EMTEC INC/NJ
Form 10-Q
August 14, 2001

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, 2001

Commission file number: 0-32789

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

Delaware	87-0273300
(State or other jurisdiction of incorporation or organization)	(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 | | No |X|

The number of shares of Common Stock outstanding as of August 10, 2001 was 7,080,498.

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2001

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

EMTEC, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2001 (unaudited)	March 31, 2001
Assets		
Current Assets		
Cash and cash equivalents	$ 157,748	$ 2,098,198
Marketable securities	5,825	292,346
Receivables:		
Trade, less allowance for doubtful accounts	11,444,183	12,828,456

Others	330,121	433,580
Inventories, net of reserve	996,471	1,019,715
Prepaid expenses	353,792	296,939
Total Current Assets	13,288,140	16,969,234
Net property and equipment	831,204	919,110
Investment in geothermal power unit	543,588	549,626
Deferred tax asset	19,816	22,996
Other assets	171,190	175,711
Total Assets	$ 14,853,938	$ 18,636,677

The accompanying notes are an integral part of these consolidated financial statements.

EMTEC, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2001 (unaudited)	March 31, 2001
Liabilities and Shareholders' Equity		
Current Liabilities		
Line of credit	$ 4,727,922	$ 6,535,405
Due to related party	19,000	19,000
Accounts payable	4,932,985	7,284,625
Income taxes payable	2,087	2,087
Customer deposits	-	203,202
Accrued liabilities	1,047,017	1,023,556
Deferred revenues	1,186,230	899,352

Total Current Liabilities	11,915,240	15,967,227
Deferred revenue	831,310	841,922
Total Liabilities	12,746,550	16,809,149
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 other comprehensive income (loss)	3,083	(5,458)
Accumulated deficit	(177,306)	(448,624)
Total Shareholders' Equity	2,107,388	1,827,528
Total Liabilities and Shareholders' Equity	$ 14,853,938	$ 18,636,677

The accompanying notes are an integral part of these consolidated financial statements.

EMTEC, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended:	
	June 30, 2001	June 30, 2000
Revenues:		
Procurement services	$ 14,545,543	$ 23,814,231
Service and consulting	4,958,242	3,616,074
Geothermal	44,342	-
Total Revenues	19,548,127	27,430,305
Cost of Revenues:		

Procurement services	12,847,215	21,506,446
Service and consulting	3,933,413	2,843,366
Geothermal	12,911	-
Total Cost of Revenues	16,793,539	24,349,812
Gross Profit:		
Procurement services	1,698,328	2,307,785
Service and consulting	1,024,829	772,708
Geothermal	31,431	-
Total Gross Profit	2,754,588	3,080,493
Operating Expenses:		
Selling, general and administrative	2,154,416	2,604,090
Termination costs	-	39,000
Interest	92,258	157,167
Startup costs, E-Business	233,416	338,506
Total Operating Expenses	2,480,090	3,138,763
Income (Loss) From Continuing Operations Before Other Income And Income Tax Expense	274,498	(58,270)
Other income- litigation settlement	-	373,911
Income tax expense	3,180	-
Income From Continuing Operations, Net of Income Taxes	271,318	315,641
Loss from discontinued operations, net of income taxes	-	(44,583)
Net Income	$ 271,318	$ 271,058
Income Per Share From Continuing Operations {Basic And Diluted}	$ 0.04	$ 0.06
Net Income Per Share {Basic And Diluted}	$ 0.04	$ 0.05
Weighted Average Number Of Shares Outstanding {Basic And Diluted}	7,080,498	5,329,501

The accompanying notes are an integral part of these consolidated financial statements.

EMTEC, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three Months Ended:	
	June 30, 2001	June 30, 2000
Cash Flows From Operating Activities		
Net income for the three months	$ 271,318	$ 271,061
Adjustments to Reconcile Net Income To Net Cash Used In Operating Activities		
Depreciation and amortization	116,822	80,895
Changes In Operating Assets and Liabilities		
Decrease (increase) in marketable securities	295,062	(174,149)
Decrease in receivables	1,487,732	65,035
Decrease (increase) in inventories	23,244	(1,090,833)
(Increase) decrease in prepaid expenses	(56,853)	157,330
Decrease in deferred tax asset	3,180	-
Decrease in accounts payable	(2,351,641)	(143,000)
Decrease in customer deposits	(203,202)	(358,000)
Increase in accrued liabilities	23,461	3,497
Increase (decrease) in deferred revenue	276,266	(155,188)
Net Cash Used In Operating Activities	(114,611)	(1,343,352)
Cash Flows From Investing Activities		
Purchases of equipment	(18,356)	(413)
Cash Flows From Financing Activities		
Net (decrease) increase in line of credit	(1,807,483)	745,553
Net Decrease in Cash and Cash Equivalents	(1,940,450)	(598,212)
Beginning Cash and Cash Equivalents	2,098,198	686,413
Ending Cash and Cash Equivalents	$ 157,748	$ 88,201

The accompanying notes are an integral part of these consolidated financial statements.

EMTEC, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED JUNE 30, 2001 AND 2000
(unaudited)

1. Basis of Presentation

The financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending March 31, 2002. For further information, refer to the annual financial statements and footnotes thereto included in Form 10-K.

2. Reverse Acquisition

On January 17, 2001, Emtec, Inc., a New Jersey corporation (the Company) was acquired by American Geological Enterprises, Inc. (AGE) through an exchange of stock at a ratio of .9753 shares of AGE stock for 1 share of Company stock whereas AGE issued stock to the shareholders of the Company in exchange for stock representing 100% of the outstanding shares of the Company. Pursuant to the acquisition agreement, AGE changed its name to Emtec, Inc. and a majority of the directors and officers of the former AGE resigned in favor of the directors and officers of the Company. In addition, Emtec, Inc. (formerly AGE) increased its authorized capitalizaton from 2,500,000 to 25,000,000 shares of common stock. Emtec, Inc. intends to seek a listing of its common stock on NASDAQ's Over-The-Counter Bulletin Board. Immediately after the transaction, the stock ownership of Emtec, Inc. {formerly AGE} was as follows:

	Shares	Percent
Former shareholders of the Company	5,329,501	75.3
Original shareholders of AGE (including public owners)	1,380,997	19.5
Transaction brokers	370,000	5.2
Total	7,080,498	100.0

Because the former shareholders of the Company acquired control of Emtec, Inc. {formerly AGE}, the transaction is considered a "reverse acquisition" by the Company for accounting purposes. The Company is treated as the accounting acquirer of Emtec, Inc. {formerly AGE}, the legal acquirer. For accounting purposes, the acquisition has been treated as an acquisition of Emtec, Inc. (formerly AGE) by Emtec. Inc., a New Jersey Corporation (the Company) and as a recapitalization of the Company. The historical financial statements of the Company are those of Emtec, Inc., a New Jersey corporation.

The historical shareholders' equity of the Company prior to the reverse acquisition has been retroactively restated for the equivalent number of shares received in the transaction after giving effect to the difference in par value

between the issuer's and acquirer's stock. Income per share amounts have also been restated to reflect the number of equivalent shares received by the former shareholders of Emtec, Inc. a New Jersey corporation.

3. Financing Agreements

The Company was in default of the financial covenants under its line of credit at March 31, 2001. Although, a commitment has been obtained from the lender to waive the defaults and amend the existing financing agreement as outlined in Form 10-K for the year ended March 31, 2001, the Company is seeking alternative financing. Management believes that the Company can obtain financing at a lower cost than the new terms outlined in the proposed amended agreement. On August 9, 2001, the Company signed a letter of intent with a new lender under more favorable terms. The Company expects that the new lender will complete their due diligence by August 30, 2001 and issue a commitment letter shortly thereafter.

4. Stock-Based Compensation

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," (SFAS No. 123) encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has adopted Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25). APB No. 25 provides that the compensation expense relative to the Company's employee stock options is measured based on the intrinsic value of the stock option. SFAS No. 123 requires companies that continue to follow APB No. 25 to provide a pro forma disclosure of the impact of applying the fair value method of SFAS No. 123.

All stock options granted for the three months ended June 30, 2001 and 2000 were determined to have a fair value of zero. The exercise price of these options was set at $ 1 per share, an amount in excess of 150% of the fair value of the underlying stock. Therefore, no options granted during the three month periods have been exercised as of June 30, 2001. A pro forma presentation of compensation cost and earnings per share is not required due to the zero fair value determination. At September 23, 1996, options to purchase 372,895 shares were issued primarily to the founders of the Company at an exercise price of $ .48 per share. At June 30, 2001, 166,227 of these founder options were outstanding. Option activity is summarized in the following table.

Options outstanding - April 1, 2001	465,259
For the three months ended June 30, 2001:	

Options granted	49,186
Options exercised	0
Options forfeited or expired	(450)
Options outstanding - June 30, 2001	513,995

5. Net Income (Loss) per Share

The net income (loss) per share and the income per share from continuing operations computations 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 continuing operations and diluted net income per share for the potential dilutive effect of securities such as stock options. The Company maintains a stock option plan as discussed in Note 3. However, based upon the pricing of the options in excess of the underlying value of the Company stock during the three months ended June 30, 2001 and 2000, the stock options are antidilutive. Therefore, there is no separate presentation of diluted net income per share.

6. Litigation

At June 2000, the Company settled the litigation against two companies (defendants) that were in discussions with Emtec about a possible merger. The complaint in the action charged the two companies for breach of contract, interference with business relationships and misappropriation of trade secrets. Under terms of the settlement, the Company received a $350,000 cash payment and 333,116 shares of the defendant's common stock. The Company recorded income of $373,911 from this settlement for the three months ended June 30, 2000. Additional costs related to the litigation and realized losses on disposition of the defendant's common stock recorded in the second half of fiscal 2001 reduced net income from the litigation settlement to $24,108 for the year ended March 31, 2001.

In 1999 Emtec, Inc. instituted litigation against a company (defendant) for breach of contract action in an amount approximating $50,000. The defendant has stated a counter claim in excess of $8 million for damages resulting from Emtec's alleged negligence, causing the defendant's computer system to become corrupted and unavailable. Damages will be contested by Emtec, as will liability. At June 30, 2001, the case is in the discovery phase.

7. Income Taxes

Income tax expense consisted of the following for the three months ended June 30, 2001 and 2000:

	2001	2000
Continuing Operations		
Current taxes		
Federal	$ -	$ -
State	-	-
	-	-
Deferred taxes		
State	3,180	-
	3,180	-
Discontinued Operations		
Current benefit		
Federal	-	-
State	-	-
	$ -	$ -
Net Income Tax Expense	$ 3,180	$ -

8. Discontinued Operations

During fiscal 2000, the Company completed the sale of assets of its two South Carolina locations (Greenville and Charleston) to a company formed by some of its prior employees. The Company recorded an additional loss from discontinued operations of $ 44,583 for the three months ended June 30, 2000. The loss is primarily due to bad debt charges in excess of recorded allowances related to trade receivables.

9. Segment Information

The following is financial information relating to the operating segments:

Three months ended June 30:	2001	2000
External Sales		

Mt. Laurel, NJ	$ 2,705,294	$ 3,513,027
Cranford, NJ	8,108,140	14,619,515
Atlanta, GA	4,420,820	5,326,956
Norwalk, CT	752,190	935,943
Education-Atlanta	3,517,345	3,034,867
Geothermal	44,342	-
Total External Sales	$ 19,548,127	$ 27,430,308
Interest Expense		
Mt. Laurel, NJ	$ 11,828	$ 21,589
Cranford, NJ	43,184	70,744
Atlanta, GA	22,627	35,903
Norwalk, CT	4,571	6,517
Education-Atlanta	10,206	19,912
e-Business	65	-
Geothermal	-	-
Allocated Interest Expense	92,481	154,665
(Over) under allocation	(223)	2,502
Total Interest Expense	$ 92,258	$ 157,167

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Depreciation and Amortization		
Mt. Laurel, NJ	$ 9,000	$ 15,900
Cranford, NJ	22,461	30,760
Atlanta, GA	28,152	14,312
Norwalk, CT	2,850	2,000
Education-Atlanta	150	1,400
e-Business	3,000	-
Geothermal	6,039	-
Allocated Depreciation and Amortization	71,652	64,372
Unallocated amounts	45,170	16,523
Total Depreciation and Amortization	$ 116,822	$ 80,895

Three months ended June 30:	2001	2000
Operating Profit/(Loss)		
Mt. Laurel, NJ	$(65,994)	$(181,464)
Cranford, NJ	310,446	233,786
Atlanta, GA	(63,349)	62,647
Norwalk, CT	(46,820)	(5,086)
Education-Atlanta	355,448	170,363
e-Business	(233,416)	(338,506)
Geothermal	18,191	-
Net Segment Operating Profit (Loss)	274,506	(58,260)
Under Allocated Corporate Expenses	(3,188)	(7)
Income (Loss) from Continuing Operations before Other Income and Income Tax Expense	$ 271,318	$(58,267)

Identifiable Assets:

	June 30, 2001	March 31, 2001
Mt. Laurel, NJ	$ 1,496,528	$ 2,691,963
Cranford, NJ	3,933,175	7,690,440
Atlanta, GA	3,067,044	2,239,838
Norwalk, CT	535,308	433,860
Education-Atlanta	3,658,663	1,401,107
e-Business	34,000	-
Geothermal	578,588	549,626
Total Identifiable Assets	13,303,306	15,006,834
Corporate And Other Assets	1,550,632	3,629,843
Total Assets	$ 14,853,938	$ 18,636,677

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.

A. Results of Operations

a) Three Months Ended June 30, 2001 Compared to Three Months Ended June 30, 2000.

(1) Total Revenues

Total revenues from the IT business decreased by 28.90%, or $7.92 million, to $19.50 million for three months ended June 30, 2001. Product procurement revenues decreased by 38.92%, or $9.27 million, to $14.55 million for three months ended June 30, 2001. This decline in product procurement revenue is mainly due to the continued focus on our services and consulting organization as well as a slow-down in the economy. Services and consulting revenue increased by 37.12%, or $1.34 million, to $4.96 million for three months ended June 30, 2001 compared to $3.62 million for three months ended June 30, 2000.

Geothermal Revenues of $44,342 for three months ended June 30, 2001 are consistent with the previous period's revenues for a comparable period.

(2) Gross Profit

Our aggregate gross profit from the IT business declined by 11.60%, or $357,336, to $2.72 million for three months ended June 30, 2001. This decrease is mainly due to lower product procurement revenues. Measured as a percentage of net sales, our overall gross profit margin increased to 13.96% for three months ended June 30, 2001 from 11.23% for three months ended June 30, 2000.

Gross profit margin attributable to product sales increased to 11.68% for three months ended June 30, 2001 from 9.69% for three months ended June 30, 2000. This increase in product procurement gross margin is attributable to lower cost of sales for products obtained from our vendors as well as lower inventory write-offs during this period. Gross margin attributable to services and consulting revenue decreased slightly to 20.67% of services and consulting revenue for three months ended June 30, 2001 from 21.37% for three months ended June 30, 2000. This decrease is mainly due to slightly lower utilization rates within the service and consulting group.

The geothermal gross profit of $31,431 for three months ended June 30, 2001 is consistent with the gross profit for comparable previous periods.

(3) Sales, General, and Administrative Expenses

Sales, general, and administrative expenses decreased by 17.27%, or $449,674, to $2.15 million for three months ended June 30, 2001 from $2.60 million for three months ended June 30, 2000. This decrease is primarily a result of lower sales commission expenses as well as our continued efforts to streamline many of our sales and operational functions.

(4) Interest Expense

Interest expense decreased by 41.30%, or $65,000 to $92,000 for three months ended June 30, 2001 from $157,000 for three months ended June 30, 2000. This decrease is primarily a result of lower sales volume as well as our continued efforts to streamline our accounts receivable credit policies and collection functions.

(5) Startup Costs; e-Business

Startup Costs; e-Business for three months ended June 30, 2001 was $233K, or 9.41% of total operating expenses compared to $338K, or 10.78% of total operating expense for three months ended June 30, 2000. This decrease is due to mainly two reasons; 1) lower head count within the group, 2) generation of $40,000 revenue from e-Business activities during three months ended June 30, 2001 as compared to $0 from three months ended June 30, 2000.

(6) Income Taxes

Income tax expense of $3,180 was recorded for three months ended June 30, 2001.

B. Liquidity and Capital Resources

Cash and cash equivalents at June 30, 2001 of $157,748 decreased by $1,940,450, from $2,098,198 at March 31, 2001. We are a net borrower, so our cash and cash equivalents balance must be analyzed along with the balance on our line of credit. Working capital at June 30, 2001, and March 31, 2001, was $1,372,900 and $1,002,007, respectively.

Since our inception, we have funded our operations primarily from borrowings under our credit facility. On September 24, 1999, the Company and IBM Credit Corporation ("IBM") executed an Inventory and Working Capital Financing Agreement whereby IBM expanded the Company's credit facility to enable the Company to borrow up to $15 million. Interest on the borrowings is charged monthly at one half point above the current prime rate. The loan is secured by substantially all of our assets. At June 30, 2001, we had $4.73 million outstanding under the credit facility.

Our lending agreement with IBM contains financial covenants that require us to maintain a minimum current ratio, minimum total liabilities to net tangible worth ratio, and minimum results of assets to current liabilities ratio, and total liabilities to net tangible worth ratio. The Company and IBM have been unable to reach an agreement on the revised terms of the credit facility so we are seeking an alternate lender. We cannot state with any certainty how successful the Company will be in finding an appropriate replacement lender. The lending agreement with IBM may be renewed on September 23, 2001 for an additional one-year term, or terminated on that date, at the option of either party.

On August 9, 2001 the Company signed a letter of intent with Summit Business Capital Corporation whereby SBCC will offer the Company a revolving credit facility up to $11 million based on 85% of eligible accounts receivable. The Company expects that SBCC will complete their due diligence and audit by August 30, 2001 and will issue a commitment letter soon after that.

We have open credit lines with our primary trade vendors such as Ingram Micro and Tech Data. As of June 30, 2001, the credit line with Ingram Micro was $4.5 million, an 18% APR interest rate and an outstanding balance of $1.30 million. As of June 30, 2001, the credit line with Tech Data was $1.5 million, no interest charged and an outstanding balance of $1.13 million. Under both credit lines we are obligated to pay each invoice within 30 days from the date of such invoice. We do not have written agreements with either Ingram Micro or Tech Data.

Capital expenditures of $18,356 during three months ended June 30, 2001, were primarily for the purchase of computer equipment for internal use.

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.

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 $7.40 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 $74,000 annually.

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
Executive Officer
(Principal Executive Officer)

By: /s/ SAM BHATT

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

Date: August 14, 2001