories and financial, sales, marketing, technical, and other resources substantially greater than we do. As a result, our competitors may be able to adapt more quickly to changes in client needs or to devote greater resources than we can to the sales of IT products and the provision of IT services and we may not have the resources to compete effectively.

Our inability to maintain high personnel-utilization rates may adversely impact our profit potentiality.

The most significant cost relating to the services component of our business is personnel expense, which consists of salaries, benefits, and payroll related expenses. Thus, the financial performance of our service business is based primarily upon billing margins (billable hourly rates less the costs to us of service personnel on an hourly basis) and utilization rates (billable hours divided by paid hours). The future success of the services component of our business will depend in large part upon our ability to maintain high utilization rates at profitable billing margins. The competition for quality technical personnel has continued to intensify, resulting in increased personnel costs. This intense competition has caused our billing margins to be lower than they might otherwise have been. Our utilization rates for service personnel likely will also be adversely affected during periods of rapid and concentrated hiring.

Our revenues and expenses are unpredictable. A decrease in revenues or increase in expenses could materially adversely affect our operating results.

Our operating results have been, and will continue to be, impacted by changes in technical personnel billing and utilization rates. Moreover, we expect that downward pricing pressure will persist due to the continued commoditization of computer products. Further, there are numerous other factors, which are not within our control that can contribute to fluctuations in our operating results, including the following:

- patterns of capital spending by customers;
- the timing, size, and mix of product and service orders and deliveries;
- the timing and size of new projects, including projects for new customers; and
- changes in trends affecting outsourcing of IT services.

We also believe that, to a limited degree, our business is seasonal with a greater proportion of our product sales occurring in the first quarter of our fiscal year due to the capital budgeting and spending patterns of some of our larger customers. Operating results have been, and may in the future also be, affected by the cost, timing, and other effects of

Our new services have not achieved widespread client acceptance. If they do not achieve market acceptance, our p

acquisitions, including the mix of product and service revenues of acquired companies.

Since our inception, we have funded our operations primarily from borrowings under our credit facility.

Our credit facility contains financial covenants. As of August 31, 2007, we were not in compliance with our net income financial covenant with the Lender. On November 16, 2007, we received a waiver from the Lender with respect to our financial covenant compliance. We had an outstanding balance of \$5.85 million under the revolving portion of the Credit Facility, and \$2.63 million (included in our accounts payable) outstanding plus \$1.80 million in open approvals under the floor plan portion of the Credit Facility with Lender

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at August 31, 2007. Net availability of \$8.78 million was available under the revolving portion of the Credit Facility, and \$12.95 million was available under the floor plan portion of the Credit Facility as of August 31, 2007. However, there can be no assurance that we will be in compliance with all of our financial covenants in future and the Lender will not immediately call for repayment of the outstanding borrowings under the credit facility.

Reduction in or elimination of our credit facilities with our primary trade vendors could have a material adverse effect on our business and operations.

As of August 31, 2007, our open terms credit lines with our primary trade vendors, including aggregators and manufacturers was \$30.45 million. Under these credit lines, we are typically obligated to pay each invoice within 30-45 days from the date of such invoice. These credit lines could be reduced or eliminated without a notice, and this action could have a material adversely affect our business, result of operations, and financial condition.

Our revenues are derived from a few major customers, the loss of any of which could cause our results of operations to be adversely affected.

A large portion of our revenues is drawn from various civilian and military U.S. governmental departments and agencies. These customers include the Department of Defense, Department of Justice, Department of Homeland Security, Department of Health and Human Services, Department of Agriculture, Department of Commerce and the GSA. During the last three fiscal years ended on August 31, 2007, 2006 and 2005, U.S. governmental department and agency related sales accounted for approximately 52.3%, 52.6%, and 76.1% of our total revenues, respectively.

Any of the following additional risk factors could have a material negative impact on our business:

Seasonality of federal government related business makes future financial results less predictable; Due to our dependence on governments demand for IT products, a material decline in overall sales to the government as a whole, or to a certain key agency thereof, could have a material adverse effect on our results of operations. Several of the key factors in maintaining our relationships with the federal government agencies are:

Our performance on individual contracts and delivery orders

The strength of our professional reputation

The relationships of our key executives with customer personnel

Our compliance with complex procurement laws and regulations related to the formation, administration and performance of federal government contracts.

Our revenues and expenses are unpredictable. A decrease in revenues or increase in expenses could materially ad

Adverse changes in U.S. Federal Government fiscal spending could have a negative effect on our sales, gross margin, and cash flow.

Changes in U.S. Federal Government spending policies or budget priorities could directly affect our financial performance. Among the factors that could materially harm our business are:

a significant decline in spending by the U.S. Federal Government in general or by specific departments or agencies in particular;

changes in the structure, composition and/or buying patterns of the U.S. Federal Government;
the adoption of new laws or regulations changing procurement practices; or
delays in the payment of our invoices by government payment offices.

The U.S. Federal Government's overall information technology spending for the 2008 fiscal year was announced to be \$67 billion. This represents an increase of 3.1% over fiscal year 2007. The U.S. Federal Government's information technology spending for 2007 fiscal year were approximately \$65.46 billion, a reduction of approximately 3.0% down from fiscal year 2006. These or other factors could cause U.S. Federal Government agencies and departments to reduce their purchases under contracts, to exercise their right to terminate contracts, or not to exercise options to renew contracts, any of which would cause us to lose future revenue.

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Any issue that compromises our relationship with agencies of the U.S. Federal Government would cause serious harm to our business.

Our sales are highly dependent on the government's demand for IT products. We believe that U.S. Federal Government contracts will continue to be a source of the majority of our sales for the foreseeable future. For this reason, any issue that compromises our relationship with agencies of the U.S. Federal Government would cause serious harm to our business. A material decline in overall sales to the U.S. Federal Government as a whole, or to certain key agencies thereof, could have a materially adverse effect on our results of operations. Among the key factors in maintaining our relationships with U.S. Federal Government agencies are:

our performance on individual contracts and delivery orders;
the strength of our professional reputation;
the relationships of our key executives with customer personnel; and
our compliance with complex procurement laws and regulations related to the formation, administration and performance of U.S. Federal Government contracts.

To the extent that our performance does not meet customer expectations, or our reputation or relationships deteriorate, this would cause a negative effect on our sales, profitability and cash flow. Noncompliance with government procurement regulations or contract provisions could result in substantial monetary fines or damages, suspension or debarment from doing business with the U.S. Federal Government, and civil or criminal liability.

We may not qualify as a small business for new contract awards.

Emtec Federal maintains a small-business designation with the Federal Government under its GSA Schedule, ECS III, ADMC-2 and all current BPAs held based upon our size status (headcount based) at the time of the contract's original award date. As a small business, Emtec Federal enjoys a number of benefits, including being able to compete for small business orders, qualifying as a small business subcontractor, bidding pursuant to small purchase procedures directed to non-manufacturer small business, and offering government agencies an avenue to meet their internal small

business purchase goals.

A company's size status under a contract is based on the North American Industry Classification System (NAICS) Code referenced in the subject contract's solicitation. Depending on the NAICS Code referenced in a solicitation, Emtec Federal may or may not qualify as a small business for new contract awards. Additionally, Federal Acquisition Regulations, effective June 30, 2007, will require a small business contractor to recertify its size status prior to an extension of a contract with a term of longer than five years, and in other specific circumstances.

We are subject to regular review and audit by our government customers, government auditors and others, and these reviews can lead to the non-renewal or termination of existing contracts, legal actions, fines and liabilities and other remedies against us.

From time to time, we are subject to review and audit by governmental agencies relating to our governmental business as well as our taxes. Given the demands of working for governmental agencies, we expect that from time to time we will have disagreements or experience performance issues with the various government customers for which we work. If performance or other issues arise as a result of any investigative process, the government retains the right to pursue remedies, which could include fines or the threatened termination, termination or non-renewal under any affected contract. If any fines are levied or contract so terminated or not renewed, our ability to secure future contracts could be adversely affected. Further, the negative publicity that could arise from disagreements with the government could have an adverse effect on our reputation in the industry, reduce our ability to compete for new contracts, and may also have a material adverse effect on our business, financial condition, results of operations and cash flow.

If we are unable to generate sufficient revenues, we may have to further down size.

For fiscal years ended August 31, 2006 and 2007, revenues decreased from \$224.5 million to \$217.0 million. Gross margin decreased from \$25.1 million for fiscal year ended August 31, 2006 to \$23.2 million for fiscal year ended August 31, 2007. If we are unable to increase our revenues in future

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periods, then we may be forced to consolidate our operations to reduce operating expenses sufficiently to achieve profitable operations. There can be no assurances that we will be able to generate sufficient new business or that our cost containment measures in place will provide us the ability to attain profits in the future.

We may not generate profits in the future, and we had net loss in recent year.

For the year ended August 31, 2007, we incurred an operating loss of \$2.7 million, which included potential merger related costs of \$1.10 million and amended employment agreements and management agreement charges of \$2.33 million as operating expenses. Continuing net operating losses may limit our ability to service our debt and fund our operations and we may not generate net income from operations in the future. Factors contributing to our operating loss included, but were not limited to, lower gross profits due to a continuing IT spending slow-down in various governmental entities, lower manufacturer rebates and incentives, competitive pressure, aggressive pricing strategies, lower utilization of our technical engineers, potential acquisition related costs, and costs associated with our amendment or termination of certain employment and management agreements. These and other factors may adversely affect our ability to generate profits in the future.

We may not qualify as a small business for new contract awards.

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Continuous operating losses in future quarters could result in impairment of goodwill.

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired companies. Effective January 1, 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets and as a result, 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. We have 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.

Emtec has been designated as a single reporting unit for financial reporting purposes. We perform an impairment test based on a market approach that uses our market capitalization at that date as the fair value of the Company. Under this method, we compare the fair value of the reporting unit to its carrying value inclusive of goodwill. If the fair value exceeds the carrying value there is no impairment and no further analysis is necessary. If we continue to have operating losses, fail to attain have market acceptance, or market conditions in the stock market cause our market valuation to decline, we may incur charges for impairment of goodwill.

Our quarterly sales and cash flows are volatile, which makes our future financial results difficult to forecast.

Our sales, operating results and cash flows have been, and are expected to continue to be, subject to significant fluctuations from quarter to quarter due to a number of factors including:

- The seasonality of our business due to the U.S. Federal Government's buying and funding patterns;
- Fluctuations in our gross margins due to variations in the mix of products and services sold;
- The number, size and scope of orders from our customers;
- Availability of price protection, purchase discounts and rebate programs from vendors;
- Contractual terms and degree of completion of projects;
- Changes in our sales cycles as we move towards solution selling; and

Changes in accounting rules, such as recording expenses for employee stock option grants and tax accounting principles.

Our recent level of gross margins may not be sustainable. In addition, changes in services gross margin may result from various factors such as changes in the mix between technical support services and advanced services, as well as the timing of service contract initiations, renewals and utilization of service personnel. As a consequence, sales volumes and operating results for future periods are difficult to predict and, therefore, prior results are not necessarily indicative of results to be expected in future periods.

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We must maintain our status as an authorized reseller/service of IT products. The loss on any one of such authorizations could have a material adverse effect on our business and operations.

We are materially dependent on our continued status as an approved reseller of IT products and our continued authorization as an IT service provider. Without such authorizations, we would be unable to provide the range of products and services we currently offer, including warranty services, and manufacturers support services contracts. Our resale agreements with manufacturers generally are terminable by manufacturers upon 30 days prior written

notice. The loss of one or more of such authorizations could have a material adverse effect on our business and results of operations.

We have no long-term sales commitments from any of our suppliers. A loss of any of our principal suppliers would material adversely affect our IT reseller business.

Our IT reseller business depends on large part upon our access to aggregators and manufacturers, to supply us with products at competitive prices and on reasonable terms for resale by us to our customers. Certain agreements may be terminated by such companies upon 30 days prior written notice. We cannot assure you that we will be able to continue to obtain products from the aggregators and manufacturers at prices or on terms acceptable to us, if at all.

Our client engagements entail significant risks and a failure to meet a client's expectations could materially adversely affect our reputation and business.

Many of our engagements involve projects that are critical to the operations of our customers' businesses and provide benefits that may be difficult to quantify. Our failure or inability to meet a client's expectations in the performance of our services could result in a material adverse change to the client's operations and therefore could give rise to claims against us or damage our reputation, adversely affecting our business, results of operations, and financial condition.

Holders of our common stock may face a lack of liquidity.

Our common stock is currently traded on the Over-the-Counter Bulletin Board market. Given the fact that our common stock is thinly traded, there can be no assurance that the desirable characteristics of an active trading market for such securities will ever develop or be maintained. Therefore, each investor's ability to control the timing of the liquidation of the investment in our common stock will be restricted and an investor may be required to retain his investment in our common stock indefinitely.

The market price of our common stock has been and is likely to continue to be volatile, which may make it difficult for shareholders to resell common stock when they want to and at prices they find attractive.

Our share price has been volatile due, in part, to the general volatile securities market. Factors other than our operating results may affect our share price may include the level of perceived growth of the industries in which we participate, market expectations of our performance success of the partners, and the sale or purchase of large amounts of our common stock.

Compliance with changing regulations of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, and new SEC regulations, are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in higher costs necessitated by ongoing revisions to disclosure and governance practices. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased selling, general and administrative expense and a diversion of management's time and attention from revenue-generating activities to compliance activities. In particular, our efforts

We must maintain our status as an authorized reseller/service of IT products. The loss on any one of such authorizations

to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of internal control over financial reporting and our external auditors' audit of that assessment require the commitment of significant financial and managerial resources. Further, our Board members, Chief Executive Officer and Chief

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Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified Board members and executive officers, which could harm our business.

If we fail to maintain an effective system of internal controls over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers or obtain new customers.

We are in the process of evaluating our internal controls over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors on the effectiveness of our internal controls beginning with the fiscal years ending August 31, 2008 and 2009, respectively. In this regard, management will be required to dedicate internal resources to (i) assess and document the adequacy of internal controls over financial reporting, and (ii) take steps to improve control processes, where appropriate. If we fail to correct any issues in the design or operating effectiveness of internal control over financial reporting or fail to prevent fraud, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers and obtain new customers.

Pursuing strategic acquisitions may not be successful and could increase our selling, general and administrative expenses significantly.

We are seeking to expand our service offerings. We plan to enhance our base of technical and sales personnel, and to nurture and expand client relationships by means of acquisitions of companies whose businesses complement our businesses and, in particular, expand into the area of software consulting services. We intend to focus on companies with management teams who are willing to commit to long-term participation in our organization and who share our vision of continued growth. For the year ended August 31, 2007, our selling, general and administrative expenses included potential merger-related costs of \$1.10 million. \$678,116 of these costs were due to the termination of the Stock Purchase Agreement with Configuration Management, Inc., which included \$500,000 in advance payments made against the purchase price and \$178,116 in professional fees and other related expenses, and the remaining \$424,140 were associated with other potential merger-related due-diligence fees and fees charged by the potential lender.

If we make future acquisitions of companies, technology and other assets that involve numerous risks such as difficulty integrating acquired companies, technologies and assets or generating an acceptable return on our

Compliance with changing regulations of corporate governance and public disclosure may result in additional expenses

investment.

We may pursue opportunities to acquire companies, technologies and assets that would complement our current service offerings, expand the breadth of our markets, enhance our technical capabilities, or that may otherwise offer growth opportunities as we have done in the past. Acquisitions involve numerous risks, including the following:

difficulties in integrating the system with our current operations;
diversion of management's attention away from normal daily operations of our business;
difficulty in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
initial dependence on an unfamiliar system while training personnel in its use;
insufficient revenues to offset increased expenses associated with acquisitions; and
the potential loss of key employees of the acquired companies.

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Acquisitions may also cause us to:

issue common stock or preferred stock or assume stock option plans that would dilute current shareholder's percentage ownership;

use cash, which may result in a reduction of our liquidity;
assume liabilities;

record goodwill and other intangible assets that would be subject to impairment testing and potential periodic impairment charges;

incur amortization expenses related to certain intangible assets;
incur large and immediate write-offs; and
become subject to litigation.

Mergers and acquisitions of companies in our industry and related industries are inherently risky, and no assurance can be given that our acquisition strategy will be successful, that we will have the resources to pursue this strategy, and that such acquisitions will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could harm our business and operating results in a material way. Even when an acquired company has already developed and marketed products or services, there can be no assurance that product enhancements will be made in a timely fashion or that all pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products or services.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We lease space in six locations. Our corporate headquarters is currently located in Marlton, New Jersey. The following table contains certain information about each of our leased facilities:

Address	Size (In Square Feet)	Monthly Rent	Expiration Date
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If we make future acquisitions of companies, technology and other assets that involve numerous risks such as diffic

525 Lincoln Drive, 5 Greentree Center, Marlton, NJ 08053	2,920	\$ 3,913	November 30, 2009
500 Satellite Blvd. Suwanee, GA 30024	21,284	\$ 12,416	November 30, 2009
7843 Bayberry Road, Jacksonville, FL 32256	3,340	\$ 2,365	February 28, 2008
880 Third Avenue, 12 th floor New York, NY 10022	7,635	\$ 24,777	June 30, 2008 ⁽¹⁾
11 Diamond Road Springfield, NJ 07081	42,480	\$ 15,000	April 30, 2009
14121 Parke Long Court Suite 200 Chantilly, VA 20151	5,837	\$ 8,610	August 31, 2010
352 Seventh Avenue, 17 th floor New York, NY 10001	1,600	\$ 7,700	May 31, 2008

- (1) We assumed this lease on January 9, 2002 in connection with our acquisition of Devise Associates, Inc. We have sub-leased this office space though June 30, 2008 for an approximate monthly rental payment of \$15,700. We believe these facilities will satisfy our anticipated needs for the foreseeable future.

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Item 3. Legal Proceedings

In March 2002, Logical Business Solutions, Inc. (Logical), one of our competitors, instituted an action in the Circuit Court, Fourth Judicial Circuit, in Duval County, Florida, against us and Cheryl Pullen, one of our employees, alleging that we wrongfully interfered with its contractual relationship with one of its customers. On September 5, 2007, Logical, Cheryl Pullen and the Company executed a Mediated Settlement Agreement in the Circuit Court, Fourth Judicial Circuit, in Duval County, Florida whereby all parties agreed to a settlement in the amount of \$15,000 and a full release of future claims.

We are subject to legal proceedings that arise in the ordinary course of business, but we do not believe these claims will have a material adverse impact on our financial position or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

Executive Officers of the Registrant

The following table sets forth certain information as to each of our executive officers:

Name	Age	Positions and Offices Presently Held
Dinesh R. Desai	57	Chairman of the Board, Chief Executive Officer and President
Brian McAdams	65	Director and Vice Chairman
Keith Grabel	55	Director and President Sales and Marketing

Stephen C. Donnelly	49	Chief Financial Officer
John P. Howlett	63	Vice Chairman of Corporate Development
Ronald A. Seitz	60	President Emtec Operations
Frank Blaul	42	Executive Vice President Sales and Marketing
Sam Bhatt	40	Vice President of Finance and Secretary

Dinesh R. Desai. Since August 5, 2005, Mr. Desai has been Chairman of the Board, Chief Executive Officer and President of the Company. Prior to August 2005 and from 1986, Mr. Desai has been the Chairman and CEO of DARR Global Holdings, Inc., a management consulting firm. Since 2004, he has served as Chairman on the Board of Directors of two private corporations, Westwood Computer Corporation and DARR Westwood Technology Corporation. Mr. Desai was a President, CEO, Co-Chairman and an owner of a privately-held manufacturer, Western Sky Industries (Western Sky), of highly engineered, proprietary component parts used primarily in aerospace applications. Western Sky grew from approximately \$3 million in revenues to over \$170 million in revenues during the 1990 s prior to being sold to McKechnie in 1999. Prior to 1986, Mr. Desai spent twelve years with American Can and Arco Chemical in various management positions, including marketing, manufacturing, finance, planning and research and development. Mr. Desai has also served as a member of the Board of Directors of the Enterprise Center, a Nonprofit Organization. Mr. Desai holds a Bachelor of Science Degree in chemical engineering from the Indian Institute of Technology in Bombay, India, and a Masters of Science Degree in both chemical and industrial engineering from Montana State University. He earned a Masters in Business Administration from Temple University in 1978.

Brian McAdams. Since August 5, 2005, Mr. McAdams has been Director and Vice Chairman of the Company. Prior to August 2005 and from 2001, Mr. McAdams served as a Senior Partner with DARR Global Holdings, as the Vice Chairman of Westwood Computer Corporation, the CEO of Passport Express Services, Inc., and the CEO of My Help Desk, Inc. He has held prior positions as director at two public companies: Crusader Bank Corporation and National Media Corporation, where he served as both Chairman and CEO.

Keith Grabel. Since August 5, 2005, Mr. Grabel has been Director and President of Sales and Marketing of the Company. Prior to August 2005 and from 2000, Mr. Grabel has held the positions of president and director of Westwood Computer Corporation. He has also served as president and director of DARR Westwood Technology Corp. Mr. Grabel graduated from the University of Miami School of Business in 1974.

Stephen Donnelly. Since August 5, 2005 Mr. Donnelly has been the Chief Financial Officer of the Company. Prior to August 5, 2005 and since 2002, Mr. Donnelly has been the Chief Financial Officer of DARR Global Holdings, Inc. a management consulting firm. Since 2004, he has served as an officer for

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Westwood Computer Corporation. Between 1993 and 2002, Mr. Donnelly worked as a Manager and Managing Director for Acquisition Management Services, Inc., a merger and acquisition advisory firm. Prior to that, he has worked as a Director of Operations for a privately-held human resource and employee benefits software developer and as a Financial Manager for a healthcare organization. Mr. Donnelly began his career with the accounting firm of PriceWaterhouse. He is a Certified Public Accountant with a Bachelor s degree in Accounting from Villanova University (in 1980).

John P. Howlett. Since January 2006, John P. Howlett has been Vice Chairman of Corporate Development. Prior to January 2006, Mr. Howlett was President of Emtec Northeast Operations since August 5, 2005. Prior to August 5, 2005 he was our Chairman of the Board and Chief Executive Officer since January 17, 2001 and Chief Executive Officer of Emtec-NJ since August, 1997 and Chairman of Emtec-NJ since August, 1998. He has been a director of Emtec-NJ since October, 1996. Mr. Howlett was the founder (in 1983) of Cranford, New Jersey-based Comprehensive

Business Systems, Inc. (CBSI). CBSI primarily provided microcomputer systems, network integration, training, and data communications to mid-size and Fortune 1000 corporations. In October 1996, CBSI merged into Emtec-NJ. Prior to founding CBSI, Mr. Howlett was with the AT&T Long Lines Division for twelve years. He earned a Bachelor of Science degree in Electrical Engineering from Rose Hulman Institute of Technology in Terre Haute, Indiana, and a Master of Business Administration degree from Fairleigh Dickinson University in New Jersey. A Vietnam veteran, Mr. Howlett served in the U.S. Army for four years.

Ronald A. Seitz. Since March 2006, Ronald A. Seitz has been President of Emtec Operations. Prior to March 2006, Mr. Seitz was President of Emtec Southeast Operations since August 5, 2005. Prior to August 5, 2005 he was our President and Chief Operating Officer since February 2003 and Executive Vice-President and a director since January 17, 2001 and Executive Vice President of Emtec-NJ since March, 1996. Prior to that he was the Chief Operating Officer of Emtec-NJ. He has been a director of Emtec-NJ since April, 1995. Mr. Seitz was the founder (in 1980) of Charleston, South Carolina-based Computer Source, Inc. (CSI). CSI primarily provided microcomputer systems, network integration, and data communications to mid-size and Fortune 1000 corporations. In April 1995, CSI merged with Landress Information Systems of Mt. Laurel, New Jersey to become Emtec-NJ. Prior to founding CSI, Mr. Seitz was employed for six years as an engineer with the U.S. government in Washington, DC. He graduated from North Carolina State University with a Bachelor of Science degree and from George Washington University with an MBA in computer science. Mr. Seitz also holds a DMD degree from the Dental School at the Medical University of South Carolina.

Frank Blaul. Since July 15, 2007, Frank R. Blaul has been Executive Vice President of Sales and Marketing. Prior to joining Emtec, Mr. Blaul was Vice President of Global Government Sales and Marketing for the global centralized-computing-solutions provider Clear Cube technologies, headquartered in Austin Texas. From 1997 to 2006, Mr. Blaul held Senior Sales, Marketing, and Business Development Leadership with EDS, IBM, and ViON Corporation, an exclusive US Federal, state and local Marketing arm for Hitachi Data Systems (HDS). During this period Mr. Blaul was credited with Total Contract Awards in excess of \$1 billion, resulting in \$500 million in new revenue growth, while continually building and developing high performance teams. Mr. Blaul has held P&L responsibilities up to \$300 million. From 1991 – 1997, Mr. Blaul was the President and General Manager of a Mid-Atlantic regional office-products master distributor, a value-added reseller of microcomputer and network-integration solutions serving a broad range of Fortune 500, Government, and SMB customer segments. Prior to 1986, Mr. Blaul spent five years with Ruben H. Donnelley Corporation, receiving numerous top-sales-production awards during his tenure. Mr. Blaul continues to remain active with the Armed Forces Electronics Association (AFCEA), Industry Advisory Council (IAC), Potomac Officers Club, and The Northern Virginia Technology Council (NVTC). Mr. Blaul attended Frostburg State University, where he studied Business and Computer Science.

Sam Bhatt. Since August 5, 2005, Sam Bhatt has been Vice President of Finance and Secretary. Prior to August 5, 2005 he was our Vice President of Finance and Treasurer of Emtec since January 17, 2001 and of Emtec-NJ since July 2000. Prior to that and from July, 1997, he was Director of Accounting for Emtec-NJ. He also held the positions at Emtec-NJ of Accounting Manager (from 1994 to July, 1997) and of Senior Accountant (from 1992 to 1994). Mr. Bhatt holds a Bachelor of Science Degree in business administration from Drexel University in Pennsylvania and a Diploma in Hotel Management from the Institute of Hotel Management and Catering Technology in Mumbai, India.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is quoted on the Over-The-Counter Bulletin Board market under the symbol ETEC. The following table sets forth the high and low closing prices of our common stock for the periods indicated:

Three Months Ended	High	Low
August 31, 2007	\$ 1.01	\$ 0.70
May 31, 2007	\$ 1.09	\$ 0.79
February 28, 2007	\$ 1.59	\$ 0.95
November 30, 2006	\$ 1.27	\$ 1.00
August 31, 2006	\$ 1.75	\$ 1.00
May 31, 2006	\$ 1.85	\$ 1.11
February 28, 2006	\$ 2.17	\$ 1.58
November 30, 2005	\$ 2.48	\$ 1.60

The above quotations represent prices between dealers and do not include retail mark-ups, markdowns or commissions. They do not necessarily represent actual transactions.

As of November 14, 2007, there were 561 record holders of our common stock, although we believe that beneficial holders approximate 850.

We have not previously declared any dividends. It is not likely that dividends on the shares will be declared in the foreseeable future. Under our current loan agreement, we may not declare any dividends without the consent of our lenders. However, even if our lenders consented, the determination and payment of dividends with respect to the shares in the future will be within the discretion of our board of directors and will depend on our earnings, capital requirements and operating and financial condition, among other factors.

The following table sets forth the information regarding equity compensation plans, as of August 31, 2007.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders ⁽¹⁾	853,474	\$ 1.24	546,526

Equity compensation plans not approved by security holders

Total 853,474 \$ 1.24 546,526

(1) Our 2006 Stock-Based Incentive Compensation Plan (the 2006 Plan) was approved by our stockholders on May 8, 2006. The 2006 Plan authorizes the granting of stock options to directors and eligible employees. We have reserved 1,400,000 shares of our common stock for issuance under the 2006 Plan at prices not less than 100% of the fair value of our common stock on the date of grant (110% in the case of shareholders owning more than 10% of the our common stock). Options under the 2006 Plan may terminate after 10 years and may vest over a four year period.

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PERFORMANCE GRAPH

The following graph illustrates the cumulative total stockholder return (rounded to the nearest whole dollar) of our Common Stock during the period from March 31, 2003 through August 31, 2007 and compares it to the cumulative total return on (i) the Nasdaq Composite Index and (ii) the Peer Group Index (capitalization weighted). The comparison assumes a \$100 investment on March 31, 2003 in our Common Stock and in each of the foregoing indices and assumes reinvestment of dividends, if any. This table is not intended to forecast future performance of our Common Stock.

EMTEC, INC. RELATIVE MARKET PERFORMANCE TOTAL RETURN MARCH 31, 2003 AUGUST 31, 2007

	3/03	3/04	3/05	8/05	8/06	8/07
Emtec, Inc	100.00	450.00	453.33	800.00	333.33	243.33
NASDAQ Composite	100.00	151.71	152.98	164.20	170.21	202.18
Peer Group	100.00	251.73	236.48	236.02	216.03	272.21

(1) Graph assumes \$100 invested on March 31, 2003 in the Company's Common Stock, the Nasdaq Composite Index and the Peer Group Index (capitalization weighted).

(2) Cumulative total return assumes reinvestment of dividends, if any.

The Company has constructed a Peer Group Index consisting of computer systems integrators that also provide information technology services and products to their clients, including MTM Technologies, Inc., Pomeroy IT Solutions, Inc., TransNet Corporation, GTSI, Enpointe Technologies, Halifax and INSIGHT Enterprises. The Company believes that these companies most closely resemble the Company's business mix and that their performance is representative of the industry.

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Item 6. Selected Financial Data

The following selected consolidated financial data presented below should be read in conjunction with our consolidated financial statements including the accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations, both elsewhere in this Report. The data as of August 31, 2007 and 2006 and for each of the three years ended August 31, 2007, 2006 and 2005 have been derived from, and should be read in conjunction with, our audited consolidated financial statements and accompanying notes, which are contained elsewhere in this Report. The data as of August 31, 2004 and 2003 and for the periods from September 1, 2003 to April 16, 2004 (Darr Predecessor Period) and from April 17, 2004 to August 31, 2004 (Darr Successor Period) and for the year ended August 31, 2003 have been derived from our audited financial statements, which are not contained in this Report.

	Years Ended August 31,			(Successor	(Predecessor	2003
	2007	2006	2005	Period) 2004	Period) 2004	
Net revenues	\$216,980,138	\$224,511,942	\$162,632,042	\$41,641,604	\$88,229,719	\$97,449,611
Net Income (loss)	\$(2,279,987)	\$197,915	\$826,985	\$122,281	\$885,837	\$467,390
Net Income per common share (basic & diluted)	\$(0.16)	\$0.01	\$0.08	\$0.01	\$0.09	\$0.05

* Liquidation value of \$1,030,000

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Reference is made to the Risk Factors outlined in Item 1A for a discussion of important factors that could cause actual results to differ from expectations and any of our forward-looking statements contained herein. The following discussion as of August 31, 2007 and 2006 and the corresponding data for the years ended August 31, 2007, 2006 and 2005 have been derived from, and should be read in conjunction with, our audited consolidated financial statements and accompanying notes, which are contained elsewhere in this Report.

Overview

We are an information technology company, providing consulting, services and products to commercial, U.S. Federal Government, education, U.S. state and local clients. Our services and products address the technology needs of our clients including communications, data management, enterprise computing, managed services, storage and data center planning and development. Our solutions are crafted to enable our clients to become more efficient and effective, thereby making them more profitable and giving them a competitive advantage. To date, the most significant portion of our revenues has been derived from our activities as a reseller of IT products, such as workstations, servers, microcomputers, application software and networking and communications equipment. However, we are actively endeavoring to increase the portion of our revenues that are derived from IT services.

Our primary business objective is to become a leading single-source provider of high quality and innovative IT consulting, services and products. Through our strategic partners, we have an expanded array of products and technology solutions to offer our clients.

TABLE OF CONTENTS**Quarterly Financial Summary**

	Year Ended August 31, 2007				
	First	Second	Third	Fourth	Fiscal
	Quarter	Quarter	Quarter	Quarter	2007
Revenue	\$64,939,143	\$41,154,373	\$44,163,067	\$66,723,555	\$216,980,138
Gross Profit	6,058,647	4,351,968	4,669,424	8,074,149	23,154,188
Net Income (Loss)	\$33,051	\$(2,695,744)	\$(465,248)	\$847,954	\$(2,279,987)
Net Income (Loss) per share:					
Basic and Diluted	\$0.00	\$(0.19)	\$(0.03)	\$0.06	\$(0.16)

Our fourth quarter ended August 31, 2007 was the strongest quarter of the fiscal year with revenues of \$66.72 million and net income of \$847,954. This was primarily attributable to an overall increase in revenues, particularly in education business, and in various civilian and military U.S. governmental departments and agencies. The increase in the education business was attributable to our continued implementation of various computer roll-out projects which we began in May 2007. These roll-out projects will continue during the early portion of the first quarter of the current fiscal year.

Overview of Financial Statements Presented Herein

As previously noted, the Merger on August 5, 2005 with Darr was treated as an acquisition of Emtec by Darr and a recapitalization of Darr and the registrant. Darr is deemed to be the acquiring company for financial reporting purposes and Emtec's historical financial statements for periods prior to the Merger become those of Darr.

In evaluating our results of operations and financial performance, our management has used combined results for the fiscal year ended August 31, 2005 as a single measurement period. Due to the Merger, we believe that comparisons between the eleven months ended August 5, 2005 and either Darr's results for the period from September 1, 2004 to August 5, 2005 or Emtec's results for the period from August 6, 2005 through August 31, 2005 may impede the ability of users of our financial information to understand our operating and cash flow performance. Consequently, in order to enhance an analysis of our operating results and cash flows, we have presented our operating results and cash flows on a combined basis for the fiscal year ended August 31, 2005. This combined presentation for the fiscal year ended August 31, 2005 simply represents the mathematical addition of the pre-acquisition results of operations of Darr for the period from September 1, 2004 through August 5, 2005 and the results of operations of Emtec, following the Merger, for the period from August 6, 2005 through August 31, 2005. The consolidated financial statements for the years ended August 31, 2006 and 2007 include the accounts and transactions of the post-Merger combined company.

TABLE OF CONTENTS**Results of Operations**

Comparison of Years Ended August 31, 2007 and 2006

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of our Results of Operations for the fiscal years ended August 31, 2007 and 2006.

EMTEC, INC. CONSOLIDATED STATEMENTS OF OPERATIONS Years Ended August 31,

	2007		2006	Change	%	
Revenues	\$216,980,138		\$224,511,942	\$(7,531,804)	-3.4	%
Cost of revenues	193,825,950		199,382,350	(5,556,400)	-2.8	%
Gross profit	23,154,188		25,129,592	(1,975,404)	-7.9	%
Percent of revenues	10.7	%	11.2			%
Operating expenses:						
Selling, general, and administrative expenses	21,830,037		22,098,186	(268,149)	-1.2	%
Management fee related party	145,834		350,000	(204,166)	-58.3	%
Amended employment agreements and management agreement charges	2,329,800			2,329,800		N/A
Rent expense related party	357,300		355,731	1,569	0.4	%
Depreciation and amortization	1,171,815		945,685	226,130	23.9	%
Total operating expenses	25,834,786		23,749,602	2,085,184	8.8	%
Percent of revenues	11.9	%	10.6			%
Operating income (loss)	(2,680,598)		1,379,990	(4,060,588)	-294.2	%
Percent of revenues	-1.2	%	0.6			%
Other expense (income):						
Interest income other	(105,507)		(52,013)	(53,494)	102.8	%
Interest expense	1,079,209		1,064,703	14,506	1.4	%
Other	(462)		(38,619)	38,157		N/A
Income (loss) before income taxes (benefits)	(3,653,838)		405,919	(4,059,757)	-1000.1	%
Provision for income taxes (benefits)	(1,373,851)		208,004	(1,581,855)	-760.5	%
Net income (loss)	\$(2,279,987)		\$197,915	\$(2,477,902)	-1252.0	%
Percent of revenues	-1.1	%	0.1			%
Total Revenues						

Our revenues, by client types, are comprised of the following:

	For the Years Ended			August 31, 2006		
	August 31, 2007			August 31, 2006		
Departments of the United States Government	\$113,462,452	52.3	%	\$118,167,014	52.6	%
State and Local Governments	13,807,391	6.4	%	25,299,178	11.3	%
Commercial Companies	49,286,075	22.7	%	51,606,516	23.0	%
Education and other	40,424,220	18.6	%	29,439,234	13.1	%
Total Revenues	\$216,980,138	100.0	%	\$224,511,942	100.0	%

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Total revenues decreased \$7.53 million, or 3.4%, to \$216.98 million for the year ended August 31, 2007, compared to \$224.51 million for the year ended August 31, 2006. This decrease is mainly due to an overall decrease in our customers IT spending, particularly various governmental agencies in the State of New Jersey and in various civilian and military U.S. governmental departments and agencies.

During the year ended August 31, 2007 and 2006, U.S. governmental department and agency related revenues represented approximately 52.3% and 52.6% of total revenues, respectively. These clients include the Department of Defense, Department of Justice, Department of Homeland Security, Department of Health and Human Services, Department of Agriculture, Department of Commerce and the General Service Administration.

It is expected that federal government business revenues will continue to represent a large portion of our total revenues as we continue to strive to penetrate wider and deeper into various civilian and military agencies. We have broadened the number of multi-year contracts in which we are participating, and we are one of nine awardees of a U.S. Army contract that contemplates the awardees participating in government purchases, which may approximate \$5.0 billion over 10 years. Additionally, we were awarded a NASA SEWP IV contract, under which we will be able to participate in possible government purchases. We continue to bid on new contracts. As a result of our existing federal government contracts, as well as our ongoing focus on seeking new contracts, we believe that our total future revenues derived from the federal government business will be similar to prior periods although our business may be subject to federal government budgetary pressures and constraints. The federal business typically experiences increased activity during the months August through November.

The state and local government business remains uncertain as to the tight budgetary pressures continues with governmental agencies in the State of New Jersey.

The commercial sector is also expected to remain stable. There is a solid well-established client base to build upon as we expand product and service offerings to existing clients as well as develop new relationships in the sizable New Jersey/New York marketplace.

During the year ended August 31, 2007, our education business increased to approximately \$40.4 million from \$29.4 million for the year ended August 31, 2006. This increase was primarily attributable to various computer roll-out projects we began to implement in May 2007. These roll-out projects will continue during the early portion of the first quarter of the current fiscal year.

We have historically not been adversely affected by inflation; technological advances and competition within the IT industry have generally caused the prices of the products we sell to decline, and product life-cycles tend to be short. These factors require that our growth in unit sales exceed any declines in prices in order for us to increase our net sales.

Gross Profit

Aggregate gross profit decreased \$1.98 million, or 7.9%, to \$23.15 million for the year ended August 31, 2007 as compared to \$25.13 million for the year ended August 31, 2006. This decrease is mainly due to a decrease in revenue as discussed in the Total Revenues section.

Measured as a percentage of revenues, our gross profit margin decreased to 10.7% of total revenues for the year ended August 31, 2007 from 11.2% for the year ended August 31, 2006. This decrease is mainly due to competitive pressure, aggressive pricing strategies, a decline in state and local revenues, the mix of product and services sold, the mix of

client type and utilization of our technical engineers.

Factors that may affect gross profits in the future include changes in product margins, rebates and other incentives offered by various manufacturers, changes in technical employee utilization rates, the mix of products and services sold, the mix of client type and the decision to aggressively price certain products and services.

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Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by \$268,149, to \$21.83 million for the year ended August 31, 2007, compared to \$22.10 million for the year ended August 31, 2006. Selling, general and administrative expenses for the year ended August 31, 2007 include the following expenses:

Merger related costs of \$1.10 million. \$678,116 of these costs were due to the termination of the Stock Purchase Agreement with Configuration Management, Inc., which included \$500,000 in advance payments made against the purchase price and \$178,116 in professional fees and other related expenses and the remaining \$424,140 were associated with other potential merger related due diligence fees and fees charged by the potential lender; Stock compensation expense related to the issuance of stock options and nonvested stock was \$427,037 for the year ended August 31, 2007;

Approximately \$335,000 in costs for the marketing activities associated with the name change of our subsidiary to Emtec Federal, Inc. from Westwood Computer Corporation were incurred during this period;

Severance costs paid during the period of approximately \$242,000; and

Approximately \$125,000 in costs associated with office consolidation incurred during this period.

Excluding the above listed expenses, our selling, general and administrative expenses would have decreased by approximately \$2.50 million to \$19.60 million for the year ended August 31, 2007 as compared with \$22.10 million for the year ended August 31, 2006. This decrease in selling, general and administrative expenses is mainly due to the following:

Sales commission expense decreased by approximately \$428,000, which is directly related to the decrease in our gross profit resulting from lower revenues;

An overall decrease of approximately \$1.69 million in compensation and benefits expenses;

A decrease of approximately \$363,000 in professional fees due to reduced reliance on outside professionals and a full year with our current auditors;

Approximately \$387,000 of reduced costs resulting from decreases in a variety of areas including insurance, rent, utilities, building expense, travel, entertainment and others.

In addition, to improve operational efficiencies within the organization, we have made operational and management changes to our business, the impact of which we expect to see in future quarters. We will continue to emphasize operating efficiencies through cost containment strategies, re-engineering efforts and improved service delivery techniques, particularly within selling, marketing, general and administrative expenses.

Factors that may in the future have a negative impact on our selling, general and administrative costs include costs associated with marketing and selling activities, potential merger related costs, technological improvement costs, compliance costs associated with SEC rules and increases in our insurance costs.

Management Fee-Related Party

Management fees paid to a related party for the year ended August 31, 2007 compared to the year ended August 31, 2006 decreased by \$204,166. This decrease is due to the termination of the Management Services Agreement dated

February 5, 2007. Under the terms of the agreement, DARR Global Holdings, Inc. (DARR Global), a related party, charged the Company a monthly management fee of \$29,167.

Amended Employment Agreements and Management Agreement Charges

On February 5, 2007, in connection with the entry into amended and restated employment agreements with Keith Grabel and Mary Margaret Grabel, and in connection with the termination of the Management Services Agreement, Westwood issued subordinated promissory notes to Mr. Grabel, Mrs. Grabel and DARR Global in the principal amount of \$671,300, \$655,600, and \$1,002,900, respectively. The total principal

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amount of these notes equaling \$2,329,800 has been recorded as amended employment agreements and management agreement charges on the consolidated statements of operations for the year ended August 31, 2007.

Rent Expense-Related Party

We occupy approximately 42,000 square feet of office and warehouse space in Springfield, New Jersey. This space is leased from a limited liability company, owned by certain directors and officers and related family members of the Company. The lease term is through April 2009 with monthly base rent of \$15,000. During the year ended August 31, 2007 and 2006, we recorded \$180,000 in expense under this lease.

We also occupy approximately 21,000 square feet of office and warehouse space in a 70,000 square foot building in Suwanee, GA. This space is leased from a limited liability company, in which certain officers of our company are passive investors, owning approximately a 20% equity interest. The lease term is for 5 years with monthly base rent of \$12,500. During the year ended August 31, 2007 and 2006, we recorded \$177,300 and \$175,731 in expense under this lease, respectively.

Management believes the leases noted above are being leased at a rate consistent with the market rate.

Depreciation and Amortization

Depreciation and Amortization expense increased by 23.9%, or \$226,130, to \$1.17 million for the year ended August 31, 2007, compared to \$945,685 for the year ended August 31, 2006. This increase in depreciation expense is primarily attributable to \$583,945 of increased investment in property and equipment and higher depreciation rate for assets purchased in prior years. These capital assets acquisitions were primarily for computer equipment for internal use, the purchase of software licenses and integration related costs to upgrade our accounting systems.

Intangible assets at August 31, 2007 and August 31, 2006 consisted of the value ascribed to customer relationships of \$8,661,712 less accumulated amortization of \$1,228,936 and \$648,585, respectively. The assets ascribed to customer relationships are being amortized on a straight-line basis over 13 to 15 years. Amortization expense was \$580,351 and \$579,717 for the years ended August 31, 2007 and 2006, respectively.

Operating Income (loss)

Operating loss for the year ended August 31, 2007 was \$2.68 million, which included potential merger-related costs of \$1.10 million and amended employment agreements and management agreement charges of \$2.33 million. Without these potential merger-related costs and amended employment agreements and management agreement charges, our operating income would have been \$749,202 for the year ended August 31, 2007.

Interest Expense

Interest expense increased by 1.4%, or \$14,506, to \$1.08 million for the year ended August 31, 2007, compared to \$1.06 million for the year ended August 31, 2006. This is mainly due to a higher average balance on our line of credit and a higher interest rate due to an increasing prime rate, higher days sales outstanding during the period and interest charges associated with new promissory notes.

Provision for Income Taxes

We recorded an income tax benefit of \$1.37 million during the year ended August 31, 2007. This income tax benefit is primarily due to recording deferred tax assets associated with net operating loss carryforwards and amended employment agreements and management agreement charges associated with loss of \$3.65 million for the year ended August 31, 2007. We estimate that it is more likely than not that the deferred tax assets recorded as of August 31, 2007 will be realized in future periods, and accordingly no valuation allowance related to our deferred tax assets has been recorded.

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Comparison of Years Ended August 31, 2006 and 2005

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of our Results of Operations for the fiscal years ended August 31, 2006, and 2005. The consolidated financial statements include the accounts and transactions of the Company for the year ended August 31, 2006 and the results of operations for the year ended August 31, 2005 represents results of operations of Darr for the 2005 fiscal year plus the results of operations of Emtec for the period from August 6, 2005 to August 31, 2005.

EMTEC, INC. CONSOLIDATED STATEMENTS OF INCOME Years Ended August 31,

	2006	2005	Change	%
Revenues	\$224,511,942	\$162,632,042	\$61,879,900	38.0 %
Cost of revenues	199,382,350	148,587,442	50,794,908	34.2 %
Gross profit	25,129,592	14,044,600	11,084,992	78.9 %
Percent of revenues	11.2	%	8.6	%
Operating expenses:				
Selling, general, and administrative expenses	22,098,186	11,858,576	10,239,610	86.3 %
Management fee related party	350,000	350,000		0.0 %
Rent expense related party	355,731	194,190	161,541	83.2 %
Depreciation and amortization	945,685	174,944	770,741	440.6 %
Total operating expenses	23,749,602	12,577,710	11,171,892	88.8 %
Percent of revenues	10.6	%	7.7	%
Operating income	1,379,990	1,466,890	(86,900)	-5.9 %
Percent of revenues	0.6	%	0.9	%

Other expense (income):				
Interest income other	(52,013)	(120,520)	68,507	-56.8 %
Interest expense	1,064,703	611,479	453,224	74.1 %
Other	(38,619)	(303,604)	264,985	N/A
Income before income taxes	405,919	1,279,535	(873,616)	-68.3 %
Provision for income taxes	208,004	452,550	(244,546)	-54.0 %
Net income	\$197,915	\$826,985	\$(629,070)	-76.1 %
Percent of revenues	0.1 %	0.5 %		

Total Revenues

Revenues from various commercial, education, state and local clients have increased as a result of the Merger. Our revenues, by client types, are comprised of the following for the years ended:

	For the Years Ended					
	August 31, 2006			August 31, 2005		
Departments of the United States Government	\$ 118,167,014	52.6 %		\$ 123,823,906	76.1 %	
State and Local Governments	25,299,178	11.3 %		17,625,586	10.8 %	
Commercial Companies	51,606,516	23.0 %		12,338,163	7.6 %	
Education and other	29,439,234	13.1 %		8,844,387	5.4 %	
Total Revenues	\$ 224,511,942	100.0 %		\$ 162,632,042	100.0 %	

Total revenues increased by 38.0% or \$61.88 million to \$224.51 million for the year ended August 31, 2006, compared to \$162.63 million for the year ended August 31, 2005. This increase is primarily attributable to the addition of the revenue generated by Old Emtec to the business. Total additional incremental revenue

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attributed to Old Emtec approximated \$71.71 million for the year ended August 31, 2006. Without this incremental revenue that resulted from the acquisition, our total revenue would have decreased by 6.3% or \$9.83 million for the year ended August 31, 2006. This decrease is mainly due to a sale of IT products to the United States Department of Agriculture (USDA) of approximately \$21.79 million, which occurred during the three months ended May 31, 2005.

Without this USDA sale, our total revenue for the year ended August 31, 2006 would have increased by \$11.96 million. This increase is primarily attributable to an overall increase in the federal government business, excluding the impact of the USDA sale.

Gross Profit

Aggregate gross profit increased by 78.9% or \$11.08 million to \$25.13 million for the year ended August 31, 2006 as compared to \$14.04 million for the year ended August 31, 2005. This increase is primarily attributable to Old Emtec's gross profit of \$10.49 million for the year ended August 31, 2006, which represented approximately 94.6% of our total increase in gross profit. The remainder of the \$595,929 increase in our gross profit is attributable to favorable price drops and incentives offered by manufacturers as well as our continuous focus on selling higher margin products. Overall gross profit for the year ended August 31, 2006 includes a reduction in gross profit of approximately \$338,000 due to inventory damage that occurred to a large shipment during the quarter ended February 28, 2006.

Measured as a percentage of revenues, our gross profit margin increased to 11.2% of total revenues for the year ended August 31, 2006 from 8.6% for the year ended August 31, 2005. This increase is also mainly attributable to the Merger. Gross profit margin of the Old Emtec business equaled to 14.4% of Old Emtec total revenues for the year

ended August 31, 2006. Without this acquisition, our gross profit margin would have increased to 9.5% of total revenues for the year ended August 31, 2006 from 8.5% for the year ended August 31, 2005. This percentage increase is primarily attributable to greater selling efforts, favorable price drops and incentives offered by manufacturers. We cannot expect that price drops and incentives are going to repeat in the future.

Factors that may affect gross margins in the future include changes in product margins, rebates and other incentives offered by various manufacturers, changes in technical employee utilization rates, the mix of products and services sold, and the decision to aggressively price certain products and services.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by 86.3% or \$10.24 million to \$22.10 million for the year ended August 31, 2006, compared to \$11.86 million for the year ended August 31, 2005. This increase is mainly due to the Merger. Total additional incremental selling, general and administrative expenses associated with the Merger approximated \$8.87 million for the year ended August 31, 2006. Without this acquisition, our selling, general and administrative expenses would have increased by 12.5%, or \$1.37 million to \$12.39 million for the year ended August 31, 2006. This increase in selling, general and administrative expenses is mainly due to the following:

Professional fees increased approximately \$675,000 due to compliance costs associated with the SEC and in connection with the Merger; and

Compensation and benefits expense increased approximately \$900,000 due to a company wide increase in head count associated with our long-term investment in new employees as well as higher commission costs associated with higher gross profit.

We do not expect professional fees associated with the Merger to continue in future periods. In addition, to improve operational efficiencies within the organization, we have made several operational and management changes to our business. We expect to see the impact of these changes in future quarters and we will continue to emphasize operating efficiencies through cost containment strategies, re-engineering efforts and improved service delivery techniques, particularly within selling, marketing, general and administrative expenses.

Factors that may in the future have a negative impact on our selling, general and administrative costs include costs associated with marketing and selling activities, compliance costs associated with Securities and Exchange Commission rules and increases in our insurance costs.

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Management Fee-Related Party

There was no change in the management fee to a related party for the year ended August, 31, 2006 compared to the year ended August 31, 2005. DARR Global, a related party, charged the Company a management fee of \$350,000 annually.

Rent Expense-Related Party

Rent Expense-related party increased by 83.2% or \$161,541 to \$355,731 for the year ended August 31, 2006, compared to \$194,190 for the year ended August 31, 2005. The increase in rent expense-related party is due to the Merger and the assumption of the lease from a limited liability company, in which officers of our company are passive investors, owning approximately 20% equity interest. Under the term of the lease, we occupy approximately 21,000 square feet of office and warehouse space out of a total of approximately 70,000 square feet in Suwannee, GA. The lease term is for 5 years with monthly base rent of \$12,500. During the year ended August 31, 2006, we recorded

\$175,731 in expense under this lease.

We also occupy approximately 42,000 square feet of office and warehouse space in Springfield, New Jersey. This space is leased from a limited liability company, which is owned by certain directors and officers and related family members of the Company. The lease term is through April 2009 with monthly base rent of \$15,000. During the year ended August 31, 2006, we recorded \$180,000 in expense under this lease.

Depreciation and Amortization

Depreciation and amortization expense increased by 440.6% or \$770,741 to \$945,685 for the year ended August 31, 2006, compared to \$174,944 for the year ended August 31, 2005. This increase is primarily attributable to the Merger.

Depreciation and amortization expense associated with the Merger represented approximately for \$645,706 of increase. Additionally, we made fixed asset acquisitions of \$764,904 during the current fiscal year, which increased our depreciation expense. These capital assets acquisitions were primarily for the purchase of computer equipment for internal use, the purchase of software licenses to upgrade our accounting systems, leasehold improvements, and for furniture and fixtures.

Intangible assets at August 31, 2006 and 2005 consisted of the value ascribed to customer relationships of \$8,661,712 less accumulated amortization of \$648,585 and \$68,868, respectively. The assets ascribed to customer relationships are being amortized on a straight-line basis over 13-15 years. Amortization expense was \$579,717 and \$61,598 for each of the years ended August 31, 2006 and 2005, respectively.

Interest Expense

Interest expense increased by 74.1% or \$453,224 to \$1.06 million for the year ended August 31, 2006, compared to \$611,479 for the year ended August 31, 2005. This is mainly due to a higher balance on our line of credit and a higher interest rate due to an increasing prime rate, and higher days sales outstanding during the period.

Provision for Income Taxes

Income taxes decreased by 54.0% or \$244,546 to \$208,004 for the year ended August 31, 2006, compared to \$452,550 for the year ended August 31, 2005. Income tax expense of \$208,004 includes approximately \$73,000 in estimated income tax expense related to the IRS income tax audit for the prior years recorded during the three months ended February 28, 2006. Without this income tax expense related to the income tax audit, our income tax expense would have been approximately \$135,004. This decrease is primarily attributable to the 76.1% decrease in income before income taxes in the current year compared to the prior year. Effective tax rate for the year ended August 31, 2006, without the income tax expense related to the IRS income tax audit, is 33.3% compared with 35.4% for the year ended August 31, 2005. This is mainly due to a lower effective state income tax rate for current year.

Recently Issued Accounting Standards

Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or

expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. We adopted FIN No. 48 on September 1, 2007 and are assessing its potential impact on our financial position, results of operations and cash flows. As a result of this ongoing assessment, we believe that the adoption of FIN No. 48 may increase our tax liability by up to \$500,000. For additional information, see Footnote 16 of our Consolidated Financial Statements.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The standard is effective for the Company as of the beginning of its first fiscal year beginning after November 15, 2007, or September 1, 2008.

Fair Value Option for Financial Assets and Liabilities

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS No. 159 or Standard). SFAS No. 159 provides all entities with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply the complex provisions of hedge accounting. The Standard also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards. The standard is effective for the Company as of the beginning of its first fiscal year beginning after November 15, 2007, or September 1, 2008.

Liquidity and Capital Resources

Cash at August 31, 2007 of \$2.25 million represented an increase of \$1.33 million from \$917,683 at August 31, 2006. We are a net borrower; consequently, we believe our cash balance must be viewed along with the available balance on our line of credit. Borrowings under our line of credit at August 31, 2007 increased to \$5.85 million from \$881,459 at August 31, 2006. As of August 31, 2007, our net working capital was approximately \$2.58 million less than it was at August 31, 2006. The decrease in working capital is mainly due to the following:

Payment of \$272,332, which paid in full amounts due and owing to Joyce Tischler under a separation agreement dated April 16, 2004 during the year ended August 31, 2007;

On February 5, 2007, in connection with the entry into amended and restated employment agreements with Keith Grabel and Mary Margaret Grabel, and in connection with the termination of the Management Services Agreement, Westwood issued subordinated promissory notes to Mr. Grabel, Ms. Grabel and DARR Global in the principal amount of \$671,300, \$655,600, and \$1,002,900, respectively. The current portion of these long-term notes, totaling \$839,729, and total payments of \$469,007 on these notes decreased working capital;

Investment in Property and Equipment of \$583,945;

Operating losses incurred during the year ended August 31, 2007, which included potential merger-related costs of \$1.10 million. \$678,116 of these costs were due to the termination of the Stock Purchase Agreement with Configuration Management, Inc., which included \$500,000 in advance payments made against the purchase price and \$178,116 in professional fees and other related expenses, and the remaining \$424,140 were associated with other potential merger-related due-diligence fees and fees charged by the potential lender, as discussed in our Results of

Operations sections above.

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Additionally, during the year ended August 31, 2007, we made following payments:

\$533,281 to former stockholders of the Company, which paid in-full the amount due and owing under the 5% and 8% junior subordinated notes during the year ended August 31, 2007;

\$408,564, which included the interest payment of \$214,082 through March 2007, to DARR Westwood LLC under the subordinated note during the year ended August 31, 2007.

On December 7, 2006, the Company and its subsidiaries, Emtec NJ, Emtec LLC, and Emtec Federal, (collectively, the Borrower), entered into a Loan and Security Agreement with De Lage Landen Financial Services, Inc. (the Lender) pursuant to which the Lender has agreed to provide the Borrower a revolving credit loan and floor plan loan (the Credit Facility). The Credit Facility provides for aggregate borrowings of the lesser of \$32.0 million or 85% of Borrower s eligible accounts receivable, plus 100% of unsold inventory financed by the Lender, minus a \$5.0 million reserve. The floor plan loan portion of the Credit Facility is for the purchase of inventory from approved vendors and for other business purposes. The Credit Facility subjects the Borrower to mandatory repayments upon the occurrence of certain events as set forth in the Credit Facility.

Borrowings under the Credit Facility will bear interest at an annual rate equal to the rate of interest published in the Money Rates section of the Wall Street Journal minus 0.5% for revolving credit loans. Floor plan loans shall not bear interest until the Borrower is in default unless a floor plan loan is unsubsidized; then such floor plan loan will accrue interest once made at the rate agreed to by the parties. Interest on outstanding floor plan loans accrues per annum at the rate of 2.5% in excess of the interest rate published in the Money Rates section of the Wall Street Journal.

To secure the payment of the obligations under the Credit Facility, the Borrower granted to the Lender a security interest in all of Borrower s interests in certain of its assets, including inventory, equipment, fixtures, accounts, chattel paper, instruments, deposit accounts, documents, general intangibles, letters of credit rights, and all judgments, claims and insurance policies.

In addition, the Lender and Avnet, Inc., one of our trade creditors, entered into an intercreditor agreement in which the Lender agreed to give Avnet a first lien position on all future unbilled service maintenance billings and which provides that, as regards to Avnet, all debt obligations to the Lender are accorded priority.

Simultaneous with the execution of the Credit Facility, the Borrower terminated its Business Financing Agreement and Wholesale Financing Agreement with GE Commercial Distribution Finance Corporation and satisfied all outstanding obligations under those agreements.

As of August 31, 2007, we had an outstanding balance of \$5.85 million under the revolving portion of the Credit Facility and \$2.63 million outstanding (included in the Company s accounts payable) balances plus \$1.80 million in open approvals under the floor plan portion of the Credit Facility with Lender. Net availability of \$8.78 million was available under the revolving portion of the Credit Facility and \$12.95 million was available under was available under the floor plan portion of the Credit Facility as of August 31, 2007.

As of August 31, 2007, the Company determined that it was not in compliance with its net income financial covenant with the Lender. As of November 16, 2007, the Company received a waiver from the Lender with respect to its financial covenant compliance.

As of August 31, 2007, we had outstanding balances under our open term credit facilities with our primary trade vendors, including aggregators and manufacturers, of approximately \$30.0 million with outstanding principal of

approximately \$20.83 million. Under these lines, we are typically obligated to pay each invoice within 30-45 days from the date of such invoice. These credit lines could be reduced or eliminated without notice and this action could have a material adverse affect on our business, result of operations, and financial condition.

Capital expenditures of \$583,945 during the year ended August 31, 2007 related primarily to the purchase of computer equipment for internal use, the purchase of software licenses, integration related costs to upgrade our accounting systems, and leasehold improvement to our offices in New Jersey. We anticipate our capital

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expenditures for our fiscal year ending August 31, 2008 will be approximately \$600,000, of which approximately \$350,000 will be for the upgrade of our organizational computer system and the remaining \$250,000 will primarily be for the purchase of computer equipment for internal use and leasehold improvement.

The following are our long-term contractual obligations for leases, debt and other long-term liabilities as of August 31, 2007.

Contractual Obligations:	Payments Due by Period:				
	Total	Less Than 1 Year	1 3 Years	4 5 Years	More Than 5 Years
Long-Term Debt Obligations	\$ 4,026,174	\$ 1,280,660	\$ 2,617,602	\$ 127,912	\$
Operating Lease Obligations	1,425,556	821,225	604,073	258	
Total	\$ 5,451,730	\$ 2,101,885	\$ 3,221,675	\$ 128,170	\$

We anticipate that our primary sources of liquidity in fiscal year 2008 will be cash generated from operations, trade vendor credit and cash available to us under our Credit Facility. Our future financial performance will depend on our ability to continue to reduce and manage operating expenses as well as our ability to grow revenues. Any loss of clients, whether due to price competition or technological advances, will have an adverse affect on our revenues. Our future financial performance could be negatively affected by unforeseen factors and unplanned expenses. See Forward Looking Statements and Risk Factors .

We have no arrangements or other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources.

We believe that funds generated from operations, trade vendor credit and bank borrowings should be sufficient to meet our current operating cash requirements through the next twelve months. However, there can be no assurance that all of the aforementioned sources of cash can be realized.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The methods, estimates, and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The SEC has defined critical accounting policies as policies that involve critical accounting estimates that require (i) management to make assumptions that are highly uncertain at the time the estimate is made, and (ii) different estimates that could have been reasonably used for the current period, or changes in the estimates that are reasonably likely to occur from period to period, which would have a material impact on the presentation of our financial condition, changes in financial condition or in result of operations. Based on this definition, our most critical policies include: revenue recognition, allowance for doubtful

accounts, inventory valuation reserve, the assessment of recoverability of long-lived assets, the assessment of recoverability of goodwill and intangible assets, rebates, and income taxes.

Revenue Recognition

We recognize revenue from the sales of products when risk of loss and title passes which is upon client acceptance.

Revenue from the sale of warranties and support service contracts is recognized on a straight-line basis over the term of the contract, in accordance with Financial Accounting Standards Board Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* (FTB 90-1).

We may also enter into sales arrangements with clients that contain multiple elements. We recognize revenue from sale arrangements that contain both products and manufacturer warranties in accordance with Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, based on the relative fair value of the individual components. The relative fair value of individual components is based on historical sales of the components sold separately.

Product revenue represents sales of computer hardware and pre-packaged software. These arrangements often include software installations, configurations, and imaging, along with delivery and set-up of hardware.

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We follow the criteria contained in EITF 00-21 and Staff Accounting Bulletin 104 (SAB 104) in recognizing revenue associated with these transactions. We perform software installations, configurations and imaging services at our locations prior to the delivery of the product. Some client arrangements include set-up services performed at client locations where our personnel perform the routine tasks of removing the equipment from boxes, and setting up the equipment at client workstations by plugging in all necessary connections. This service is usually performed the same day as delivery. Revenue is recognized on the date of acceptance, except as follows:

In some instances, the set-up service is performed after date of delivery. We recognize revenue for the hardware component at date of delivery when the amount of revenue allocable to this component is not contingent upon the completion of set-up services and, therefore, our client has agreed that the transaction is complete as to the hardware component. In instances where our client does not accept delivery until set-up services are completed, we defer all revenue in the transaction until client acceptance occurs.

There are occasions when a client requests a transaction on a bill & hold basis. We follow the SAB 104 criteria and recognize revenue from these sales prior to date of physical delivery only when all the criteria of SAB 104 are met. We do not modify our normal billing and credit terms for these customers. The customer is invoiced at the date of revenue recognition when all of the criteria have been met.

We have experienced minimal customer returns. Since all eligible products must be returned to us within 30 days from the date of the invoice, we reduce the product revenue and cost of goods in each accounting period based on the actual returns that occurred in the next 30 days after the close of the accounting period.

Service and consulting revenue include time billings based upon billable hours charged to clients, fixed price short-term projects, hardware maintenance contracts, and manufacturer support service contracts. These contracts generally are task specific and do not involve multiple deliverables. Revenues from time billings are recognized as services are delivered. Revenues from short-term fixed price projects are recognized using the proportionate performance method by determining the level of service performed based upon the amount of labor cost incurred on the project versus the total labor costs to perform the project because this is the most readily reliable measure of

output. Revenues from hardware maintenance contracts are recognized ratably over the contract period.

Revenues from manufacturer support service contracts where the manufacturer is responsible for fulfilling the service requirements of the client are recognized immediately on their contract sale date. Manufacturer support service contracts contain cancellation privileges that allow our clients to terminate a contract with 90 days written notice. In this event, the client is entitled to a pro-rated refund based on the remaining term of the contract, and we would owe the manufacturer a pro-rated refund of the cost of the contract. However, we have experienced no client cancellations of any significance during our most recent 3-year history and do not expect cancellations of any significance in the future.

Trade Receivables

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our clients to make required payments. We base our estimates on the aging of our accounts receivable balances and our historical write-off experience, net of recoveries. If the financial condition of our clients were to deteriorate, additional allowances may be required. We believe the accounting estimate related to the allowance for doubtful accounts is a critical accounting estimate because changes in it can significantly affect net income.

Inventories

Inventory is stated at the lower of average cost or market. Inventory is entirely finished goods purchased for resale and consists of computer hardware, computer software, computer peripherals and related supplies. We provide an inventory reserve for products we determine are obsolete or where salability has deteriorated based on management's review of products and sales.

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Goodwill and Intangible Assets

We have adopted Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS 142). As a result, amortization of goodwill was discontinued. Goodwill is the excess of the purchase price over the fair value of the net assets acquired in a business combination accounted for under the purchase method. We test goodwill and indefinite-lived assets for impairment at least annually (on June 1) in accordance with SFAS 142.

Intangible assets at August 31, 2007 and 2006 consisted of the value ascribed to customer relationships. The assets ascribed to customer relationships are being amortized on a straight-line basis over 13 to 15 years. Intangible assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable in accordance with Statement of Financial Accounting Standards No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets. Recoverability of long-lived assets is assessed by a comparison of the carrying amount to the estimated undiscounted future net cash flows expected to result from the use of the assets and their eventual disposition. If estimated undiscounted future net cash flows are less than the carrying amount, the asset is considered impaired and a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the asset.

Rebates

Rebates are recorded in the accompanying consolidated statements of income as a reduction of the cost of revenues in

accordance with Emerging Issues Task Force Abstract No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor* (EITF 02-16).

Income Taxes

Income taxes are accounted for under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In estimating future tax consequences, we generally consider all expected future events other than the enactment of changes in tax laws or rates. A valuation allowance is recognized if, on weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Off-Balance Sheet Arrangements

Under SEC regulations, in certain circumstances, we are required to make certain disclosures regarding the following off-balance sheet arrangements, if material:

Any obligation under certain guarantee contracts;

Any retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;

Any obligation under certain derivative instruments; and

Any obligation arising out of a material variable interest held by us in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to us, or engages in leasing, hedging or research and development services with us.

We do not have any off-balance sheet arrangements that are required to be disclosed pursuant to these regulations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We do not engage in trading market risk sensitive instruments and do not purchase hedging instruments or other than trading instruments that are likely to expose us to market risk, whether interest rate, foreign currency exchange, commodity price or equity price risk. We have issued no debt instruments, entered into no forward or future contracts, purchased no options and entered into no swaps. Our primary market risk exposures are those of interest rate fluctuations. A change in interest rates would affect the rate at which we could borrow funds under our revolving credit facility. Our average balance on the line of credit during fiscal year August 31, 2007 was approximately \$5.5 million. Assuming no material increase or decrease in such balance, a one percent change in the interest rate would change our interest expense by approximately \$55,000 annually.

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Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Emtec, Inc.
Marlton, New Jersey

We have audited the consolidated balance sheets of Emtec, Inc. and Subsidiaries (the Company) and the related consolidated statements of operations, cash flows and stockholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Emtec, Inc. and Subsidiaries as of August 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in the Note 1 to the financial statements, effective September 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment.

/s/ McGladrey & Pullen, LLP

Blue Bell, Pennsylvania
November 28, 2007

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Emtec, Inc.

We have audited the accompanying consolidated statements of operations, stockholders' equity, and cash flows for the year ended August 31, 2005 of Emtec, Inc. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and

disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated results of the operations and cash flows of Emtec, Inc. for the year ended August 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
December 2, 2005

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**EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
August 31, 2007 and 2006**

	2007	2006
ASSETS		
Current Assets		
Cash	\$2,251,352	\$917,683
Receivables:		
Trade, less allowance for doubtful accounts	28,774,286	27,424,737
Others	2,756,815	2,478,004
Inventories, net	5,021,516	1,295,364
Prepaid expenses	331,062	681,831
Deferred tax asset - current	653,820	636,183
Total current assets	39,788,851	33,433,802
Property and equipment, net	1,308,582	1,316,089
Customer relationships, net	7,432,776	8,013,127
Goodwill	9,014,055	9,014,055
Restricted cash	150,000	150,000
Other assets	112,505	97,751
Total assets	\$57,806,769	\$52,024,824
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Line of credit	\$5,847,494	\$881,459
Accounts payable - trade	26,578,127	23,355,126
Accounts payable - related party		254,166
Current portion of long term debt - related party	1,280,660	719,356
Income taxes payable	9,255	85,732
Accrued liabilities	4,172,008	3,443,829
Due to former stockholders	631,415	631,415

Customer deposits	183,220	693,383
Deferred revenue	1,362,333	1,069,020
Total current liabilities	40,064,512	31,133,486
Accrued severance		272,332
Deferred tax liability	1,307,155	2,785,606
Long term debt related party	2,745,514	2,290,862
Total liabilities	44,117,181	36,482,286
Commitments and contingent liabilities (Note 16)		
Stockholders Equity		
Common stock \$0.01 par value; 25,000,000 shares authorized; 17,249,875 shares issued and 14,385,286 outstanding at August 31, 2007 and 2006	172,499	172,499
Additional paid-in capital	20,348,736	19,921,699
Retained earnings (accumulated deficit)	(1,235,600)	1,044,387
	19,285,635	21,138,585
Less: treasury stock, at cost, 2,864,589 shares	(5,596,047)	(5,596,047)
Total stockholders equity	13,689,588	15,542,538
Total liabilities and stockholders equity	\$57,806,769	\$52,024,824

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

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**EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended August 31, 2007, 2006 and 2005**

	2007	2006	2005
Revenues	\$216,980,138	\$224,511,942	\$162,632,042
Cost of revenues	193,825,950	199,382,350	148,587,442
Gross profit	23,154,188	25,129,592	14,044,600
Operating expenses:			
Selling, general, and administrative expenses	21,830,037	22,098,186	11,858,576
Management fee related party	145,834	350,000	350,000
Amended employment agreements and management agreement charges	2,329,800		
Rent expense related party	357,300	355,731	194,190
Depreciation and amortization	1,171,815	945,685	174,944
Total operating expenses	25,834,786	23,749,602	12,577,710
Operating income (loss)	(2,680,598)	1,379,990	1,466,890
Other expense (income):			
Interest income other	(105,507)	(52,013)	(120,520)
Interest expense	1,079,209	1,064,703	611,479
Other	(462)	(38,619)	(303,604)

Income (loss) before income taxes (benefit)	(3,653,838)	405,919	1,279,535
Provision for income taxes (benefit)	(1,373,851)	208,004	452,550
Net income (loss)	\$(2,279,987)	\$197,915	\$826,985
Preferred stock dividends			(72,794)
Net income (loss) available to common stockholders	\$(2,279,987)	\$197,915	\$754,191
Net income (loss) per common share			
Basic and Diluted	\$(0.16)	\$0.01	\$0.08
Weighted Average Shares Outstanding			
Basic	14,385,286	14,671,170	10,075,520
Diluted	14,385,286	14,672,838	10,108,803

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

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**EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended August 31, 2007, 2006 and 2005**

	2007	2006	2005
Cash Flows From Operating Activities			
Net income (loss)	\$(2,279,987)	\$197,915	\$826,985
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used In) Operating Activities			
Depreciation and amortization	1,171,815	945,685	196,755
Deferred income tax (benefit) expense	(1,496,087)	(85,342)	(147,382)
Stock-based compensation	427,037		
Put option valuation		(11,500)	(303,604)
Amended employment agreements and management agreement charges	2,329,800		
Changes In Operating Assets and Liabilities			
Receivables	(1,628,360)	8,024,523	(2,118,382)
Inventories	(3,726,152)	4,475,226	(3,090,989)
Prepaid expenses and other assets	336,014	(226,894)	(21,380)
Accounts payable	2,968,835	(6,262,102)	5,875,608
Customer deposits	(510,163)	(575,289)	(43,935)
Income taxes payable	(76,477)	(742,927)	148,501
Accrued liabilities	728,179	(735,399)	1,362,375
Deferred compensation	(272,332)	(108,024)	
Deferred revenue	293,313	(56,185)	(74,611)
Net Cash Provided By (Used In) Operating Activities	(1,734,565)	4,839,687	2,609,941
Cash Flows From Investing Activities			
Purchases of property and equipment	(583,957)	(764,904)	(491,310)
Acquisition of businesses, net of cash acquired		(39,445)	(678,875)

Net Cash Used In Investing Activities	(583,957)	(804,349)	(1,170,185)
Cash Flows From Financing Activities			
Net increase (decrease) in line of credit	4,966,035	(3,531,067)	4,054,524
Proceeds from issuance of common stock		13,098	16,671
Repayment of amount due to former stockholders			(33,152)
Decrease (increase) in restricted cash		5,500,000	(5,350,000)
Purchase of treasury stock		(5,596,047)	
Repayment of debt	(1,313,844)	(524,875)	(322,479)
Net Cash Provided By (Used In) Financing Activities	3,652,191	(4,138,891)	(1,634,436)
Net increase (decrease) in Cash	1,333,669	(103,554)	(194,680)
Beginning Cash	917,683	1,021,237	1,215,917
Ending Cash	\$2,251,352	\$917,683	\$1,021,237
Supplemental Disclosure of Cash Flow Information			
Cash paid during the period for:			
Income taxes	\$50,457	\$1,152,865	\$417,056
Interest	1,031,839	755,618	355,474

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

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EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS
EQUITY
Years Ended August 31, 2007, 2006 and 2005