SOFTECH INC
Form 10QSB
April 14, 2005

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 February 28, 2005	Commission File Number 0-10665

SOFTECH, INC.

State of Incorporation Massachusetts	IRS Employer Identification 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 April 11, 2005 was 12,205,236 shares.

SOFTECH, INC.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

(dollars in thousands)

	February 28, 2005	May 31, 2004
ASSETS		
Cash and cash equivalents	1,183	275
Accounts receivable, net	1,868	2,175
Prepaid expenses and other assets	199	244
Total current assets	3,250	2,694
Property and equipment, net	180	199
Capitalized software costs, net	5,486	7,043
Identifiable intangible assets, net	275	550
Goodwill, net	4,598	4,598
Notes receivable	134	134
Other assets	111	115
TOTAL ASSETS	14,034	15,333

LIABILITIES AND STOCKHOLDERS' DEFICIT		
Accounts payable	204	205
Accrued expenses	1,106	1,575
Deferred maintenance revenue	4,210	3,941
Current portion of long term debt	1,293	1,293
Total current liabilities	6,813	7,014
Long-term debt, net of current portion	12,790	12,917
Stockholders' deficit	(5,569)	(4,598)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	14,034	15,333

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(in thousands, except for p

	Three Months En	
	February 28, 2005	Feb
Revenue		
Products	$ 770	$
Services	2,240	
Total revenue	3,010	
Cost of products sold	27	
Cost of services provided	433	
Gross margin	2,550	

Research and development expenses	712	
Selling, general and administrative	1,405	
Amortization of capitalized software and other intangible assets	611	
Loss from operations before interest expense	(178)	
Interest expense	216	
Net loss	$ (394)	$
Basic and diluted net loss per common share	$ (0.03)	$
Weighted average common shares outstanding	12,205	

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	(in thousands, except for pe	
	Nine Months End	
	February 28, 2005	Feb
Revenue		
Products	$ 1,875	$
Services	7,133	
Total revenue	9,008	
Cost of products sold	54	
Cost of services provided	1,231	
Gross margin	7,723	
Research and development expenses	2,064	
Selling, general and administrative	4,088	
Amortization of capitalized software and other intangible assets	1,832	

Loss from operations before interest expense	(261)	
Interest expense	682	
Net loss	$ (943)	$
Basic and diluted net loss per common share	$ (0.08)	$
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

	(dollars in thousands) Nine Months Ended	
	February 28, 2005	February 29, 2004
Cash flows from operating activities:		
Net loss	$ (943)	$ (1,469
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	1,901	1,943
Change in current assets and liabilities:		
Accounts receivable	307	476
Prepaid expenses and other assets	15	25
Accounts payable and accrued expenses	(281)	(856
Deferred maintenance revenue	269	(164
Total adjustments	2,211	1,424
Net cash provided (used) by operating activities	1,268	(45
Cash flows used by investing activities:		
Payments for WTC shares tendered this period	(189)	-
Capital expenditures	(44)	(38
Net cash used by investing activities	(233)	(38
Cash flows from financing activities:		
Principal payments under capital lease obligations	-	(16
Repayments of line of credit agreements, net	(127)	(16

Net cash used by financing activities	(127)	(32
Increase (decrease) in cash and cash equivalents	908	(115
Cash and cash equivalents, beginning of period	275	654
Cash and cash equivalents, end of period	$ 1,183	$ 539

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 2004 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, "Modification of SOP 97-2 Software Revenue Recognition with Respect to Certain Transactions" (SOP 98-9) in recognizing revenue from software transactions. Revenue from software license sales is recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, the fee is fixed and determinable and collectibility has been deemed probable. The company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the elements using the residual method. 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 purchased 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. Purchased software is recorded at cost. The Company evaluates the realizability of capitalized costs 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 nine month periods ended February 28, 2005 and February 29, 2004. Amortization expense related to capitalized software costs for the three and nine month periods ended February 28, 2005 were $611,000 and $1,832,000, respectively. Amortization expense related to capitalized software costs for the three and nine month periods ended February 29, 2004 were $610,000 and $1,835,000, respectively.

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 conducts its annual impairment test at the end of its fiscal year. The Company tested the goodwill for impairment as of May 31, 2004 and concluded, based on actual results for fiscal 2004 and projected cash flows, that no impairment existed as of May 31, 2004.

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

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" and SFAS No. 148 "Accounting for Stock-Based Compensation - An Amendment of SfAS No. 123." 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 February 28, 2005	Three Month Periods Ended February 29, 2004
Net loss - as reported	$ (394)	$ (745
Stock based compensation determined under fair value based method	(3)	(3
Net loss - pro forma	(397)	(748
Loss per share - diluted - as reported	(.03)	(.06
Loss per share - diluted - pro forma	(.03)	(.06

(in thousands, except per share data)	Nine Month Periods Ended February 28, 2005	Nine Month Periods Ended February 29, 2004
Net loss - as reported	$ (943)	$ (1,469
Stock based compensation determined under fair value based method	(8)	(9
Net loss - pro forma	(951)	(1,478
Loss per share - diluted - as reported	(.08)	(.12
Loss per share - diluted - pro forma	(.08)	(.12

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 as a component of selling, general and administrative expense, and are not material for any period presented.

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.

RECLASSIFIACTIONS:

Certain amounts in fiscal 2004 have been reclassified to conform with the presentation in fiscal 2005.

(C) LIQUIDITY

The Company ended Q3 fiscal 2005 with cash of about $1.2 million, an increase of $908,000 from May 31, 2004. Operating activities provided approximately $1.3 million of cash during the first nine 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 generated cash of about $1.3 million. The reduction in accounts payable and accrued expenses used cash of $281,000 and the cyclical increase in deferred revenue provided cash of $269,000 during the first nine months of the fiscal year. In addition, during the first nine months of fiscal 2005 the Company reduced debt by $127,000 and paid former WTC shareholders that tendered their shares a total of $189,000. WTC was purchased in December 2002. Less than 10% of the shareholders did not tender their shares at that time but have the right to do so at anytime to receive the $2.00 per share tender price. This obligation has been fully accrued as part of the purchase price of WTC. Lastly, the Company purchased approximately $44,000 of capital equipment.

Although the Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow for the full fiscal year 2005, the current economic environment, although showing signs of improvement, 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 February 28, 2005, the Company had available borrowings on its debt facilities of approximately $3.5 million.

(D) BALANCE SHEET COMPONENTS

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

	February 28, 2005	May 31, 2004
Property and equipment	$ 3,945	$ 3,867
Accumulated depreciation and amortization	(3,765)	(3,668)

Property and equipment, net	$ 180	$ 199

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	(24,567)	(23,624)
Accumulated other comprehensive loss	(259)	(231)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	$ (5,569)	$ (4,598)

(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 2005 and 2004 because their inclusion would be antidilutive. The weighted average shares outstanding for each of the income statements included in this filing are presented below (000's):

	Three Month and Nine Month Periods Ended	
	February 28, 2005	February 29, 2004
Basic weighted average shares outstanding	12,205	12,205
Effect of employee stock options outstanding	--	--
	12,205	12,205

(F) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments. For the three and nine month periods ended February 28, 2005 and February 29, 2004, the comprehensive loss was as follows (000's):

	Three Month Periods Ended	
	February 28, 2005	February 29, 2004
Net loss	$ (394)	$ (745)

Changes in:		
Foreign currency translation adjustment	(18)	(58)
Comprehensive loss	$ (412)	$ (803)

	Nine Month Periods Ended February 28, 2005	February 29, 2004
Net loss	$ (943)	$ (1,469)
Changes in:		
Foreign currency translation adjustment	(28)	(137)
Comprehensive loss	$ (971)	$ (1,606)

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 February 28, 2005	Three Months Ended February 29, 2004
North America	$ 2,294	$ 2,035
Asia	306	256
Europe	642	571
Eliminations	(232)	(94)
Consolidated Total	$ 3,010	$ 2,768

Revenue:	Nine Months Ended February 28, 2005	Nine Months Ended February 29, 2004
North America	$ 6,569	$ 6,941
Asia	849	705
Europe	1,890	1,741
Eliminations	(300)	(366)
Consolidated Total	$ 9,008	$ 9,021

Long Lived Assets:	February 28, 2005	May 31, 2004
North America	$ 10,602	$ 12,495
Europe	182	194
Consolidated Total	$ 10,784	$ 12,689

(H) NEW ACCOUNTING PRONOUNCEMENTS:

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123(R) is effective for public companies that file as small business issuers for interim or annual periods beginning after December 15, 2005. The Company is currently evaluating the impact that this statement will have on its financial condition or results of operations.

On December 31, 2002, the FASB issued 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.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

The statements made below with respect to SofTech's outlook for fiscal 2005 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:

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, "Modification of SOP 97-2 Software Revenue Recognition with Respect to Certain Transactions" (SOP 98-9) in recognizing revenue from software transactions. Revenue from software license sales is recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, the fee is fixed and determinable and collectibility has been deemed probable. The company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the elements using the residual method. 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.

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. 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.

SOFTECH, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

The Company conducts its annual impairment test at the end of its fiscal year. The Company tested the goodwill for impairment at May 31, 2004 and concluded, based on actual results for fiscal 2004 and projected cash flows, that no impairment existed as of May 31, 2004.

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

Revenue for the three and nine month periods ended February 28, 2005 and February 29, 2004 was $3.0 million and $9.0 million, respectively, as compared to $2.8 million and $9.0 million for the same periods in the prior fiscal year. This represents an increase of 8.7% for fiscal 2005 Q3 as compared to the same period in fiscal 2004 and essentially no change in revenue for the nine month periods. Both product and services revenue increases contributed to the improved revenue performance in the quarter comparisons.

Product revenue for the three and nine month periods ended February 28, 2005 was approximately $770,000 and $1.9 million, respectively, as compared to $603,000 and $2.1 million for the same periods in the prior fiscal year. This represents an increase of 27.7% for fiscal 2005 Q3 and a decrease of 8.7% for the nine months ended February 28, 2005 as compared to the same periods in fiscal 2004. For Q3 FY2005, we increased product revenue for each of our three product families as compared to the same period in fiscal 2004. ProductCenter increased 16.9%, Cadra 30.1% and the AMT product line increased 46.9%. For the nine month period ended February 28, 2005 compared to the same period last year, we experienced increased product revenue of 8.7% in Cadra and 8.5% in our AMT product families while ProductCenter decreased by 29.2%. This decline in ProductCenter product revenue for the nine month period was due to an elongation of the sales cycle as manufacturing companies have been more deliberate about making purchasing decisions especially in Q1 and Q2.

Service revenue for the three and nine month periods ended February 28, 2005 was about $2.2 million and $7.1 million, respectively, as compared to about $2.2 million and $7.0 million for the same period in fiscal 2004. This represents an increase of 3.5% and 2.4% for the three and nine month periods ended February 28, 2005 as compared to the same period in fiscal 2004, respectively. Our consulting and training revenue increased 66.5% and 58.3% for the three and nine month periods ended February 28, 2005, respectively, as compared to the same periods in the prior year. This increase in consulting and training revenue offset a decrease in maintenance revenue of 4.3% and 3.8%, respectively for the three and nine month periods ended February 28, 2005 as compared to the same periods in the prior fiscal year. The decrease in maintenance revenue in both the three and nine month periods was due to declines in the renewal rates and renewal prices from the customer base for both the ProductCenter and AMT product lines.

Gross margin as a percentage of revenue was 84.7% and 85.7 % for the three and nine month periods ended February 28, 2005, respectively, as compared to 82.3% and 83.4% for the same periods in fiscal 2004. This increase in gross margin as a percent of revenue in fiscal 2005 as compared to the same period in fiscal 2004 is due to reductions in headcount over the last year in our customer support functions and increased productivity from our consulting and training engineers.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

Research and development expenses ("R&D") were $712,000 and $2.06 million for the three and nine month periods ended February 28, 2005, respectively, as compared to $700,000 and $2.11 million for the same periods in the prior fiscal year. The relatively stable expense has been achieved through improved efficiencies gained from deploying these resources across the three product families as warranted.

Selling, general and administrative ("SG&A") expenses were $1.41 million and $4.09 million, respectively, for the three and nine month periods ended February 28, 2005 as compared to $1.46 million and $4.29 million for the same period in fiscal 2004. This represents a decrease of approximately 3.5% and 4.7% for the three and nine month periods ended February 28, 2005, respectively, as compared to the same periods in the prior fiscal year. The decreases are related to the reduction in headcount as efficiencies were realized from the combination of our SG&A organization subsequent to the acquisition of WTC. WTC was acquired in December 2002.

The non-cash expenses related to the amortization of capitalized software and other intangible assets were $.6 million and $1.8 million for the three and nine month periods ended February 28, 2005 and February 29, 2004.

Interest expense for the three and nine month periods ended February 28, 2005 were approximately $216,000 and $682,000, respectively, as compared to $255,000 and $757,000 for the same periods in fiscal 2004. This represents a decrease of

15.3% for the third quarter of fiscal 2005 compared to the same period in the previous fiscal year and a decrease of 9.9% for the nine month period ended February 28, 2005 as compared to the same period in the prior fiscal year. The average borrowings decreased to approximately $14.2 million during the current quarter as compared to $14.3 million for the same period in fiscal 2004, however, the interest rate on those borrowings decreased to about 6.1% in the current quarter from 7.2% for the same period in fiscal 2004. The average borrowings decreased to approximately $14.2 million during the first nine months of fiscal 2005 as compared to $14.3 million for the same period in fiscal 2004, however, the interest rate on those borrowings decreased to about 6.4% during the first nine months of fiscal 2005 as compared to 7.1% for the same period in fiscal 2004. The interest rate reduction is the result of negotiations with the Company's lender.

The net loss for the three and nine month periods ended February 28, 2005 was $(394,000) and $(943,000), respectively, as compared to a net loss of $(745,000) and $(1,469,000) for the same period in the prior fiscal year. The loss per share for each of the three month periods ended February 28, 2005 was $(.03) and $(.08), respectively, as compared to $(.06) and $(.12) for the same periods in the prior fiscal year.

CAPITAL RESOURCES AND LIQUIDITY

The Company ended Q3 fiscal 2005 with cash of about $1.2 million, an increase of $908,000 from May 31, 2004. Operating activities provided approximately $1.3 million of cash during the first nine 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 generated cash of about $1.3 million. The reduction in accounts payable and accrued expenses used cash of $281,000 and the cyclical increase in deferred revenue provided cash of $269,000 during the first nine months of the fiscal year. In addition, during the first nine months of fiscal 2005 the Company reduced debt by $127,000 and paid former WTC shareholders that tendered their shares a total of $189,000. WTC was purchased in December 2002. Less than 10% of the shareholders did not tender their shares at that time but have the right to do so at anytime to receive the $2.00 per share tender price. This obligation has been fully accrued as part of the purchase price of WTC. Lastly, the Company purchased approximately $44,000 of capital equipment.

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 2005, 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 February 28, 2005, the Company had available borrowings on its debt facilities of approximately $3.5 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 three full fiscal years and for the first nine months of fiscal 2005. 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.

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.

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

The Company filed a Form 8-K on January 6, 2005 related to its press release announcing second quarter results for fiscal 2005.

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: April 14, 2005 /s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer