EMTEC INC/NJ
Form 10-Q
January 20, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2008

Commission file number: 0-32789

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

Delaware	87-0273300
(State of incorporation or organization)	(I.R.S. Employer Identification No.)

525 Lincoln Drive
5 Greentree Center, Suite 117
Marlton, New Jersey 08053
(Address of principal executive offices, including zip code)

(856) 552-4204
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (see the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act). (Check one)

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

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

As of January 12, 2009, there were outstanding 15,141,993 shares of the registrant's common stock.

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED NOVEMBER 30, 2008

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements

EMTEC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	November 30, 2008 (Unaudited)	August 31, 2008
Assets		
Current Assets		
Cash	$ 2,260,529	$ 2,025,098
Receivables:		
Trade, less allowance for doubtful accounts	34,428,421	32,178,967
Others	2,364,900	2,285,542
Inventories, net	2,473,912	659,994
Prepaid expenses and other	836,055	1,006,686
Deferred tax asset - current	835,389	900,028
Total current assets	43,199,206	39,056,315
Property and equipment, net	996,988	1,108,327
Intangible assets, net	10,970,724	11,315,422
Goodwill	10,535,853	10,697,516
Deferred tax asset- long term	101,635	171,985
Other assets	105,992	124,475
Total assets	$ 65,910,398	$ 62,474,040
Liabilities and Stockholders' Equity		
Current Liabilities		
Line of credit	$ 10,057,456	$ 8,583,552
Accounts payable	27,343,249	24,824,365
Current portion of long term debt - related party	3,071,502	2,810,937
Income taxes payable	791,711	315,111
Accrued liabilities	4,629,051	5,418,625
Due to former stockholders	-	631,415
Customer deposits	-	500
Deferred revenue	1,179,208	1,323,177
Total current liabilities	47,072,177	43,907,682
Deferred tax liability	2,238,237	2,298,650
Accrued liabilities	124,359	342,708
Long term debt - related party	257,080	754,578

Total liabilities		49,691,853		47,303,618
Commitments and contingent liabilities				
Stockholders' Equity				
Common stock $0.01 par value; 25,000,000 shares authorized; 18,006,582 and 17,714,180 shares issued and 15,141,993 and 14,849,591, outstanding at November 30, 2008 and August 31, 2008, respectively		180,066		177,142
Additional paid-in capital		20,675,223		20,635,972
Retained earnings (accumulated deficit)		959,303		(46,645)
		21,814,592		20,766,469
Less: treasury stock, at cost, 2,864,589 shares		(5,596,047)		(5,596,047)
Total stockholders' equity		16,218,545		15,170,422
Total liabilities and stockholders' equity	$	65,910,398	$	62,474,040

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

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EMTEC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED NOVEMBER 30, 2008 and 2007

	2008	2007
Revenues		
Procurement services	$ 56,358,723	$ 70,762,377
Service and consulting	13,660,387	3,877,809
Total Revenues	70,019,110	74,640,186
Cost of Sales		
Cost of procurement services	50,392,498	63,029,313
Service and consulting	10,832,626	2,965,896
Total Cost of Sales	61,225,124	65,995,209
Gross Profit		
Procurement services	5,966,225	7,733,064
Service and consulting	2,827,761	911,913
Total Gross Profit	8,793,986	8,644,977
Operating expenses:		
Selling, general, and administrative expenses	6,177,875	5,755,443
Rent expense – related parties	152,496	89,325
Depreciation and amortization	533,899	300,503
Total operating expenses	6,864,270	6,145,271
Operating income	1,929,716	2,499,706
Other expense (income):		
Interest income – other	(4,903)	(17,775)
Interest expense	254,062	337,023
Other expense (income)	4,164	(18)
Income before income taxes	1,676,393	2,180,476
Provision for income taxes	670,446	934,274
Net income	$ 1,005,947	$ 1,246,202
Net income per common share		
Basic and Diluted	$ 0.07	$ 0.09
Weighted Average Shares Outstanding		
Basic	14,578,827	14,445,064

Diluted	14,632,335	14,566,446

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

EMTEC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED NOVEMBER 30, 2008 and 2007

	2008	2007
Cash Flows From Operating Activities		
Net income	$ 1,005,947	$ 1,246,202
Adjustments to Reconcile Net Income to Net Cash (Used In) Operating Activities		
Depreciation and amortization	189,201	155,415
Amortization related to intangible assets	344,698	145,088
Deferred income taxes	(215,551)	360,333
Stock-based compensation	42,175	67,352
Indemnification of professional fees	(269,882)	-
Changes In Operating Assets and Liabilities		
Receivables	(2,669,976)	(19,742,179)
Inventories	(1,813,918)	2,833,400
Prepaid expenses and other assets	189,114	(99,937)
Accounts payable	2,518,885	9,739,003
Customer deposits	(500)	(136,089)
Income taxes payable	476,600	530,783
Accrued liabilities	(411,898)	77,561
Deferred revenue	(143,969)	(21,686)
Net Cash Used In Operating Activities	(759,074)	(4,844,754)
Cash Flows From Investing Activities		
Purchases of property and equipment	(77,864)	(17,836)
Increase to goodwill/ tax settlement	(164,602)	-
Net Cash Used In Investing Activities	(242,466)	(17,836)
Cash Flows From Financing Activities		
Net increase (decrease) in line of credit	1,473,904	4,121,129
Repayment of debt	(236,932)	(239,200)
Net Cash Provided By Financing Activities	1,236,972	3,881,929
Net increase (decrease) in Cash	235,431	(980,661)
Beginning Cash	2,025,098	2,251,352
Ending Cash	$ 2,260,529	$ 1,270,691
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Income taxes	$ 208,635	$ 33,050
Interest	$ 146,309	$ 199,756
Supplemental Schedule of Non Cash Investing and Financing Activities		
Indemnification receivable due from former shareholders settled by the amounts due to former shareholders	$ 631,415	-

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

EMTEC, INC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements. Quarterly results are not necessarily indicative of results for the full year. For further information, refer to the annual financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended August 31, 2008.

2. General

Description of Business

Emtec, Inc., a Delaware Corporation, (the “Company”) is an information technology (“IT”) company, providing consulting, services and products to commercial, federal, education, state and local government clients. The Company’s areas of specific practices include communications, data management, enterprise computing, managed services and staff augmentation solutions, training, storage and data center planning and development. The Company’s client base is comprised of departments of the United States Federal Government, U.S. state and local governments, schools and commercial businesses throughout the United States. The most significant portion of the Company’s revenue is derived from activities as a reseller of IT products, such as workstations, servers, microcomputers, and application software and networking and communications equipment.

On March 20, 2008, the Company acquired, through its subsidiary Emtec Global Services LLC (“EGS”), all of the outstanding stock of Luceo, Inc. (“Luceo”) headquartered in Naperville, IL. Luceo offers a broad range of consulting/contracting services to clients throughout the United States including IT project management services, packaged software implementation, web technologies/client server application development and support.

On August 13, 2008, the Company acquired, through its subsidiary EGS, all of the outstanding stock of eBusiness Application Solutions, Inc. (‘eBAS”), and Aveeva, Inc. (“Aveeva”) headquartered in Fremont, CA and their Indian subsidiary Aviance Software India Private Limited (“Aviance”), headquartered in Bangalore, India. eBAS and Aveeva offers a broad range of software consulting services, including business analysis, quality assurance, testing, and training as well as SAP, CRM, Oracle Apps, and Java based solutions throughout the United States.

With the acquisitions of Luceo, eBAS and Aveeva, the Company divides its operating activity into two operating segments for reporting purposes: Emtec Systems Division (“Systems Division”) and Emtec Global Services Division (“Global Services Division”). Systems Divisions is the Company’s historical business and Global Services Division is the Company’s IT Staffing Augmentation Solutions and Training business including Luceo, eBAS and Aveeva.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Emtec, Inc., a New Jersey Corporation ("Emtec NJ"), Emtec Viasub LLC ("Emtec LLC"), Emtec LLC's wholly owned subsidiary Emtec Federal, Inc. ("Emtec Federal"), EGS, EGS's wholly owned subsidiaries Luceo, eBAS, Aveeva and Aveeva's subsidiary Aviance. Significant intercompany account balances and transactions have been eliminated in consolidation.

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

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period, including, but not limited to, receivable valuations, impairment of goodwill and other long-lived assets and income taxes. Management's estimates are based on historical experience, facts and circumstances available at the time, and various other assumptions that are believed to be reasonable under the circumstances. The Company reviews these matters and reflects changes in estimates as appropriate. Actual results could differ from those estimates.

Goodwill

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired companies. In accordance with Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets," goodwill is not amortized but tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company has set an annual impairment testing date of June 1. An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount.

The changes in the carrying amount of goodwill for the three months ended November 30, 2008 are as follows:

Balance at August 31, 2008	$	10,697,516
Reduction in goodwill arising from settlement of tax uncertainties acquired in April 16, 2004 merger		(161,663)
Balance at November 30, 2008	$	10,535,853

The Company determined that it has two reporting segments, Systems Division and Global Services Division. Systems Division primarily consists of the Company's historical business prior the acquisition of Luceo on March 20, 2008 and Global Services Division consists of Luceo, eBAS and Aveeva. Further, the Company determined that it has three reporting units under SFAS 142; Systems Divisions, Luceo, and eBAS/Aveeva.

Based on the income (discounted cash flows) and market-based (guideline company method) approaches there was no goodwill impairment for the System Division at June 1, 2008. Based on the income (discounted cash flow) approach there was no goodwill impairment for the Luceo reporting unit at June 1, 2008. At November 30, 2008, Emtec's market capitalization was less than its total stockholders' equity, which is one factor the Company considered when determining whether goodwill should be tested for impairment between annual tests. The Company does not currently believe that the reduced market capitalization represents a goodwill impairment indicator as of November 30, 2008, however, if current market conditions persist and the Company's estimated value under the income and market-based approaches is effected, then it is possible that the Company may have to take a goodwill impairment charge against earnings in a future period.

Identifiable Intangible Assets

At November 30, 2008 and August 31, 2008, the components of identifiable intangible assets are as follows:

	November 30, 2008	August 31, 2008
Customer relationships	$ 12,861,712	$ 12,861,712
Non-compete agreements	370,000	370,000
	13,231,712	13,231,712
Accumulated amortization	(2,260,988)	(1,916,290)
	$ 10,970,724	$ 11,315,422

Customer relationships represent the value ascribed to customer relationships purchased in 2005 and the acquisitions of Luceo and eBAS/Aveeva in fiscal 2008. The amounts ascribed to customer relationships are being amortized on a straight-line basis over 5-15 years.

Non-compete agreements represent the value ascribed to covenants not to compete employment agreements with certain members of Luceo and eBAS/Aveeva's management entered into at the date of the respective acquisitions. The amounts ascribed to non-compete agreements are being amortized on a straight-line basis over five years.

Amortization expense was $344,698 and $145,088 for the three months ended November 30, 2008 and 2007, respectively. We currently expect future amortization for the next 5 years ending August 31, 2009 through 2013 will be approximately $1,370,000 per year.

Long-lived assets, including customer relationships and property and equipment, are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable in accordance with "SFAS" No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." Recoverability of long-lived assets is assessed by a comparison of the carrying amount to the estimated undiscounted future net cash flows expected to result from the use of the assets and their eventual disposition. If estimated undiscounted future net cash flows are less than the carrying amount, the asset is considered impaired, and a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the asset. No impairment of long-lived assets occurred during the three months ended November 30, 2008.

Earnings Per Share

Basic earnings per share amounts are computed by dividing net income available to common stockholders (the numerator) by the weighted average shares outstanding (the denominator), during the period. Shares issued during the period are weighted for the portion of the period that they were outstanding.

The computation of diluted earnings per share is similar to the computation of basic earnings (loss) per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive options, restricted stock awards and warrants had been exercised as of the end of the period. Potentially dilutive shares consist of stock options, restricted stock awards and warrants totaling 53,508 and 121,382 shares for the three months ended November 30, 2008 and 2007, respectively. Outstanding warrants to purchase 1,682,444 and 1,648,807 common shares as of November 30, 2008 and 2007, respectively, were not included in the computation of diluted earnings per share for the three months ended November 30, 2008 and 2007, because the exercise price was greater than the average market price of the Company's common shares over those periods.

Income Taxes and Due to Former Stockholders

On September 1, 2007, the Company adopted FASB Interpretation No. 48 ("FIN 48"). FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. Subsequent to the initial adoption of FIN 48, our policy is to recognize interest and penalty expense associated with uncertain tax positions as a component of income tax expense in the consolidated statements of operations.

In October 2008, the Company settled the August 2003 and April 2004 tax audits of Emtec-Federal {formerly Westwood Computer Corporation ("Westwood")} with the Appeals Office of the IRS. The settlement agreement resulted in an additional federal income tax payment of $145,070, which included interest of $40,908. The Company has initiated the preparation of 2003 and 2004 amended New Jersey income tax returns to pay additional New Jersey tax liability that results from the IRS settlement. The accounting to record the settlements of these pre-merger tax liabilities under FIN 48 resulted in adjustments to goodwill and to deferred tax assets. Since the underlining provisions of the executed Westwood merger agreement included indemnification coverage by Westwood's former stockholders, the Company recorded a receivable "due from the Westwood former stockholders", of $631,415. The $631,415 included pre-merger tax liabilities totaling $361,533 plus associated professional fees to defend the Company's tax positions totaling $269,882. The $361,533 portion of the Company's indemnity claim was recorded as a reduction to goodwill acquired in the April 2004 Westwood merger. The remaining $269,882 portion was recorded as a reduction to selling, general & administrative expenses for the three months ended November 30, 2008.

The "due from Westwood former stockholders" receivable was satisfied during October 2008, based on offsetting amounts "due to Westwood former stockholders" totaling $631,415. The amounts "due to Westwood former stockholders" represented funds we held as unclaimed merger consideration.

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Reconciliation of Unrecognized Tax Liability for the three months ended November 30, 2008:

Balance at September 1, 2008	$	692,532
Unrecognized tax postions of prior periods:		
Increase		-
Decrease		-
Unrecognized tax postions of current year:		
Increase		3,371
Decrease		-
Decrease in Unrecognized tax benefits due to settlements		(547,119)
Decrease in Unrecognized tax benefits due to lapse of statute of limitations		-
Balance at November 30, 2008	$	148,784
Total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate	$	50,903
Accrued interest and penalties for unrecognized tax benefits as of November 30, 2008 balance sheet	$	63,470
Interest and penalties classified as income tax expense (benefit)- for the three months ended November 30, 2008	$	(23,594)

3. Acquisitions

Luceo, Inc.

On March 20, 2008, EGS, Luceo and Sivapatham Natarajan (“Mr. Natarajan”) entered into a Stock Purchase Agreement, pursuant to which EGS agreed to acquire all of the outstanding stock of Luceo from Mr. Natarajan for the purchase price that consists of (i) cash at closing in an aggregate amount equal to $1,795,000; (ii) a subordinated promissory note in a principal amount of $820,000 which is payable in two equal installments of $410,000 each on the 12 month and 18 month anniversaries of the closing and (iii) contingent payments of additional cash consideration each year for the next three years on the anniversary of the closing if certain performance goals are met. During the year ended August 31, 2008, the purchase price was reduced by $68,489 in connection with the working capital adjustment.

Unaudited pro forma condensed results of operations are not included because the effect of the acquisition is not material.

eBusiness Applications Solutions, Inc. and Aveeva, Inc.

On August 13, 2008, EGS, a wholly-owned subsidiary of Emtec, eBAS, Aveeva and Ms. Chopra entered into a Purchase Agreement, pursuant to which EGS agreed to acquire all of the outstanding stock of eBAS and Aveeva from Ms. Chopra. The purchase price consists of (i) cash at closing in an aggregate amount equal to $7,313,500 and (ii) the potential right to pay contingent consideration of $1 million each year for the next three years on the anniversary of the closing if certain performance goals are met. The purchase price may be increased or decreased pursuant to a post-closing working capital adjustment.

Unaudited pro forma results of operations as if the acquisition of eBAS/Aveeva had occurred as of September 1, 2007 is presented below.

	Three months ended November 30,			
		2008		2007
Revenue	$	70,019,110	$	84,011,475
Net income		1,005,947		1,480,863
Basic and diluted earning per share	$	0.07	$	0.10

The unaudited pro forma results have been prepared for comparative purposes only and include certain adjustments. All adjustments were tax effected. They do not purport to be indicative of the results of operations that actually would have resulted had the combination occurred on September 1, 2007 or of future results of operations of the consolidated entities.

4. Stock-Based Compensation and Warrants

Stock Options

The Company's 2006 Stock-Based Incentive Compensation Plan (the "2006 Plan") was approved by the stockholders on May 8, 2006. The 2006 Plan authorizes the granting of stock options to directors and eligible employees. The Company has reserved 1,400,000 shares of its common stock for issuance under the 2006 Plan at prices not less than 100% of the fair value of the Company's common stock on the date of grant (110% in the case of stockholders owning more than 10% of the Company's common stock). Options under the 2006 Plan have terms from 7 to 10 years and vest from immediately through a term of 4 years.

The Company measures the fair value of options on the grant date using the Black-Scholes option valuation model. The Company estimated the expected volatility using the Company's historical stock price data over the expected term of the stock options. The Company also used historical exercise patterns and forfeiture behaviors to estimate the options, expected term and our forfeiture rate. The risk-free interest rate is based on the U.S. Treasury zero-coupon yield curve in effect on the grant date. Both expected volatility and the risk-free interest rate are based on a period that approximates the expected term.

A summary of stock options for the three months ended November 30, 2008 is as follows:

For the Three Months Ended November 30, 2008	Shares		Weighted Average Exercise Price	Weighted Average Remaining Term		Aggregate Intrinsic Value *
Options Outstanding -September 1, 2008	386,500	$	1.22			
Options Granted	20,000	$	0.33			
Options Exercised	-					
Options Forfeited or Expired	(1,000)	$	1.31			
Options Outstanding - November 30, 2008	405,500	$	1.13	6.06 years	$	6,200
Options Exercisable -November 30, 2008	169,500	$	1.08	7.27 years	$	6,200

* Represents the total pre-tax intrinsic value based on the Company's average closing stock prices for the three months ended November 30, 2008.

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The following assumptions were used to value stock options issued during the three months ended November 30:

	2008	2007
Weighted-Average Fair Value	$ 0.28	$ 0.47
Assumptions		
Expected Volatility	106.49%	100%
Expected Term	5 years	5 years
Expected Forfeiture Rate	0%	0%
Dividend Yield	0%	0%
Risk-Free Interest Rate	1.89%	3.21%

Non-vested Stock (Restricted Stock)

During the fiscal year ended August 31, 2007, the Company granted 459,224 shares of non-vested (restricted) stock to certain members of senior management and employees. These non-vested shares vest equally over 4 years. During January 2008, the Company granted 10,331 shares of stock to a member of senior management team. During November 2008, the Company granted 292,402 shares of non-vested (restricted) stock to certain members of senior management in connection with annual bonus compensation. These non-vested shares vest over a one-year period. The fair value of these shares was determined based upon the quoted closing price of the Company's stock on the Over-the-Counter Bulletin Board on the grant date. The Company recognizes compensation expense associated with the issuance of such shares using the closing price of the Company's common stock on the date of grant over the vesting period on a straight-line basis.

The following table summarizes the Company's restricted stock activity during the three months ended November 30, 2008:

For the Three Months Ended November 30, 2008	Shares	Weighted Average Grant Date Fair Value	Fair Value
Nonvested - September 1, 2008	330,542	$ 1.24	
Granted	292,402	$ 0.36	
Vested	(59,778)	$ 1.24	$ 21,520 (a)
Forfeited	-	-	
Nonvested -November 30, 2008	563,166	$ 0.78	$ 202,740 (b)
Vested -November 30, 2008	193,541	$ 1.25	$ 150,166 (a)

(a) The fair value of vested restricted stock shares represents the total pre-tax fair value, based on the closing stock price on the day of vesting, which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date.

(b) The aggregate fair value of the non-vested restricted stock shares expected to vest represents the total pre-tax fair value, based on the Company's closing stock price as of November 30, 2008 which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date.

Stock Options and Non-vested Stock

Stock-based compensation costs related to the 2006 Plan totaled $42,175 and $67,352 during the three months ended November 30, 2008 and 2007, respectively. As of November 30, 2008, the Company had recognized a cumulative total of $756,448 in compensation costs and had $295,959 of unrecognized compensation cost related to these instruments. The cost is expected to be recognized over a remaining period of 3 years.

Warrants

On August 5, 2005, the Company issued certain stockholders stock warrants that evidence the obligation of the Company to issue a variable number of shares, in the aggregate, equal to 10% of then total issued and outstanding shares of the Company's common stock, measured on a post-exercise basis, at any date during the 5-year term of the warrants, which ends August 5, 2010. The aggregate exercise price of these warrants is fixed at $3,695,752. The exercise price per warrant will vary based upon the number of shares issuable under the warrants. The number of shares issuable under the warrants totaled 1,682,444 and 1,648,807 shares, with an exercise price of $2.20 and $2.24 per share, as of November 30, 2008 and 2007, respectively. The outstanding warrants were anti-dilutive for the three months ended November 30, 2008 and 2007, because the exercise price was greater than the average market price of the Company's common shares.

5. Line of Credit

The Company, Emtec NJ, Emtec LLC, Emtec Federal, Emtec Global, Luceo, eBAS, and Aveeva (collectively, the "Borrower"), have a Loan and Security Agreement with De Lage Landen Financial Services, Inc. (the "Lender") pursuant to which the Lender provides the Borrower with a revolving credit loan and floor plan loan (the "Credit Facility"). The Credit Facility provides for aggregate borrowings of the lesser of $32.0 million or 85% of Borrower's eligible accounts receivable, plus 100% of unsold inventory financed by the Lender. The floor plan loan portion of the Credit Facility is for the purchase of inventory from approved vendors and for other business purposes. The Credit Facility subjects the Borrower to mandatory repayments upon the occurrence of certain events as set forth in the Credit Facility.

As of November 30, 2008, borrowings under the Credit Facility bore interest at an annual rate equal to the rate of interest published in the "Money Rates" section of the Wall Street Journal minus 0.5% (3.50% as of November 30, 2008) for revolving credit loans. Floor plan loans do not bear interest until, and unless, the Borrower is in default, unless a floorplan loan is unsubsidized, then, such floor plan loan will accrue interest once made, at the rate agreed to by the parties. Interest on outstanding floor plan loans accrues at the rate of 2.5% per annum in excess of the interest rate published in the "Money Rates" section of the Wall Street Journal. The rate in effect was 6.50% as of November 2008. The Company did not have any unsubsidized floorplan loans during the three months ended November 30, 2008 and 2007. The rates discussed in this paragraph were in effect through the December 6, 2008 renewal date of the Credit Facility.

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

The Company had balances of $10.06 million and $8.58 million outstanding under the revolving portion of the Credit Facility, and balances of $2.91 million and $2.05 million (included in the Company's accounts payable) outstanding plus $1.15 million and $444,700 in open approvals under the floor plan portion of the Credit Facility at November 30, 2008 and August 31, 2008, respectively. Net availability of $16.55 million and $14.44 million was available under the revolving portion of the Credit Facility, and additionally $1.33 million and $6.49 million was available under the floor plan portion of the Credit Facility, as of November 30, 2008 and August 31, 2008, respectively.
As of November 30, 2008, the Company determined that it was in compliance with its financial covenants with the Lender.

On December 5, 2008, the Borrower entered into a First Amendment and Joinder to Loan and Security Agreement and Schedule to Loan and Security Agreement (the "First Amendment") with the Lender, pursuant to which the Lender has agreed to extend the term of the Credit Facility from December 7, 2008 until December 7, 2010 and to make certain other amendments to the Credit Facility, including the following:

§ The First Amendment changes the base rate of interest to the three month (90 day) LIBOR rate from the previous base rate of the "Prime Rate."

§ The First Amendment changes the interest rate for revolving credit loans to the base rate plus 3.25% from the previous interest rate for revolving credit loans of the base rate minus 0.5%, and changes the interest rate for floorplan loans, if applicable, to 6.25% in excess of the base rate from the previous interest rate for floorplan loans of 2.5% in excess of the base rate.

§ The First Amendment amends the Schedule to provide that the Borrowers must pay the Lender a floorplan annual volume commitment fee if the aggregate amount of all floorplan loans does not equal or exceed $60,000,000 in a 12 month period from December 1st through November 30th. The floorplan commitment fee is equal to the amount that the floorplan usage during such 12 month period is less than $60,000,000 multiplied by 1%. If the Borrower terminates the Credit Facility during a 12 month period, the Borrower shall be required to pay the Lender a pro rated portion of the annual volume commitment fee.

In addition by executing the First Amendment, Emtec Global, Luceo, eBAS and Aveeva each joined the Credit Facility as a Borrower and granted DLL a security interest in all of their respective interests in certain of their respective assets, including inventory, equipment, fixtures, accounts, chattel paper, instruments, deposit accounts, documents, general intangibles, letter of credits rights, and all judgments, claims and insurance policies. Emtec Global pledged 100% of the outstanding shares of its domestic subsidiaries, eBAS and Luceo, and Emtec Global and Aveeva pledged 65% in the aggregate of the outstanding shares of Aviance Software (India) Pvt. Ltd., an Indian company.

6. Concentration of Credit Risk and Significant Clients

Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of accounts receivable.

The Company’s revenues, by client type, are comprised of the following:

	For the Three Months Ended November 30,				
		2008	% of Total		2007	% of Total
Departments of the U.S. Government	$	40,195,246	57.4%	$	48,370,513	64.8%
State and Local Governments		2,996,195	4.3%		3,718,015	5.0%
Commercial Companies		16,758,915	23.9%		13,082,477	17.5%
Education and other		10,068,754	14.4%		9,469,181	12.7%
Total Revenues	$	70,019,110	100.0%	$	74,640,186	100.0%

Major Customers

Three months ended November 30, 2008

Sales to a school district in Georgia accounted for approximately $8.9 million or 12.8% and $5.6 million or 7.5% of the Company’s total revenues for three months ended November 30, 2008 and 2007, respectively.

Three months ended November 30, 2007

Sales to a department of the United States Government accounted for approximately $10.2 million or 13.7% and $3.7 million or 4.8% of the Company’s total revenue for the three months ended November 30, 2007 and 2008, respectively.

The Company reviews a client's credit history before extending credit. The Company does not require collateral or other security to support credit sales. The Company provides for an allowance for doubtful accounts based on the credit risk of specific clients, historical experience and other identified risks. Trade receivables are carried at original invoice less an estimate made for doubtful receivables, based on review by management of all outstanding amounts on a periodic basis. Trade receivables are considered delinquent when payment is not received within standard terms of sale, and are charged-off against the allowance for doubtful accounts when management determines that recovery is unlikely and ceases its collection efforts.

The trade account receivables consist of the following:

		November 30, 2008		August 31, 2008
Trade receivables	$	34,819,558	$	32,570,104
Allowance for doubtful accounts		(391,137)		(391,137)
Trade receivables, net	$	34,428,421	$	32,178,967

7. Accrued Liabilities

Current accrued liabilities consisted of the following:

	November 30, 2008	August 31, 2008
Accrued payroll	$ 1,763,173	$ 2,384,922
Accrued commissions	719,696	730,848
Accrued state sales taxes	95,428	97,514
Accrued third party service fees	132,625	108,070
Other accrued expenses	1,918,129	2,097,271
	$ 4,629,051	$ 5,418,625

8. Related Party Transactions

One of the Company's facilities is leased under a non-cancelable operating lease agreement with an entity that is owned by certain directors and officers of the Company and their related family members. Rent expense was $45,000 for each of the three months ended November 30, 2008 and 2007, respectively. The facilities consist of office and warehouse space totaling 42,480 square feet, located in Springfield, New Jersey

The Company is occupying approximately 26,000 square feet of office and warehouse space in a 70,000- square-foot building in Suwannee, GA. This space is leased from GS&T Properties, LLC, in which certain officers of the Company are passive investors with an approximately 20% equity interest. The lease term is for 5 years, with monthly base rent of $15,832. During the three months ended November 30, 2008 and 2007, the Company recorded expense under this lease totaling $47,496 and $44,325, respectively.

In conjunction with the acquisition of eBAS/Aveeva, the Company entered into a lease for approximately 20,000 square feet of office space. This space is leased from the spouse of the President of eBAS/Aveeva. The lease term is through August 31, 2011, with a monthly rent of $20,000. For the three months ended November 30, 2008, the Company recorded expense under this lease totaling $60,000.

Management believes the lease payments are at or below market rate for similar facilities for the leases noted above.

EgisNova Corp. is an information technology staffing company, owned by the spouse of the President of Luceo. EgisNova Corp. provides subcontractor services to Luceo. EgisNova Corp. provided gross services to Luceo totaling $306 for the three months ended November 30, 2008.

9. Segment Information

The Company has adopted Statement of Financial Accounting Standard No. 131, "Disclosure about Segments of an Enterprise and Related Information." The Company's business activities are divided into two business segments, Systems Division and Global Services Division. Systems Division provides services and products to commercial, federal, education, state and local government clients. System Division's areas of specific practices include communications, data management, enterprise computing, managed services, storage and data center planning and development. Systems Division's client base is comprised of departments of the United States Federal Government, state and local governments, schools and commercial businesses throughout the United States. Global Services Division offers a broad range of consulting/contracting services to clients throughout the United States including IT project management services, packaged software implementation, web technologies/client server application development and extended service maintenance and upgrades. Global Services is comprised primarily of the business operations acquired through the acquisitions of Luceo on March 20, 2008 and eBAS/Aveeva on August 13, 2008.

Summarized financial information relating to the Company's operating segments is as follows:

	November 30,2008 (Unaudited)	August 31, 2008
Identifiable Assets:		
Systems Division	49,629,764	46,212,267
Global Services Division	16,280,634	16,261,773
Total Assets	65,910,398	62,474,040

	Three months ended November 30, 2008	2007
	(Unaudited)	
Revenues		
Systems Division	59,306,220	74,640,186
Global Services Division	10,712,890	-
Total Revenue	70,019,110	74,640,186
Gross Profit		
Systems Division	6,686,672	8,644,977
Global Services Division	2,107,314	-
Gross Profit	8,793,986	8,644,977
Operating Income		
Systems Division	1,200,045	2,499,706
Global Services Division	729,670	-
Operating Income	1,929,716	2,499,706
Interest and Other Expense (Income)		
Systems Division	134,558	319,230
Global Services Division	118,764	-
Interest and Other Expense (Income)	253,323	319,230
Provision for Income Taxes		
Systems Division	416,097	934,274
Global Services Division	254,349	-
Provision for Income Taxes	670,446	934,274
Net Income		
Systems Division	649,390	1,246,202
Global Services Division	356,557	-
Net Income	1,005,947	1,246,202

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 on Form 10-Q.

Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Quarterly Report on Form 10-Q and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the "SEC"). In addition to historical information, this Quarterly Report on Form 10-Q contains our beliefs regarding future events and our future financial performance. In some cases, you can identify those so-called "forward-looking statements" by words such as "may," "will," "should," expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue" or those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. We undertake no obligation to publicly release any revisions to forward-looking statements after the date of this report. In evaluating those statements, you should specifically consider various factors, including the risk factors discussed in our Annual Report on Form 10-K for the year ended August 31, 2008 and other reports or documents that we file from time to time with the SEC. All forward-looking statements attributable to us or a person acting on our behalf are expressly qualified in their entirety by this cautionary statement.

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

Overview of Emtec

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

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

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

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

For three months ended November 30, 2008 and 2007, our Systems Divisions revenues decreased to $59.31 million from $74.64 million. If we are unable to increase our revenues in future periods, whether due to the effects of the economic downturn on our commercial business or otherwise, then we may be forced to consolidate our operations to reduce operating expenses sufficiently to achieve profitable operations. We have implemented several cost containment measures beginning in December 2008 that will reduce our selling, general and administrative expenses in future quarters, but there can be no assurance that we will be able to generate sufficient new business or that our cost containment measures in place will provide us the ability to maintain profitability in the future.

Our financial results can be impacted by the level of business activity of our clients, in particular our commercial clients. The current economic downturn may continue to cause reductions in technology and discretionary spending by our clients. Furthermore, business activity from our government and education clients may also decrease as their spending will be impacted by declining tax revenues associated with this economic downturn.

On March 20, 2008, we acquired through our subsidiary EGS all of the outstanding stock of Luceo, headquartered in Naperville, Illinois. Luceo offers a broad range of consulting/contracting services to clients throughout the United States, which specializes in providing IT project management services, packaged software implementation, web technologies/client server application development and support.

On August 13, 2008, we acquired through our subsidiary EGS all of the outstanding stock of eBAS and Aveeva headquartered in Fremont, California and Aveeva's Indian subsidiary Aviance, headquartered in Bangalore, India. eBAS and Aveeva offer a broad range of software consulting services including business analysis, quality assurance, testing, and training as well as SAP, CRM, Oracle Apps, and Java based solutions.

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

Results of Operations

Comparison of Three Months Ended November 30, 2008 and November 30, 2007

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of our Results of Operations for each of the three months ended November 30, 2008 and 2007.

EMTEC, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

Three Months Ended November 30,

	2008	2007	Change	%
Revenues				
Procurement services	$ 56,358,723	$ 70,762,377	$ (14,403,654)	-20.4%
Service and consulting	13,660,387	3,877,809	9,782,578	252.3%
Total Revenues	70,019,110	74,640,186	(4,621,076)	-6.2%
Cost of Sales				
Cost of procurement services	50,392,498	63,029,313	(12,636,815)	-20.0%
Service and consulting	10,832,626	2,965,896	7,866,730	265.2%
Total Cost of Sales	61,225,124	65,995,209	(4,770,085)	-7.2%
Gross Profit				
Procurement services	5,966,225	7,733,064	(1,766,839)	-22.8%
Procurement services %	10.6%	10.9%		
Service and consulting	2,827,761	911,913	1,915,848	210.1%
Service and consulting %	20.7%	23.5%		
Total Gross Profit	8,793,986	8,644,977	149,009	1.7%
Total Gross Profit %	12.6%	11.6%		
Operating expenses:				
Selling, general, and administrative expenses	6,177,875	5,755,443	422,432	7.3%
Rent expense – related party	152,496	89,325	63,171	70.7%
Depreciation and amortization	533,899	300,503	233,396	77.7%
Total operating expenses	6,864,270	6,145,271	718,999	11.7%
Pecent of revenues	9.8%	8.2%		
Operating income				