SOFTECH INC
Form 10QSB
January 15, 2004

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

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

For the Quarter Ended November 30, 2003	Commission File Number 0-10665

SOFTECH, INC.

State of Incorporation	IRS Employer Identification
Massachusetts	04-2453033

2 Highwood Drive, Tewksbury, MA 01876
Telephone (978) 640-6222

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 outstanding of registrant's common stock at December 31, 2003 was 12,205,236 shares.

SOFTECH, INC.

INDEX

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS
(dollars in thousands)

	November 30, 2003 (unaudited)	(a
ASSETS		
Cash and cash equivalents	$ 306	$
Restricted cash	-	
Accounts receivable, net	1,731	2
Prepaid expenses and other assets	142	
Total current assets	2,179	3
Property and equipment, net	242	
Capitalized software costs, net	8,078	9
Identifiable intangible assets, net	733	
Goodwill, net	4,598	4
Notes receivable	134	
Other assets	159	

TOTAL ASSETS	$ 16,123	$ 18

LIABILITIES AND STOCKHOLDERS' DEFICIT

Accounts payable	$ 251	$
Accrued expenses	1,591	2
Deferred maintenance revenue	3,433	4
Current portion of capital lease obligations	17	
Current portion of long term debt	2,100	1
Total current liabilities	7,392	7
Non-current deferred revenue	-	
Long-term debt, net of current portion	12,282	13
Total long-term debt	12,282	13
Stockholders' deficit	(3,551)	(2
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 16,123	$ 18

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)
(in thousands, except for per share data)

	Three Months Ended	
	November 30, 2003	November 2002

Revenue		
Products	$ 868	$
Services	2,442	1
Total revenue	3,310	2
Cost of products sold	11	
Cost of services provided	491	
Gross margin	2,808	2
Research and development expenses	768	
Selling, general and administrative	1,427	1
Amortization of capitalized software and other intangible assets	610	
Income from operations before interest expense and income taxes	3	
Interest expense	249	
Loss from operations before income taxes	(246)	
Provision for income taxes	-	
Net loss	$ (246)	$
Basic and diluted net loss per common share	$ (0.02)	$
Weighted average common shares outstanding	12,205	1

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(in thousands, except for per share data)
(Unaudited)

	Six Months Ended	
	November 30,	Novem

		2003		2
Revenue				
Products	$	1,451	$	
Services		4,802		
Total revenue		6,253		
Cost of products sold		19		
Cost of services provided		984		
Gross margin		5,250		
Research and development expenses		1,541		
Selling, general and administrative		2,706		
Amortization of capitalized software and other intangible assets		1,225		
Loss from operations before interest expense and income taxes		(222)		
Interest expense		502		
Loss from operations before income taxes		(724)		
Provision for income taxes		-		
Net loss	$	(724)	$	
Basic and diluted net loss per common share	$	(0.06)	$	
Weighted average common shares outstanding		12,205		

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

(dollars in thousands)

	Six Months End	
	November 30, 2003	N
Cash flows from operating activities:		
Net loss	$ (724)	$
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,311	
Change in current assets and liabilities:		
Accounts receivable	321	
Prepaid expenses and other assets	77	
Accounts payable and accrued expenses	(680)	
Deferred maintenance revenue	(845)	
Total adjustments	184	
Net cash used by operating activities	(540)	
Cash flows used by investing activities:		
Purchase of marketable securities	-	
Capital expenditures	(24)	
Net cash used by investing activities	(24)	
Cash flows from financing activities:		
Principal payments under capital lease obligations	(13)	
Proceeds from line of credit agreements, net	229	
Net cash provided by financing activities	216	
Increase (decrease) in cash and cash equivalents	(348)	
Cash and cash equivalents, beginning of period	654	
Cash and cash equivalents, end of period	$ 306	$

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(A) The consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission from the accounts of SofTech, Inc. and its wholly owned subsidiaries (the "Company") without audit; however, in the opinion of management, the information presented reflects all adjustments which are of a normal recurring nature and elimination of intercompany transactions which are necessary to present fairly the Company's financial position and results of operations. It is recommended that these consolidated condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's fiscal year 2003 Annual Report on Form 10-KSB.

(B) SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION:

The Company has adopted the provisions of Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2) as amended by SOP No. 98-9, in recognizing revenue from software transactions. Revenue from software license sales are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility has been determined. To the extent that obligations exist for other services, the Company allocates revenue between the license and the services based upon their relative fair value. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements. Revenue from engineering, consulting and training services is recognized as those services are rendered.

CAPITALIZED SOFTWARE COSTS AND RESEARCH AND DEVELOPMENT:

The Company capitalizes certain costs incurred to internally develop and/or purchase software that is licensed to customers. Capitalization of internally developed software begins upon the establishment of technological feasibility. Costs incurred prior to the establishment of technological feasibility are expensed as incurred. The Company evaluates the realizability and the related periods of amortization on a regular basis. Such costs are amortized over estimated useful lives ranging from three to ten years. The Company did not capitalize any internally developed software during the three and six month periods ended November 30, 2003 or 2002.

ACCOUNTING FOR GOODWILL AND OTHER INTANGIBLE ASSETS

Effective June 1, 2002, the Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. This statement affects the Company's treatment of goodwill and other intangible assets. This statement requires that goodwill existing at the date of adoption be reviewed for possible impairment and that impairment tests be periodically repeated, with impaired assets written down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified within the statement's criteria. Intangible assets with finite useful lives will continue to be amortized over those periods. Amortization of goodwill ceased as of May 31, 2002.

The Company completed the first step of the transitional goodwill impairment test during the three months ended November 30, 2002 based on the amount of goodwill as of the beginning of fiscal year 2003, as required by SFAS No. 142. Based on the results of the first step of the transitional goodwill impairment test, the Company has determined that the fair value of each of the reporting units exceeded their carrying amounts and, therefore, no goodwill impairment existed as of June 1, 2002.

The Company tested the goodwill for impairment as of May 31, 2003 and concluded, based on actual results for fiscal 2003 and projected cash flows from each of the reporting units, that no impairment existed as of May 31, 2003.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

LONG-LIVED ASSETS:

The Company periodically reviews the carrying value of all intangible assets with a finite life (primarily capitalized software costs) and other long-lived assets. If indicators of impairment exist, the Company compares the undiscounted cash flows estimated to be generated by those assets over their estimated economic life to the related carrying value of those assets to determine if the assets are impaired. If the carrying value of the asset is greater than the estimated undiscounted cash flows, the carrying value of the assets would be decreased to their fair value through a charge to operations. The Company does not have any long-lived assets it considers to be impaired. The Company has determined that all of its intangible assets (other than goodwill) have finite lives and, therefore, the Company has continued to amortize its intangible assets.

STOCK BASED COMPENSATION

On December 31, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 148 (SFAS 148), Accounting for Stock-Based Compensation -- Transition and Disclosure, amending FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. This Statement amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. The Company has complied with the disclosure provisions in these financial statements.

The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and provides the required pro forma disclosures prescribed by SFAS 123 and SFAS 148.

The Company has adopted the disclosure-only provisions of SFAS 123. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market. No compensation expense was recognized during the three and six month periods ended November 30, 2003 or 2002.

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock option plans. Because the number of shares is known and the exercise price of options granted has been equal to fair value at date of grant, no compensation expense has been recognized in the statements of operations. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards under these plans, consistent with the methodology prescribed under SFAS 123, the Company's net loss and loss per share would have approximated the pro forma amounts indicated below:

(in thousands, except per share data)	Three Month Periods Ended Novemb 2003	2002
Net income (loss) - as reported	$(246)	$(213)
Net income (loss) - pro forma	(254)	(218)
Loss per share - diluted - as reported	(.02)	(.02)
Loss per share - diluted - pro forma	(.02)	(.02)

SOFTECH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(in thousands, except per share data)	Six Month Periods Ended November 30, 2003	2002
Net income (loss) - as reported	$(724)	$(745)
Net income (loss) - pro forma	(740)	(753)
Loss per share - diluted - as reported	(.06)	(.06)
Loss per share - diluted - pro forma	(.06)	(.06)

FOREIGN CURRENCY TRANSLATION:

The functional currency of the Company's foreign operations (France, Germany and Italy) is the local currency. As a result, assets and liabilities are translated at period-end exchange rates and revenues and expenses are translated at the average exchange rates. Adjustments resulting from translation of such financial statements are classified in accumulated other comprehensive income (loss). Foreign currency gains and losses arising from transactions are included in the statement of operations.

USE OF ESTIMATES:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates included in the financial statements are the valuation of long term assets including intangibles (goodwill, capitalized software and other intangible assets), deferred tax assets and the allowance for doubtful accounts. Actual results could differ from those estimates.

(C) LIQUIDITY

The Company ended the first half of fiscal 2004 with cash of $306,000. Operating activities utilized $540,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation together with a decrease in accounts receivable and other assets generated cash of $985,000. The reduction in accounts payable and accrued expenses used cash of $680,000 and the cyclical reduction in deferred revenue utilized cash of $845,000 during the first half of the fiscal year.

Although the Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow in fiscal 2004, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable.

The Company believes that the cash on hand together with cash flow from operations and its available borrowings under its credit facility will be sufficient for meeting its liquidity and capital resource needs for the next year. At November 30, 2003, the Company had available borrowings on its debt facilities of approximately $3.3 million.

(D) Details of certain balance sheet captions are as follows (000's):

	November 30, 2003 (unaudited)	May 31, 2003 (audited)
Property and equipment	$ 3,851	$ 3,827
Accumulated depreciation and amortization	(3,609)	(3,521)
Property and equipment, net	$ 242	$ 306

SOFTECH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Common stock, $.10 par value	$ 1,274	$ 1,274
Capital in excess of par value	19,544	19,544
Accumulated deficit	(22,495)	(21,771)
Cumulative translation adjustment	(313)	(234)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	$ (3,551)	$ (2,748)

The changes from May 31, 2003 in stockholders equity are due solely to the changes in the accumulated deficit resulting from the first half net loss of $724 and the first half foreign currency translation adjustment of $79.

(E) LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed by dividing net loss by the weighted-average number of common and equivalent dilutive common shares outstanding. Options to purchase shares of common stock have been excluded from the denominator for the computation of diluted earnings per share for all periods presented in fiscal 2004 and 2003 because their inclusion would be antidilutive. There were a total of 493,000 and 413,000 options outstanding at November 30, 2003 and 2002, respectively.

(F) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments and unrealized gain (loss) on marketable securities. For the three and six month periods ended November 30, 2003 and 2002, the comprehensive loss was as follows (000's):

	Three Month Periods Ended November 30, 2003 (unaudited)	2002 (unaudited)
Net loss	$ (246)	$ (213)
Changes in:		
Foreign currency translation adjustment	(45)	(12)
Unrealized gain on marketable securities	--	97
Comprehensive loss	$ (291)	$ (128)

	Six Month Periods Ended November 30, 2003 (unaudited)	2002 (unaudited)
Net loss	$ (724)	$ (745)
Changes in:		
Foreign currency translation adjustment	(79)	12
Unrealized gain on marketable securities	--	119
Comprehensive loss	$ (803)	$ (614)

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(G) SEGMENT INFORMATION

The Company operates in one reportable segment and is engaged in the development, marketing, distribution and support of CAD/CAM and Product Data Management computer solutions. The Company's operations are organized geographically with foreign offices in France, Germany and Italy. Components of revenue and long-lived assets (consisting primarily of intangible assets, capitalized software and property, plant and equipment) by geographic location, are as follows (000's):

Revenue:	Three Months Ended November 30, 2003 (unaudited)	Three Months Ended November 30, 2002 (unaudited)
North America	$ 2,595	$ 1,251
Asia	260	279
Europe	698	904
Eliminations	(243)	(208)
Consolidated Total	$ 3,310	$ 2,226

Revenue:	Six Months Ended November 30, 2003 (unaudited)	Six Months Ended November 30, 2002 (unaudited))
North America	$ 4,906	$ 2,300
Asia	449	469
Europe	1,170	1,409
Eliminations	(272)	(231)
Consolidated Total	$ 6,253	$ 3,947

Long Lived Assets:	November 30, 2003 (unaudited)	May 31, 2003 (audited)
North America	$ 13,752	$ 15,017
Europe	192	212
Consolidated Total	$ 13,944	$ 15,229

(H) NEW ACCOUNTING PRONOUNCEMENTS:

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, an entity capitalizes a cost by increasing the carrying amount of the long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 effective June 1, 2003 did not have a material effect on the financial position or results of operations of the Company.

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which is effective for contracts entered into or modified after June 30, 2003. This Statement amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities for the purpose of improving financial reporting by requiring contracts with comparable characteristics to be accounted for similarly. The adoption of SFAS No. 149 effective July 1, 2003 did not have a material impact on the Company's financial position or results of operations.

In May 2003, FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", which is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position or results of operations.

(I) ACQUISITION

On December 18, 2002, the Company closed its all cash tender offer ("Offer") for all of the outstanding shares of common stock of Workgroup Technology Corporation, a Delaware corporation ("WTC"), at a price of $2.00 per share. WTC was a publicly traded company listed on the Over the Counter Bulletin Board. WTC develops, supports and markets a software product to mechanical CAD ("Computer Aided Design") users that allows them to manage their design models. Its product offerings are compatible with SofTech's.

A total of 1,505,958 shares of WTC's common stock were tendered in the Offer, which, together with shares beneficially owned by SofTech prior to commencement of the Offer, represented approximately 88.8% of WTC's outstanding common stock.

Subsequent to the 2003 fiscal year end, the Company exercised an option to purchase an additional 220,000 shares of WTC thereby bringing its ownership of WTC to 90.02%. On June 18, 2003, the Company filed a short-form merger with the State of Delaware thereby acquiring the 205,662 WTC shares that had not been tendered in the Offering. This action provides the beneficial owners of those 205,662 shares the right to present them to the Company and to receive $2.00 per share in cash.

The operating results of WTC have been included in the Company's results since the acquisition date. Therefore the results of operations shown below for the three and six month periods ended November 30, 2003 are the actual results reported in this Form 10-QSB. The unaudited pro forma results of operations for the three and six month periods ended November 30, 2002 assume that the WTC acquisition had occurred as of the beginning of each of those periods.

The following unaudited pro forma comparative information is presented for illustrative purposes only and is not necessarily indicative of the consolidated results of operations for future periods or that actually would have been realized had the Company and WTC been a consolidated entity as of the beginning of the three and six month periods ended November 30, 2002 (in thousands, except per shared data). The results of WTC for the three and six month periods ended December 31, 2002 were combined with the results of SofTech for the three and six month periods ended November 30, 2002 in the preparation of this comparative information:

	Three Months Ended November 30, (unaudited) 2003	2002
Revenue	$ 3,310	$3,932
Net loss	(246)	(574)
Net loss per share:		
Basic	(.02)	(.05)
Diluted	(.02)	(.05)

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

	Six Months Ended November 30, (unaudited) 2003	2002
Revenue	$ 6,253	$ 7,209
Net loss	(724)	(1,817)
Net loss per share:		
Basic	(.06)	(.15)
Diluted	(.06)	(.15)

SOFTECH, INC. AND SUBSIDIARIES

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

The statements made below with respect to SofTech's outlook for fiscal 2004 and beyond represent "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934 and are subject to a number of risks and uncertainties. These include, among other risks and uncertainties, general business and economic conditions, generating sufficient cash flow from operations to fund working capital needs, continued integration of acquired entities, potential obsolescence of the Company's technologies, maintaining existing relationships with the Company's lenders, successful introduction and market acceptance of planned new products and the ability of the Company to attract and retain qualified personnel both in our existing markets and in new territories in an extremely competitive environment.

Critical Accounting Policies and Significant Judgments and Estimates

The Securities and Exchange Commission ("SEC") issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require the application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The Company's significant accounting policies are described in Note B to these financial statements. The Company believes that the following accounting policies require the application of management's most difficult, subjective or complex judgments:

Valuation of Long-lived and Intangible Assets

We assess the recoverability of long-lived assets and intangible assets whenever we determine that events or changes in circumstances indicate that their carrying amount may not be recoverable. Our assessment is primarily based upon our estimate of future cash flows associated with these assets. These valuations contain certain assumptions concerning estimated future revenues and future expenses for each of our two reporting units. We have determined that there is no indication of impairment of any of our assets. However, should our operating results deteriorate, we may determine that some portion of our long-lived assets or intangible assets are impaired. Such determination could result in non-cash charges to income that could materially affect our financial position or results of operations for that period.

Valuation of Goodwill

Effective June 1, 2002, the Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. This statement affects the Company's treatment of goodwill and other intangible assets. This statement requires that goodwill existing at the date of adoption be reviewed for possible impairment and that impairment tests be periodically repeated, with impaired assets written down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified within the statement's criteria. Intangible assets with finite useful lives will continue to be amortized over those periods. Amortization of goodwill and intangible assets with indeterminable lives ceased as of June 1, 2002

The Company completed the first step of the transitional goodwill impairment test during the three months ended November 30, 2002 based on the amount of goodwill as of the beginning of fiscal year 2003, as required by SFAS No. 142. Based on the results of the first step of the transitional goodwill impairment test, the Company has determined that the fair value of each of the reporting units exceeded their carrying amounts and, therefore, no goodwill impairment existed as of June 1, 2002. As a result, the second step of the transitional goodwill impairment test was not required to be completed. The Company tested the goodwill for impairment at May 31, 2003 and concluded based on actual results for fiscal 2003 and projected cash flows from each of the reporting units that no impairment existed as of May 31, 2003. The Company will be required to continue to perform a goodwill impairment test on an annual basis.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

Estimating Allowances for Doubtful Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. A significant change in the liquidity or financial position of any of our significant customers could have a material adverse effect on the collectibility of our accounts receivable and our future operating results.

Valuation of Deferred Tax Assets

We regularly evaluate our ability to recover the reported amount of our deferred income taxes considering several factors, including our estimate of the likelihood of the Company generating sufficient taxable income in future years during the period over which temporary differences reverse. The Company's deferred tax assets are currently fully reserved.

Results of Operations

On December 18, 2002, the Company closed its all cash tender offer ("Offer") for all of the outstanding shares of common stock of Workgroup Technology Corporation as more fully described above and in our previous SEC filings. The operating results of WTC have been included in the Company's results since the acquisition date. This acquisition had a material positive impact on the Company's operating results and the acquisition is the primary reason for the changes in revenue and cash flow for the three and six month periods ended November 30, 2003 (which include WTC) as compared to the three and six month periods ended November 30, 2002 (which exclude WTC).

Revenue for the three and six month periods ended November 30, 2003 was $3.3 million and $6.3 million, respectively, as compared to $2.2 million and $3.9 million for the same periods in the prior fiscal year. This represents an increase of $1.1 million or 48.7% for fiscal 2004 Q2 as compared to the same period in fiscal 2003 and an increase of $2.3 million or 58.4% for the first half of fiscal 2004 compared to the same period in fiscal 2003. WTC generated approximately $1.5 million and $2.8 million of revenue, respectively, for the three and six month periods ended November 30, 2003 thereby offsetting a decrease in the revenue of the Company's CAD and CAM products of about 17% and 22% for the three and six month periods ended November 30, 2003 as compared to the same periods in the prior year. This decrease was due primarily to a depressed capital spending environment especially for the manufacturing marketplace that uses the Company's software products.

Product revenue for the three and six month periods ended November 30, 2003 was approximately $868,000 and $1.5 million, respectively, as compared to $837,000 and $1.1 million for the same periods in the prior fiscal year. This represents an increase of $31,000 or 3.7% for fiscal 2004 Q2 as compared to the same period in fiscal 2003 and an increase of $.3 million or 27.8% for the first half of fiscal 2004 compared to the same period in fiscal 2003. WTC generated approximately $.4 million and $.7 million of product revenue, respectively, for the three and six month periods ended November 30, 2003. The product revenue for SofTech's non-WTC product offerings declined by approximately 46.8% and 33.8% for the three and six month periods ended November 30, 2003 as compared to the same periods in 2002 due to the aforementioned depressed capital spending market. In this kind of environment, orders for new product are often delayed or reduced significantly as companies adjust their capital expenditures.

Service revenue for the three and six month periods ended November 30, 2003 was $2.4 million and $4.8 million, respectively, as compared to $1.4 million and $2.8 million for the same period in fiscal 2003. This represents an increase of $1.1 million or 75.8% for fiscal 2004 Q2 as compared to the same period in fiscal 2003 and an increase of $2.0 million or 70.8% for the first half of fiscal 2004 compared to the same period in fiscal 2003. WTC generated approximately $1.1 million and $2.0 million of service revenue, respectively, for the three and six month periods ended November 30, 2003 thereby accounting for all of the increase in service revenue. Despite the difficult economic situation noted above, generally our customers continue to purchase maintenance support contracts. This is the reason

that SofTech's non-WTC service revenue remained flat despite the declines noted above for product revenue.

Revenue generated in the U.S. accounted for 71% and 74% of total revenue for the three and six month periods ended November 30, 2003, respectively, up from 47% and 52% of total revenue for the same periods in the previous year. Revenue generated in Europe for the three and six month periods ended November 30, 2003 was 21% and 19% of total revenue, respectively, as compared to 40% and 36% of total revenue for the same period in fiscal 2003. Revenue generated in Asia for the three and six month periods ended November 30, 2003 was 8% and 7% of total revenue, respectively, as compared to 13% and 12% of total revenue for the same period in fiscal 2003. Revenue generated in the U.S. increased by 107% and 113% for the three and six month periods ended November 30, 2003 as compared to the same periods in the prior fiscal year. Revenue generated in Europe decreased by 23% and 17% while revenue generated in Asia decreased 7% and 4% for the same periods. WTC's products are sold primarily in the U.S. The acquisition of WTC was responsible for the increases in the U.S. revenue noted above.

Gross margin as a percentage of revenue was 84.8% and 84.0 % for the three and six month periods ended November 30, 2003, respectively, as compared to 95.8% and 95.7% for the same periods in fiscal 2003. This decrease in gross margin as a percent of revenue in fiscal 2004 as compared to the same period in fiscal 2003 is due to WTC's consulting services which make up approximately 6% of total revenue. The consulting revenue generated is a labor intensive effort and therefore has a much lower margin as compared to the margin on software maintenance revenue. It is the Company's expectation that consulting revenue will be an important element of our business in the future and that the gross margin experience of the current quarter will be the norm.

Research and development expenses ("R&D") were $768,000 and $1.5 million for the three and six month periods ended November 30, 2003, respectively, as compared to $362,000 and $696,000 for the same periods in the prior fiscal year. This represents an increase of $406,000 or 112.2% for fiscal 2004 Q2 as compared to the same period in fiscal 2003 and an increase of $845,000 or 121.4% for the first half of fiscal 2004 compared to the same period in fiscal 2003. The increase in R&D expenditures is due primarily to the addition of WTC's development engineering group which has increased our R&D staff from 14 in fiscal 2003 to 28 in fiscal 2004.

Selling, general and administrative ("SG&A") expenses were $1.4 million and $2.7 million, respectively, for the three and six month periods ended November 30, 2003 as compared to $1.3 million and $2.5 million for the same period in fiscal 2003. This represents an increase of $.1 million or 9.2% for fiscal 2004 Q2 as compared to the same period in fiscal 2003 and an increase of $.2 million or 9.1% for the first half of fiscal 2004 compared to the same period in fiscal 2003. While the acquisition of WTC has increased the headcount in sales, sales support, marketing and administration by approximately 30%, the Company has taken cost cutting actions throughout fiscal 2003 and into the current year to reduce its infrastructure costs and gain synergies in combining these two businesses. These actions have offset the increased headcount.

The non-cash expenses related to the amortization of capitalized software and other intangible assets were $.6 million and $1.2 million for the three and six month periods ended November 30, 2003 as compared to $.4 million and $.8 million for the same periods in fiscal 2003. The increase of approximately $.2 million per quarter in fiscal 2004 compared to fiscal 2003 is related to the capitalized software and other identifiable intangible assets of WTC totaling approximately $2.7 million that are being written off on a straight line basis over 3 years.

Interest expense for the three and six month periods ended November 30, 2003 were approximately $249,000 and $502,000, respectively, as compared to $291,000 and $576,000 for the same periods in fiscal 2003. This represents a decrease of $42,000 or 14.4% for the second quarter of fiscal 2004 compared to the same period in the previous fiscal year and a decrease of $74,000 or 12.8% for the six month period ended November 30, 2003 compared to the same period in the prior fiscal year. The average borrowings increased to approximately $14.3 million during the current quarter as compared to $12.1 million for the same period in fiscal 2003, however, the average interest rate on those borrowings decreased to about 7.0% in the current quarter from 9.6% for the same period in fiscal 2003. The average borrowings increased to approximately $14.3 million during the first half of fiscal 2004 as compared to $11.7 million for the same period in fiscal 2003, however, average the interest rate on those

borrowings decreased to about 7.0% during the first half of fiscal 2004 as compared to 9.8% for the same period in fiscal 2003. The increase in average borrowings is a direct result of the funds borrowed to complete the WTC acquisition.

The net loss for the three and six month periods ended November 30, 2003 were $(246,000) and $(724,000), respectively, as compared to a net loss of $(213,000) and $(745,000) for the same period in the prior fiscal year. The loss per share for each of the three month periods ended November 30, 2003 and 2002 was $(.02) and for each of the six month periods ended November 30, 2003 and 2002 was $(.06).

Capital Resources and Liquidity

The Company ended the first half of fiscal 2004 with cash of $306,000. Operating activities utilized $540,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation together with a decrease in accounts receivable and other assets generated cash of $985,000. The reduction in accounts payable and accrued expenses used cash of $680,000 and the cyclical reduction in deferred revenue utilized cash of $845,000 during the first half of the fiscal year.

Although the Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow in fiscal 2004, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable.

The Company believes that the cash on hand together with cash flow from operations and its available borrowings under its credit facility will be sufficient for meeting its liquidity and capital resource needs for the next year. At November 30, 2003, the Company had available borrowings on its debt facilities of approximately $3.3 million.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company's business is subject to many uncertainties and risks. This Form 10-QSB also contains certain forward-looking statements within the meaning of the Private Securities Reform Act of 1995. The Company's future results may differ materially from its current results and actual results could differ materially from those projected in the forward looking statements as a result of certain risk factors, including but not limited to those set forth below, other one-time events and other important factors disclosed previously and from time to time in the Company's other filings with the SEC.

Our quarterly results may fluctuate.

The Company's quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Our quarterly revenue may fluctuate significantly for several reasons, including: the timing and success of introductions of our new products or product enhancements or those of our competitors; uncertainty created by changes in the market; difficulty in predicting the size and timing of individual orders; competition and pricing; and customer order deferrals as a result of general economic decline. Furthermore, the Company has often recognized a substantial portion of its product revenues in the last month of a quarter, with these revenues frequently concentrated in the last weeks or days of a quarter. As a result, product revenues in any quarter are substantially dependent on orders booked and shipped in the latter part of that quarter and revenues from any future quarter are not predictable with any significant degree of accuracy. We typically do not experience order backlog. For these reasons, we believe that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

We may not generate positive cash flow in the future.

During fiscal years 1998 through 2001 we generated significant cash losses from operations. The Company took aggressive cost cutting steps and reorganized its operations at the beginning of fiscal 2002. These actions have greatly reduced our fixed costs and resulted in positive cash flow from operations for the last two fiscal years. It is our expectation that we can continue to improve on our recent success, however, there can be no assurances that the Company will continue to generate positive cash in the future.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

Continued decline in business conditions and Information Technology (IT) spending could cause further decline in revenue.

The level of future IT spending remains very uncertain as does the prognosis for an economic recovery in the manufacturing sector. If IT spending continues to decline and the manufacturing sector continues to experience economic difficulty, the Company's revenues could be adversely impacted.

The Company is dependent on its lender for continued support.

We have a very strong relationship with our sole lender, Greenleaf Capital. They currently represent our sole source of financing and it is our belief that it would be difficult to find alternative financing sources in the event whereby the relationship with Greenleaf changed.

The continued integration of WTC may experience difficulty.

Since acquiring WTC in December 2002, much progress has been made in integrating our operations, reducing redundant functions and consolidating our facilities. The strategy includes more closely integrating our technologies and offering our combined customer base these solutions. The strategy also includes translating ProductCenter for users other than the U.S. English speaking market. There can be no assurance that this continued integration of our technologies or offering ProductCenter outside the U.S. will be successful.

NEW ACCOUNTING PRONOUNCEMENTS:

On December 31, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 148 (SFAS 148), Accounting for Stock-Based Compensation -- Transition and Disclosure, amending FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. This Statement amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. The Company has complied with the disclosure provisions in these financial statements.

The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and provides the required pro forma disclosures prescribed by SFAS 123 and SFAS 148.

The Company has adopted the disclosure-only provisions of SFAS 123. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market. No compensation expense was recognized during the three and six month periods ended November 30, 2003 or 2002.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, an entity capitalizes a cost by increasing the carrying amount of the long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 effective June 1, 2003 did not have a material effect on the financial position or results of operations of the Company.

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which is effective for contracts entered into or modified after June 30, 2003. This Statement amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities for the purpose of improving financial reporting by requiring contracts with comparable characteristics to be accounted for similarly. The adoption of SFAS No. 149 effective July 1, 2003 did not have a material impact on the Company's financial position or results of operations.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

In May 2003, FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", which is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position or results of operations.

SOFTECH, INC. AND SUBSIDIARIES

Item 3. Controls and Procedures

The Company's Chief Operating Officer is responsible for establishing and maintaining disclosure controls and procedures for the Company. Such officer has concluded (based upon his evaluation of these controls and procedures as of a date within 90 days of the filing of this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in this report is accumulated and communicated to the Company's management, including its principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officer also has indicated that there were no significant changes in the Company's internal controls or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K

None.

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.

SOFTECH, INC.

Date: January 14, 2004

/s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer