SOFTECH INC
Form 10QSB
January 14, 2003

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, 2002	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 December 31, 2002 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) November 30, 2002 (unaudited)	May 31, 2002 (audited)
ASSETS		
Cash and cash equivalents	$ 3,479	$ 708
Accounts receivable, net	1,395	1,671
Prepaid expenses and other assets	235	170
Total current assets	5,109	2,549
Property and equipment, net (Note B)	240	330
Capitalized software costs, net	8,601	9,371
Goodwill, net	2,197	2,197
Marketable securities	183	106
Other assets	143	143

TOTAL ASSETS	$ 16,473	$ 14,696
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Accounts payable	$ 356	$ 372
Accrued expenses	530	694
Deferred maintenance revenue	1,898	2,642
Current portion of capital lease obligations	65	79
Current portion of long term debt	1,045	714
Total current liabilities	3,894	4,501
Capital lease obligations, net of current portion	7	23
Non-current deferred revenue	459	459
Long-term debt, net of current portion	13,603	10,589
Total long-term debt	14,069	11,071
Stockholders' deficit	(1,490)	(876)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 16,473	$ 14,696

See accompanying notes to consolidated condensed financial statements.

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

	(in thousands, except f Three Months
	November 30, 2002
Revenue	
Products	$ 837
Services	1,389

Total revenue	2,226
Cost of products sold	24
Cost of services provided	70
Gross margin	2,132
Research and development expenses	362
Selling, general and administrative	1,692
Income (loss) from operations before interest expense and income taxes	78
Interest expense	291
Loss before income taxes	(213)
Provision for income taxes	-
Net loss	$ (213)
Basic and diluted net loss per common share	$ (0.02)
Weighted average common shares outstanding	12,205

See accompanying notes to consolidated condensed financial statements.

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

	(in thousands, except fo Six Months
	November 30, 2002
Revenue	
Products	$ 1,135
Services	2,812
Total revenue	3,947

Cost of products sold	33
Cost of services provided	137
Gross margin	3,777
Research and development expenses	696
Selling, general and administrative	3,250
Loss from operations before interest expense and income taxes	(169)
Interest expense	576
Loss before income taxes	(745)
Provision for income taxes	-
Net loss	$ (745)
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 thousan Six Months Ended	
	November 30, 2002	N
Cash flows from operating activities:		
Net loss	$ (745)	$
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	977	
Change in current assets and liabilities:		
Accounts receivable	276	
Prepaid expenses and other assets	(65)	
Accounts payable and accrued expenses	(180)	
Deferred maintenance revenue	(744)	

Total adjustments	264	
Net cash used by operating activities	(481)	
Cash flows used by investing activities:		
Purchase of marketable securities	(29)	
Capital expenditures	(33)	
Net cash used by investing activities	(62)	
Cash flows from financing activities:		
Principal payments under capital lease obligations	(31)	
Proceeds from line of credit agreements, net	3,345	
Net cash provided by financing activities	3,314	
Increase (decrease) in cash and cash equivalents	2,771	
Cash and cash equivalents, beginning of period	708	
Cash and cash equivalents, end of period	$ 3,479	$
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	565	
Income Taxes Paid	0	

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 2002 Annual Report on Form 10-K.

(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 eight to ten years.

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 and intangible assets with indeterminable lives 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. The Company utilized a third party independent valuation to determine the fair value of each of the reporting units based on a discounted cash flow income approach. 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 is not required to be completed. These valuations contain certain assumptions concerning estimated future revenues and future expenses for each of our two product lines, Cadra and AMT, using our fiscal 2003 budget as the baseline. For Cadra, we projected that annual revenue would decrease at rates between 1.7% and 2.4% and expenses would increase at annual rates of about 1.5%. For AMT, we projected annual revenue would increase at annual rates between 2.5% and 3.3% and that expenses would increase at annual rates of about 1.5%. No additional revenue was projected for new product offerings for either product line. Should actual results differ from these estimates, an impairment charge may be necessary in subsequent periods. The Company will be required to continue to perform a goodwill impairment test on an annual basis.

The Company did not record expense related to the amortization of goodwill during the three and six months ended November 30, 2002. 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. The following table presents the reported net loss and net loss per share data for the three and six month periods ended November 30, 2002 and 2001, as well as pro forma adjustments relating to the three and six month periods ended November 30, 2002 and 2001, as if SFAS No. 142 had been adopted on June 1, 2001.

	Three Months Ended November 30 (000's) (unaudited)	
	2002	2001
Reported net loss	$(213)	$(623)
Add back: Goodwill amortization	--	290
Adjusted net loss	$(213)	$(333)
Basic and diluted loss per share, as reported	$(.02)	$(.06)
Basic and diluted loss per share, as adjusted	$(.02)	$(.03)

	Six Months Ended November 30 (000's) (unaudited)	
	2002	2001
Reported net loss	$(745)	$(1,044)
Add back: Goodwill amortization	--	514
Adjusted net loss	$(745)	$(530)
Basic and diluted loss per share, as reported	$(.06)	$(.10)
Basic and diluted loss per share, as adjusted	$(.06)	$(.05)

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.

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 allowance for doubtful accounts, valuation of long lived assets including goodwill and intangibles (capitalized software costs) and deferred tax assets. Actual results could differ from those estimates.

(C) LIQUIDITY

The Company ended the first half of fiscal 2003 with cash of approximately $3.5 million. Operating activities used approximately $481,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation provided cash of $232,000. A net decrease in accounts receivable generated an additional $276,000. The paydown of accounts payable and accrued expenses utilized $180,000 and the decrease in deferred revenue resulted in an additional reduction of $744,000.

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 2003, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable.

During the first six months of fiscal 2003, the Company purchased $33,000 of capital equipment and an additional 33,952 shares of Workgroup Technology Corporation ("WTC") shares in open market transactions for approximately $29,000 prior to commencement of the Tender Offer in mid-November. The Company drew down additional funds, net of repayments, of $3.3 million under its Promissory Note with Greenleaf Capital in order to provide sufficient capital to acquire WTC.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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, 2002, the Company had available borrowings on its debt facilities of approximately $3.4 million.

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

	November 30, 2002 (unaudited)	May 31, 2002 (audited)
Property and equipment	$ 3,601	$ 3,568
Accumulated depreciation and amortization	(3,361)	(3,238)
Property and equipment, net	$ 240	$ 330
Common stock, $.10 par value	$ 1,274	$ 1,274
Capital in excess of par value	19,544	19,544
Accumulated deficit	(20,664)	(19,919)
Cumulative translation adjustment	(154)	(166)
Unrealized gain(loss)on marketable securities	71	(48)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	$ (1,490)	$ (876)

(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 2003 and 2002 because their inclusion would be antidilutive. The weighted average shares outstanding for each of the income statements included in this filing are presented below:

	For the Three Month Periods Ended	
	November 30, 2002 (unaudited)	November 30, 2001 (unaudited)
Basic weighted average shares outstanding	12,205,236	10,741,784
Effect of employee stock options outstanding	--	--
Diluted	12,205,236	10,741,784

	For the Six Month Periods Ended November 30, 2002 (unaudited)	November 30, 2001 (unaudited)
Basic weighted average shares outstanding	12,205,236	10,741,784
Effect of employee stock options outstanding	--	--
Diluted	12,205,236	10,741,784

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(F) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments and unrealized gain on marketable securities. For the three and six month periods ended at November 30, 2002 and 2001, the comprehensive loss was as follows (000's):

	Three Month Periods Ended November 30, 2002 (unaudited)	2001 (unaudited)
Net loss	$ (213)	$ (623)
Changes in:		
Foreign currency translation adjustment	(12)	(4)
Unrealized gain on marketable securities	97	--
Comprehensive loss	$ (128)	$ (627)

	Six Month Periods Ended November 30, 2002 (unaudited)	2001 (unaudited)
Net loss	$ (745)	$ (1,044)
Changes in:		
Foreign currency translation adjustment	12	5
Unrealized gain on marketable securities	119	--

Comprehensive loss	$ (614)	$ (1,039)

(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):

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Revenue:	Three Months Ended November 30, 2002 (unaudited)	Three Months Ended November 30, 2001 (unaudited)
North America	$1,251	$1,252
Asia	279	240
Europe	904	567
Eliminations	(208)	(70)
Consolidated Total	$2,226	$1,989

Revenue:	Six Months Ended November 30, 2002 (unaudited)	Six Months Ended November 30, 2001 (unaudited)
North America	$2,300	$2,836
Asia	469	530
Europe	1,409	1,236
Eliminations	(231)	(174)
Consolidated Total	$3,947	$4,428

Long-Lived Assets:	November 30, 2002 (unaudited)	May 31, 2002 (audited)
North America	$11,212	$12,050
Europe	152	97

Consolidated Total	$11,364	$12,147

(H) NEW ACCOUNTING PRONOUNCEMENTS

On December 31, 2002, the 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. For entities that voluntarily change to the fair value based method of accounting for stock-based employee compensation, the transition provisions are effective for fiscal years ending after December 15, 2002. For all other companies, the disclosure provisions and the amendment to APB No. 28 are effective for interim periods beginning after December 15, 2002. We do not expect the transition provisions to have any effect on our financial position, results of operations or cash flows.

On November 25, 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34. FIN 45 clarifies the requirements of FASB Statement No. 5, Accounting for Contingencies (SFAS 5), relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees.

SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. FIN 45 covers guarantee contracts that have any of the following four characteristics: (a) contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party (e.g., financial and market value guarantees), (b) contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (performance guarantees), (c) indemnification agreements that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law, and (d) indirect guarantees of the indebtedness of others.

FIN 45 specifically excludes certain guarantee contracts from its scope. Additionally, certain guarantees are not subject to FIN 45's provisions for initial recognition and measurement but are subject to its disclosure requirements. The initial recognition and measurement provisions are effective for guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for our annual financial statements the year ended May 31, 2003. We are currently evaluating the impact of FIN 45 on our financial statements and related disclosures.

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. Management believes the adoption of SFAS No. 143 will not have a material effect on the financial position or results of operations of the Company.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. It replaces SFAS No. 121. The accounting model for long-lived assets to be disposed of by sale applies to all long-lived assets, including discontinued operations. SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The adoption of SFAS No. 144 did not have a material effect on the financial position or results of operations of the Company.

In July 2002, FASB issued Statement No. 146 "Accounting for Costs Associated with Exit or Disposal Activities", which becomes effective January 2003. SFAS No. 146 requires companies to recognize costs associated with exit or disposal

activities when they are incurred rather than at the date of commitment. Management believes the adoption of SFAS No. 146 will not have a material effect on the financial position or results of operations or retained earnings.

In April 2002, FASB issued Statement No. 145, "Rescission of FASB Statements No 4, 44, and 64, Amendment of FASB 13, and Technical Corrections", which is effective for fiscal years beginning after May 15, 2002. Upon adoption of SFAS 145, companies will be required to apply the criteria in APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions" in determining the classification of gains/losses resulting from the extinguishment of debt. Upon adoption, extinguishments of debt shall be classified under the criteria in APB Opinion No. 30. The adoption of SFAS No. 145 did not have a material effect on the financial position or results of operations or retained earnings.

(I) RECLASSIFICATIONS:

Certain prior year amounts have been reclassified to conform to the current year presentation. Research and development expense for the three and six month periods ended November 30, 2001included $412,000 and $891,000, respectively, of amortization and allocation of overhead cost that have been reclassified to selling, general and administrative expense to conform to the current year presentation. These reclassifications have no effect on the previously reported results of operations or retained earnings.

(J) AMENDMENT TO PROMISSORY NOTE

On November 8, 2002, the Company amended its Promissory Note with Greenleaf Capital, Inc. Under the amended agreement the Company increased its borrowing from $11.0 million to $15.0 million. In addition, the interest rate was reduced from 9.75% to Prime Rate plus 3.0% (currently 7.25%). This amendment was entered into in order to provide the Company sufficient capital to complete the acquisition of Workgroup Technology Corporation (see Note K). The Promissory Note expires on June 12, 2007.

(K) SUBSEQUENT EVENT

On December 18, 2002, the Company successfully closed on a cash tender offer ("Offer") to acquire the outstanding shares common stock of Workgroup Technology Corporation (WTC) at a price of $2.00 per share. Approximately 1.5 million shares of WTC common stock were purchased by the Company under the Offer, which, together with the shares owned by SofTech represents approximately 89% of the outstanding shares of WTC. On January 2, 2003, the Company filed a Form 8-K with the Securities and Exchange Commission which provides additional information regarding this event.

SOFTECH, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The statements made below with respect to SofTech's outlook for fiscal 2003 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 CAD and CAM technologies, potential unfavorable outcome to existing litigation, maintaining existing relationships with the Company's lenders, remaining in compliance with debt covenants, 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 Judgements 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 A to the Company's consolidated financial statements, contained in its May 31, 2002 Annual Report on Form 10-K, as filed with the SEC. The Company believes that the following accounting policies require the application of management's most difficult, subjective or complex judgments:

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 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 product lines, Cadra and AMT, using our fiscal 2003 budget as the baseline. For Cadra, we projected that annual revenue would decrease at rates between 1.7% and 2.4% and expenses would increase at annual rates of about 1.5%. For AMT, we projected annual revenue would increase at annual rates between 2.5% and 3.3% and that expenses would increase at annual rates of about

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

1.5%. No additional revenue was projected for new product offerings for either product line.We have not determined that there has been an 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 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. The Company utilized a third party independent valuation to determine the fair value of each of the reporting units based on a discounted cash flow income approach. 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 is not required to be completed. The Company will be required to continue to perform a goodwill impairment test on an annual basis.

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 is currently fully reserved.

Results of Operations

Total revenue for the three and six month periods ended November 30, 2002 were $2.2 million and $3.9 million, respectively, compared to $2.0 million and $4.4 million for the same periods in the prior fiscal year. This represents an increase in total revenue of about $237,000 or 12% for Q2 FY2003 compared to the same period in fiscal 2002 and a decrease in revenue of about $481,000 or 11% for the first half of fiscal 2003 compared to the same period in fiscal 2002. Product revenue increased by approximately $457,000 in Q2 fiscal 2003 as compared to the same period in the prior year or about 120% and increased about $63,000 or 6% for the first half of fiscal 2003 as compared to the same period in fiscal 2002. Service revenue decreased by about $220,000 or 14% in the second quarter of fiscal 2003 as compared to the same period of fiscal 2002 and decreased by $544,000 or 11% in the first half of fiscal 2003 compared to the same period in fiscal 2002.

SOFTECH, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Total revenue for Q2 2003 as compared to the same period in fiscal 2002 was up 59% in Europe, 16% in Asia and flat in North America. For the first half of fiscal 2003 as compared to the same period in fiscal 2002, total revenue was up 14% in Europe, down 12% in Asia and down 19% in North America.

Product revenue is composed of licensing our technology to end users. The manufacturing marketplace that is served by our technology offerings has been in a prolonged slump that has resulted in greatly reduced capital spending especially on technology. The second quarter 2003 results improved greatly as compared to the same period of fiscal 2002 and did so in all geographies. North America and Asia production doubled and Europe was up 185%. Year to date 2003 as compared to 2002, North America and Asia product revenue production was down about 5% but Europe's production increased 39%.

Service revenue is composed of software maintenance on our proprietary software and revenue generated from services performed by our engineers such as installation, training and consulting. Service revenue decreased by $220,000 and $544,000 for the three and six month periods ended November 30, 2002, respectively, as compared to the same periods in the prior fiscal year. This represented a decrease of 14% and 16% for the three and six month periods ended November 30, 2002, respectively, as compared to the same periods in the prior year. The decrease for the both the quarter and the first half of fiscal 2003 as compared to the same periods in the prior year was due to a 16% reduction in North American maintenance revenue for our Cadra product line and a 24% reduction in our CAM product line. In addition, a large implementation project ended in Q1 of fiscal 2002 that had contributed about $100,000 of additional service revenue in that period. The decline in North American maintenance revenue was due partly to the very difficult economic conditions in the manufacturing sector and the loss a significant AMT product line customer in Q1 of fiscal 2002.

Research and development expenditures for the three and six month periods ended November 30, 2002 were $362,000 and $696,000, respectively, as compared to $413,000 and $792,000 in fiscal 2002. These small decreases in spending reflect an overall reduction of approximately two full time equivalents.

Selling, general and administrative expenses totaled approximately $1.7 million and $3.3 million for the three and six month periods ended November 30, 2002, respectively. The SG&A spending in the same periods in fiscal 2002 totaled $1.8 million and $3.9 million. The cessation of goodwill amortization in the current year related to the adoption of FAS 142 reduced SG&A expenses by $290,000 and $514,000 for the three and six month periods ended November 30, 2002 and is the primary explanation for the change.

Interest expense for the three and six months ended November 30, 2002 were not significantly different from the expenses incurred for the comparable periods in fiscal 2002. The Company did draw additional funds totaling $3.5 million under its amended line of credit in November for the purpose of completing the acquisition of WTC, however, the impact on interest expense was negligible given the borrowings were outstanding for only the last eight (8) days of the period.

The net loss for the three and six month periods ended November 30, 2002 was $213,000 and $745,000 as compared to $623,000 and $1,044,000 for the same periods in fiscal 2002. The number of shares

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outstanding for each of the periods in fiscal 2003 were 12.2 million as compared to 10.7 million in each of the periods in fiscal 2002. The net loss per share for the three and six month periods ended November 30, 2002 was $.02 and $.06, respectively, as compared to the net loss per share of $.06 and $.10 for the same periods in fiscal 2002.

Capital Resources and Liquidity

The Company ended the first half of fiscal 2003 with cash of approximately $3.5 million. Operating activities used approximately $481,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation provided cash of $232,000. A net decrease in accounts receivable generated an additional $276,000. The paydown of accounts payable and accrued expenses utilized $180,000 and the decrease in deferred revenue resulted in an additional reduction of $744,000.

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 2003, the current economic environment especially in the manufacturing sector makes forecasting revenue based on historical models difficult and somewhat unreliable.

During the first six months of fiscal 2003, the Company purchased $33,000 of capital equipment and an additional 33,952 shares of Workgroup Technology Corporation ("WTC") shares in open market transactions for approximately $29,000 prior to commencement of the Tender Offer in mid-November. The Company drew down additional funds, net of repayments, of $3.3 million under its Promissory Note with Greenleaf Capital in order to provide sufficient capital to acquire WTC.

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, 2002, the Company had available borrowings on its debt facilities of approximately $3.4 million.

NEW ACCOUNTING PRONOUNCEMENTS

On December 31, 2002, the 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. For entities that voluntarily change to the fair value based method of accounting for stock-based employee compensation, the transition provisions are effective for fiscal years ending after December 15, 2002. For all other companies, the disclosure provisions and the amendment to APB No. 28 are effective for interim periods beginning after December 15, 2002. We do not expect the transition provisions to have any effect on our financial position, results of operations or cash flows.

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On November 25, 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34. FIN 45 clarifies the requirements of FASB Statement No. 5, Accounting for Contingencies (SFAS 5), relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees.

FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. FIN 45 covers guarantee contracts that have any of the following four characteristics: (a) contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party (e.g., financial and market value guarantees), (b) contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (performance guarantees), (c) indemnification agreements that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law, and (d) indirect guarantees of the indebtedness of others.

FIN 45 specifically excludes certain guarantee contracts from its scope. Additionally, certain guarantees are not subject to FIN 45's provisions for initial recognition and measurement but are subject to its disclosure requirements. The initial recognition and measurement provisions are effective for guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for our annual financial statements the year ended May 31, 2003. We are currently evaluating the impact of FIN

45 on our financial statements and related disclosures.

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. Management believes the adoption of SFAS No. 143 will not have a material effect on the financial position or results of operations of the Company.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. It replaces SFAS No. 121. The accounting model for long-lived assets to be disposed of by sale applies to all long-lived assets, including discontinued operations. SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be

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distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The adoption of SFAS No. 144 did not have a material effect on the financial position or results of operations of the Company.

In July 2002, FASB issued Statement No. 146 "Accounting for Costs Associated with Exit or Disposal Activities", which becomes effective January 2003. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment. Management believes the adoption of SFAS No. 146 will not have a material effect on the financial position or results of operations or retained earnings.

In April 2002, FASB issued Statement No. 145, "Rescission of FASB Statements No 4, 44, and 64, Amendment of FASB 13, and Technical Corrections", which is effective for fiscal years beginning after May 15, 2002. Upon adoption of SFAS 145, companies will be required to apply the criteria in APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and

Extraordinary, Unusual, and Infrequently Occurring Events and Transactions" in determining the classification of gains/losses resulting from the extinguishment of debt. Upon adoption, extinguishments of debt shall be classified under the criteria in APB Opinion No. 30. The adoption of SFAS No. 145 did not have a material effect on the financial position or results of operations or retained earnings.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We face exposure to financial market risks, including adverse movements and changes in interest rates. We conduct operations in Europe (Germany, Italy and France) where the local currency is the Euro and we are therefore subject to risk with regard to currency rate changes. In addition, we have a substantial long term debt obligation. Our borrowing rate is set at Prime Rate plus 3. A change in the Prime Rate of 50 Basis points would change our annual interest expense by approximately $73,000.

PART II. OTHER INFORMATION

Item 5. 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 their 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.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Certification Issued Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Certification Issued Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the three-month period ended November 30, 2002.

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, 2003 /s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer

SOFTECH, INC.
2 Highwood Drive
Tewksbury, MA 01876

Certification Issued Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Joseph P. Mullaney, President and Chief Operating Officer of SofTech, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of SofTech, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: January 14, 2003 /s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer

SofTech, Inc.
2 Highwood drive
Tewksbury, MA 01876

(Certification Issued Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)

I, Joseph P. Mullaney, certify that:

1. I am the President and Chief Operating Officer of SofTech, Inc.

2. I have read the quarterly report of SofTech, Inc. filed on Form 10-Q for the quarter ending November 30, 2002 (the "Report"), including the financial statements contained in the Report.

3. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in this quarterly report fairly presents, in all material respects, the financial condition and results of operations of SofTech, Inc. for and as of the period described.

Date: January 14, 2003 /s/ Joseph P. Mullaney

Joseph P. Mullaney
President
Chief Operating Officer