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EMTEC INC/NJ
Form 10-Q
August 14, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For The Quarter Ended
June 30, 2002

Commission file number: 0-32789

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

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0273300
(I.R.S. Employer
Identification Number)

817 East Gate Drive
Mt. Laurel, New Jersey 08054
(Address of principal executive offices)

(856) 235-2121
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ [X]

No ☐ []

The number of shares of Common Stock outstanding as of August 10, 2002 was 7,080,498.

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2002

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

EMTEC, INC. CONSOLIDATED BALANCE SHEETS

	June 30, 2002 ----- (unaudited)	March 31, 2002 -----
Assets		
Current Assets		
Cash and cash equivalents	\$ 235,330	\$ 1,552,666
Receivables:		
Trade, less allowance		
for doubtful accounts	11,107,835	6,288,425
Others	635,906	296,529
Inventories, net of reserve	2,095,336	1,089,950
Deferred Tax Asset	26,491	26,491

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Prepaid expenses	399,692	388,307
	-----	-----
Total Current Assets	14,500,590	9,642,638
Net property and equipment	1,003,638	703,940
Investment in geothermal power unit	573,543	581,612
Deferred tax asset	42,936	42,936
Other assets	416,530	417,617
	-----	-----
Total Assets	\$16,537,237	\$11,388,473
	=====	=====

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

EMTEC, INC. CONSOLIDATED BALANCE SHEETS

	June 30, 2001	March 31, 2001
	-----	-----
	(unaudited)	
Liabilities and Shareholders' Equity		
Current Liabilities		
Line of credit	\$ 1,330,382	\$ -
Due to related party	19,000	19,000
Accounts payable	9,536,917	6,609,837
Customer deposits	-	245,387
Accrued liabilities	1,516,716	764,282
Deferred revenues	1,121,026	840,413
	-----	-----
Total Current Liabilities	13,524,041	8,478,919
Deferred revenue	788,860	799,472
Deferred tax liability	60,124	60,124
	-----	-----
Total Liabilities	14,373,025	9,338,515
	-----	-----

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Shareholders' Equity

Common stock, \$.01 par value; 25,000,000 shares authorized; 7,080,498 shares issued and outstanding	70,805	70,805
Additional paid-in capital	2,210,805	2,210,805
Accumulated deficit	(117,398)	(231,652)
	-----	-----
Total Shareholders' Equity	2,164,212	2,049,958
	-----	-----
Total Liabilities and Shareholders' Equity	\$16,537,237	\$11,388,473
	=====	=====

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

EMTEC, INC. CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Three Months Ended:	
	June 30, 2002	June 30, 2001
	-----	-----
Revenues:		
Procurement services	\$ 15,980,546	\$ 14,545,543
Service and consulting	8,328,479	4,958,242
Geothermal	45,349	44,342
	-----	-----
Total Revenues	24,354,374	19,548,127
	-----	-----
Cost of Revenues:		
Procurement services	14,061,661	12,847,215
Service and consulting	7,159,810	3,933,413
Geothermal	17,598	12,911
	-----	-----
Total Cost of Revenues	21,239,069	16,793,539
	-----	-----
Gross Profit:		
Procurement services	1,918,885	1,698,328

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Service and consulting	1,168,669	1,024,829
Geothermal	27,751	31,431
	-----	-----
Total Gross Profit	3,115,305	2,754,588
	-----	-----
Operating Expenses:		
Selling, general and administrative	2,973,917	2,154,416
Interest	27,136	92,258
E-Business costs	-	233,416
	-----	-----
Total Operating Expenses	3,001,050	2,480,090
	-----	-----
Income Before Income Tax Expense	114,255	274,498
Income tax expense	-	3,180
	-----	-----
Net Income	\$ 114,255	\$ 271,318
	=====	=====
Net Income Per Share {Basic And Diluted}	\$ 0.02	\$ 0.04
Weighted Average Number Of Shares Outstanding {Basic And Diluted}	7,080,498	7,080,498

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

EMTEC, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Three Months Ended:	
	June 30,	June 30,
	2002	2001
	-----	-----
Cash Flows From Operating Activities		
Net income for the three months	\$ 114,255	\$ 271,318

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Adjustments to Reconcile Net Income To Net

Cash Used In Operating Activities

Depreciation and amortization	132,085	116,822
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Changes In Operating Assets and Liabilities

Decrease in marketable securities	-	295,062
(Increase) Decrease in receivables	(5,158,788)	1,487,732
(Increase) Decrease in inventories	(1,005,386)	23,244
Increase in prepaid expenses	(11,385)	(56,853)
Decrease in deferred tax asset	-	3,180
Decrease in other assets	1,087	-
Increase (Decrease) in accounts payable	2,927,080	(2,351,641)
Decrease in customer deposits	(245,387)	(203,202)
Increase in accrued liabilities	752,434	23,461
Increase in deferred revenue	270,001	276,266
	-----	-----

Net Cash Used In Operating Activities	(2,224,004)	(114,611)
---------------------------------------	-------------	-----------

Cash Flows From Investing Activities

Purchases of equipment	(423,714)	(18,356)
------------------------	-----------	----------

Cash Flows From Financing Activities

Net increase (decrease) in line of credit	1,330,382	(1,807,483)
	-----	-----

Net Decrease in Cash and Cash Equivalents	(1,317,336)	(1,940,450)
---	-------------	-------------

Beginning Cash and Cash Equivalents	1,552,666	2,098,198
	-----	-----

Ending Cash and Cash Equivalents	\$ 235,000	\$ 157,748
	=====	=====

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

EMTEC, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS THREE MONTHS ENDED JUNE 30, 2002 AND 2001 (unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the

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information and note disclosures required by generally accepted accounting principles in the United States. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Quarterly results are not necessarily indicative of results for the full year. For further information, refer to the annual financial statements and notes thereto included in the Company's Form 10-K.

2. Net Income (Loss) per Share

Computations of net income (loss) per share have been made in accordance with Statement of Financial Accounting Standards No. 128 "Earnings Per Share" (SFAS No. 128). These per share computations use the weighted average number of shares outstanding during the period. SFAS No. 128 requires a separate presentation of diluted income per share from diluted net income per share for the potential dilutive effect of securities such as stock options.

3. Line of Credit

On November 21, 2001, the Company entered into a \$10.0 million revolving credit facility with Fleet Capital Corporation, formerly Summit Business Capital Corporation ("Fleet") under which the Company may borrow on 85% of its eligible trade receivables. Interest on outstanding loans under the revolving credit facility with Fleet is charged monthly at a fluctuating rate per annum equal to 0.25% above the prime rate and, at our option, interest on up to 50% of the outstanding loans may be charged at libor plus 2.75%. The Fleet revolving credit facility is collateralized by a lien upon and security interest in substantially all of the Company assets. Since current credit facilities with two of the Company's primary trade vendors, (GE Access, and Ingram Micro,) were also collateralized by substantially all of the Company's assets, Fleet, GE Access and Ingram Micro, have entered into intercreditor agreements, which provide that as regards to these vendors, debt obligations to Fleet are accorded priority. The lending agreement contains financial covenants that require the Company to maintain a maximum leverage ratio, a minimum debt ratio, a minimum tangible net worth ratio, and a minimum result of operations. As of June 30, 2002, the Company was in compliance with all of its financial covenants. The Company has two letters of credit totaling to \$1 million assigned as security deposits issued against their line of credit. At June 30, 2002, the Company had a \$1.33 million outstanding balance and an unused line of credit available of \$7.67 million under the credit facility.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by, the unaudited financial statements, including the notes thereto, appearing elsewhere in this quarterly report, 10-Q.

Management's Discussion and Analysis of Financial Condition and Results of

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Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management believes the following critical accounting policies affect the more significant judgment and estimates used in the preparation of the consolidated financial statements. On an on-going basis, management evaluates its estimates and judgments, including those related to the allowance for doubtful accounts, inventories, intangible assets, income taxes, and litigation. Management bases its estimates and judgments on historical experiences. These estimates form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions and conditions.

Critical Accounting Policies

o Revenue Recognition

The Company recognizes revenues based upon Staff Accounting Bulletin #101 (SAB 101). SAB 101 states that revenue recognition cannot occur until the earnings process is complete (evidenced), by an agreement between the company and the customer, there has been delivery and acceptance, collectibility is probable, and pricing is fixed and determinable. If significant obligations remain after delivery, revenue is deferred until such obligations are fulfilled. The Company had followed these principles of revenue recognition prior to the implementation of SAB 101. Therefore, SAB 101 has had no impact on revenue reporting. Procurement services represent sales of computer hardware and prepackaged software. Revenue from consulting and support service contracts are recognized ratably over the contract or service period. Revenues from manufacturer support service contracts where the manufacturer is responsible for fulfilling the service requirements of the customer are recognized immediately at their contract date.

o Trade Receivables

The Company provides an allowance for losses on trade receivables based on a review of the current status of existing receivables, its age, and management's evaluation of periodic aging of the accounts.

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o Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Cost is based on standard costs generated principally by the most recent purchase prices. The Company provides an inventory reserve for obsolescence and deterioration based on management's review of the current status of the excess inventory, its age, and net realizable value based upon assumptions about future demand and market condition.

o 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

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future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, the Company generally considers 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 the deferred tax assets will not be realized. At June 30, 2002, the Company has reported 90% valuation allowance.

Results of Operations

Three Months Ended June 30, 2002 Compared to Three Months Ended June 30, 2001.

Total Revenues

Total revenues for the IT business which includes procurement services, and service and consulting, increased by 24.64% or \$4.80 million, to \$24.31 million for the three months ended June 30, 2002, compared to \$19.50 million for the three months ended June 30, 2001. Services and consulting revenue increased by 67.97%, or \$3.37 million, to \$8.33 million for the three months ended June 30, 2002 compared to \$4.96 million for the three months ended June 30, 2001. This increase is mainly attributable to an increase in our manufacturers support services contracts revenues. Manufacturers support services contracts revenue increased by 149.77%, or \$3.42 million, to \$5.71 million for the three months ended June 30, 2002 compared to \$2.29 million for the three months ended June 30, 2001. This increase in manufacturers support services contracts revenue is mainly attributable to a \$3.8 million sale to one customer. Procurement revenues also increased by 9.87%, or \$1.43 million, to \$15.98 million for the three months ended June 30, 2002. This increase in product procurement revenue is mainly attributable to our winning new business with a school district in Jacksonville, Florida. Procurement revenue associated with this business equaled almost \$2.0 million for three months ended June 30, 2002.

Geothermal Revenues of \$45,349 for the three months ended June 30, 2002 are consistent with the revenues for comparable previous periods.

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Gross Profit

Our aggregate gross profit for IT business increased by 13.38%, or \$364,397, to \$3.09 million for the three months ended June 30, 2002. This increase is mainly attributable to a 24.64% increase in our IT revenues. Measured as a percentage of out total revenues for IT business, our overall gross profit margin decreased to 12.70% of total revenues for the three months ended June 30, 2002 from 13.93% for the three months ended June 30, 2001. This decrease is mainly due to lower gross profit margin from our services and consulting revenues.

Gross profit for product sales increased by 12.99%, or \$220,557, to \$1.92 million for the three months ended June 30, 2002 as compared with \$1.70 million for the three months ended June 30, 2001. This increase is mainly attributable to a 9.87% increase in product revenue. Measured as a percentage of procurement revenues, our gross profit margin attributable to procurement revenues increased to 12.01% for the three months ended June 30, 2002 from 11.68% for the three

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months ended June 30, 2001. This increase is mainly attributable to better sales activities during this period and our ability to obtain better pricing from our distributors in some cases.

Gross profit for service and consulting increased by 14.04%, or \$143,840, to \$1.17 million for the three months ended June 30, 2002 as compared with \$1.02 million for the three months ended June 30, 2001. This increase is attributable to an increase in the gross margin of manufacturers support services contracts revenues. Manufacturers support services contracts gross margin increased by 118.85%, or \$516,560, to \$951,186 for the three months ended June 30, 2002 as compared with \$434,626 for the three months ended June 30, 2001. This increase in manufacturers support service contracts gross margin is mainly attributable to gross margin of approximately \$580,000 associated with a \$3.8 million sale to one customer. Also, measured as a percentage of our gross margin attributable to services and consulting revenue decreased to 14.03% of services and consulting revenue for the three months ended June 30, 2002 from 20.67% for the three months ended June 30, 2001. This decrease is due to lower utilization rates of engineers during this quarter.

The geothermal gross profit of \$27,751 for the three months ended June 30, 2002 is consistent with the gross profit for comparable previous periods.

Sales, General, and Administrative Expenses

Sales, general, and administrative expenses increased by 38.03%, or \$819,501, to \$2.97 million for the three months ended June 30, 2002 as compared with \$2.15 million for the three months ended June 30, 2001. This increase is primarily a result of the following: 1) \$450,000 increase in sales department expenses due to additional sales personnel salaries, commissions, recruiting, travel, telephone, and other related expenses, 2) \$100,000 increase is due to marketing related expenses, 3) \$150,000 increase is due to the addition of New York City and Jacksonville locations and related expenses, including rent, insurance, depreciation, building maintenance and others, and 4) \$60,000 increase is due to a change in the allowance for bad-debt account.

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Interest expense

Interest expense for the three months ended June 30, 2002 decreased by 70.59%, or \$65,122, to \$27,136 the three months ended June 30, 2002 as compared with \$92,258 for the three months ended June 30, 2001. This decrease is mainly attributable to lower interest rates, lower balance on line of credit, and improved accounts receivable collection performance.

e-Business Costs

e-Business costs for the three months ended June 30, 2002 was \$0, as compared with \$233,416 for the three months ended June 30, 2001. As of January 2002 we have discontinued our e-Business division which was started in January 2000. This cost mainly included the building of a sales and consulting team of approximately 8 employees, including training, certifying, marketing, and advertising expenses.

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Income Taxes

Income tax expense for the three months ended June 30, 2002 was \$0, as compared with \$3,180 for the three months ended June 30, 2001.

Recently Issued Accounting Standards

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements." This SAB summarizes certain of the SEC staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. Adoption of SAB No. 101 did not have a material effect on the Company's results of operations.

In July 2001, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 141, "Business Combinations," which supersedes Accounting Principles Board (APB) Opinion No. 16. SFAS No. 141 requires all business combinations initiated after June 30, 2001 be accounted for under the purchase method. In addition, SFAS No. 141 establishes criteria for the recognition of intangible assets separately from goodwill. The Company does not expect that the adoption of SFAS No. 141 will have a material effect on the Company's results of operations, financial position or cash flow.

Also in July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which supersedes APB Opinion No. 17. Under SFAS No. 142 goodwill and indefinite lived intangible assets will no longer be amortized, but rather will be tested for impairment at least annually. In addition, the amortization period of intangible assets with finite lives will no longer be limited to 40 years. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001, which for the Company means the standard will be adopted on April 1, 2002. The Company is currently assessing the impact of SFAS No. 142 on its results of operations.

The FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," in August 2001. SFAS No. 144, which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of, supercedes SFAS No. 121 and is effective for fiscal years beginning after December 15, 2001. The Company has adopted SFAS No. 144 effective at April 1, 2002 and is currently evaluating the impact the adoption of the new accounting standards will have on its financial condition and results of operations.

Liquidity and Capital Resources

Cash and cash equivalents at June 30, 2002 of \$235,330 decreased by \$1,317,336, from \$1,552,666 at March 31, 2002. We are a net borrower; consequently, we believe our cash and cash equivalents balance must be viewed along with available balance on our line of credit.

Since our inception, we have funded our operations primarily from borrowings under our credit facility. On November 21, 2001, we entered into a

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\$10.0 million revolving credit facility with Fleet Capital Corporation, formerly Summit Business Capital Corporation ("Fleet"). Interest on outstanding loans under our revolving credit facility with Fleet is charged monthly at a fluctuating rate per annum equal to 0.25% above the Prime Rate and, at our option, interest on up to 50% of the outstanding loans may be charged at LIBOR plus 2.75%. Our Fleet revolving credit facility is collateralized by a lien upon and security interest in substantially all of our assets. As our current credit facilities with two of our primary trade vendors, GE Access, and Ingram Micro, were also collateralized by substantially all of our assets, we, Fleet, GE Access and Ingram Micro, have entered into intercreditor agreements, which provide that as regards to these vendors, our obligations to Fleet are accorded priority. On November 21, 2001, we also entered into a Wholesale Financing Security Agreement with IBM. This credit facility, which is collateralized by a \$750,000 letter of credit from Fleet in favor of IBM, affords us up to a like amount of credit to purchase IBM products. On January 9, 2002, Fleet has also issued \$250,000 letter of credit in favor of Vandergrand Properties Co., L.P., and our landlord for New York City office as a security deposit for the building lease. At June 30, 2002, we had \$1.33 million outstanding balance under the credit facility and the unused line of credit available is \$7.67 million with Fleet.

Our lending agreement with Fleet contains financial covenants that require us to maintain a minimum leverage ratio, minimum debt service coverage ratio, minimum tangible net worth, and prohibits quarterly losses. As of June 30, 2002 the Company was in compliance with all of its covenants.

At June 30 2002, our credit facilities with our primary trade vendors, GE Access, Ingram Micro, and Tech Data were as follows: 1) Credit Line with GE Access was \$7.70 million, no interest charged, and an outstanding balance of \$6.0 million. 2) Credit line with Ingram Micro was \$1.75 million, at an 18% APR interest rate and an outstanding balance of \$716,890. 3) Credit line with Tech Data was \$2.5 million, no interest charged and an outstanding balance of \$1.5 million. Under these credit lines we are obligated to pay each invoice within 30 days from the date of such invoice

Capital expenditures of \$423,000 during three months ended June 30, 2001 are divided into following categories; 1) Approximately \$368,000 is for the purchase of computer hardware and software for our Network Operations Center to enhance our offerings in Managed Services, 2) Approximately \$55,000 is for the purchase of vehicle, furniture and fixture, and equipment for internal use. We anticipate additional \$400,000 of capital expenditures to upgrade our network operation center, and to purchase equipment for internal use for the fiscal year ending March 31, 2003.

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The Company has 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 our available funds, together with existing and anticipated credit facilities, will be adequate to satisfy our current and planned operations for at least the next 12 months.

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Item 3. Quantitative and Qualitative Information 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 for the past two years has been approximately \$4.10 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 \$41,000 annually.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized

EMTEC, INC.

By: /s/ JOHN P. HOWLETT

John P. Howlett
Chairman, President, and Chief

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Executive Officer
(Principal Executive Officer)

By: /s/ SAM BHATT

Sam Bhatt
Vice President - Finance and Operations
(Principal Financial and
Accounting Officer)

Date: August 14, 2002

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STATEMENT OF DIFFERENCES

The section symbol shall be expressed as..... 'SS'