SOFTECH INC
Form 10-Q
January 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

# FORM 10-Q

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

For the quarterly period ended November 30, 2013

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

For the transition period from _________________ to ___________________

Commission File Number
0-10665

SOFTECH, INC.

(Exact name of the Registrant as specified in its charter)

| | |
|---|---|
| Massachusetts | 04-2453033 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S Employer Identification No.) |

650 Suffolk Street, Suite 415, Lowell, MA 01854

(Address of principal executive offices and zip code)

Telephone (978) 513-2700

(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 .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec. 232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X . No .

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 definitions of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer . Accelerated filer . Non-accelerated filer . 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 . No X .

The number of shares outstanding of registrant s common stock at January 8, 2014 was 875,135 shares.

SOFTECH, INC.

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED BALANCE SHEETS**

| | (in thousands) | |
|---|---|---|
| | (unaudited) November 30, 2013 | May 31, 2013 |
| ASSETS | | |
| Cash and cash equivalents | $ 1,612 | $ 1,188 |
| Restricted cash | 1,406 | 100 |
| Accounts receivable (less allowance for uncollectible accounts of $29 as of November 30, 2013 and May 31, 2013) | 1,091 | 895 |
| Receivable from product line sale | 320 | - |
| Prepaid and other assets | 157 | 299 |
| Total current assets | 4,586 | 2,482 |
| Property and equipment, net | 70 | 61 |
| Goodwill | 992 | 4,249 |
| Capitalized software development costs, net | 384 | 376 |
| Capitalized patent costs | 103 | 101 |
| Debt issuance costs, net | 238 | 250 |
| Notes receivable and other assets | 178 | 195 |
| TOTAL ASSETS | $ 6,551 | $ 7,714 |
| LIABILITIES, REDEEMABLE COMMON STOCK AND SHAREHOLDERS EQUITY | | |
| Accounts payable | $ 237 | $ 137 |
| Accrued expenses | 947 | 602 |
| Other current liabilities | 46 | 89 |
| Deferred maintenance revenue | 1,002 | 2,147 |
| Current portion of capital lease | 13 | 13 |
| Current portion of debt | 135 | - |
| Total current liabilities | 2,380 | 2,988 |

| | | | | |
|---|---|---|---|---|
| Capital lease, net of current portion | | 31 | | 39 |
| Long-term debt | | 2,520 | | 2,700 |
| Warrant liability | | 45 | | - |
| Total liabilities | | 4,976 | | 5,727 |
| Redeemable common stock, $0.10 par value, 50,000 shares issued and outstanding at November 30, 2013 and May 31, 2013 | | 275 | | 275 |
| Shareholders equity : | | | | |
| Common stock, $0.10 par value 20,000,000 shares authorized, 875,135 and 1,045,135 issued and outstanding at November 30, 2013 and May 31, 2013, respectively | | 100 | | 100 |
| Treasury stock, $0.10 par value, 170,000 shares at cost | | (63) | | - |
| Capital in excess of par value | | 27,375 | | 27,369 |
| Accumulated deficit | | (25,643) | | (25,333) |
| Accumulated other comprehensive loss | | (469) | | (424) |
| Total shareholders equity | | 1,300 | | 1,712 |
| TOTAL LIABILITIES, REDEEMABLE COMMON STOCK AND SHAREHOLDERS EQUITY | $ | 6,551 | $ | 7,714 |

See accompanying notes to unaudited consolidated financial statements.

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)**

| | (in thousands, except for share and per share data) For the Three Months Ended | | | |
|---|---|---|---|---|
| | November 30, 2013 | | November 30, 2012 | |
| Revenue: | | | | |
| Products | $ | 376 | $ | 478 |
| Services | | 1,038 | | 1,194 |
| Royalties from sale of patents | | - | | 100 |
| Total revenue | | 1,414 | | 1,772 |
| Cost of revenue: | | | | |
| Products | | 28 | | 24 |
| Services | | 264 | | 323 |
| Total cost of revenue | | 292 | | 347 |
| Gross margin | | 1,122 | | 1,425 |
| Research and development expenses | | 304 | | 323 |
| Selling, general and administrative expenses | | 866 | | 789 |
| Gain on sale of product line | | (91) | | - |
| Operating income | | 43 | | 313 |
| Interest expense | | 104 | | 69 |
| Other income | | (17) | | (8) |
| Net income (loss) | $ | (44) | $ | 252 |
| Basic and diluted net income (loss) per share: | $ | (0.05) | $ | 0.25 |
| Weighted average common shares outstanding-basic | | 875,135 | | 995,468 |
| Weighted average common shares outstanding-diluted | | 875,135 | | 997,751 |

See accompanying notes to unaudited consolidated financial statements.

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)**

| | (in thousands, except for share and per share data) For the Six Months Ended | | | |
|---|---|---|---|---|
| | November 30, 2013 | | November 30, 2012 | |
| Revenue: | | | | |
| Products | $ | 618 | $ | 693 |
| Services | | 2,172 | | 2,359 |
| Royalties from sale of patents | | - | | 290 |
| Total revenue | | 2,790 | | 3,342 |
| Cost of revenue: | | | | |
| Products | | 62 | | 49 |
| Services | | 572 | | 631 |
| Total cost of revenue | | 634 | | 680 |
| Gross margin | | 2,156 | | 2,662 |
| Research and development expenses | | 639 | | 567 |
| Selling, general and administrative expenses | | 1,747 | | 1,547 |
| Gain on sale of product line | | (91) | | - |
| Operating income (loss) | | (139) | | 548 |
| Interest expense | | 199 | | 134 |
| Other income | | (28) | | (11) |
| Net income (loss) | $ | (310) | $ | 425 |
| Basic and diluted net income (loss) per share: | $ | (0.35) | $ | 0.43 |
| Weighted average common shares outstanding-basic | | 888,140 | | 995,295 |
| Weighted average common shares outstanding-diluted | | 888,140 | | 996,572 |

See accompanying notes to unaudited consolidated financial statements.

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF**

**COMPREHENSIVE INCOME (LOSS) (UNAUDITED)**

| | (in thousands, except for share and per share data) For the Three Months Ended | |
|---|---|---|
| | November 30, 2013 | November 30, 2012 |
| Net income (loss) | $ (44) | $ 252 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustment | (25) | 12 |
| Total other comprehensive income (loss) | (25) | 12 |
| Comprehensive income (loss) | $ (69) | $ 264 |

See accompanying notes to unaudited consolidated financial statements.

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF**

**COMPREHENSIVE INCOME (LOSS) (UNAUDITED)**

| | (in thousands, except for share and per share data) For the Six Months Ended | |
|---|---|---|
| | November 30, 2013 | November 30, 2012 |
| Net income (loss) | $ (310) | $ 425 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustment | (45) | 6 |
| Total other comprehensive income (loss) | (45) | 6 |
| Comprehensive income (loss) | $ (355) | $ 431 |

See accompanying notes to unaudited consolidated financial statements.

**SOFTECH, INC. AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)**

| | ( in thousands) For the Six Months Ended | |
|---|---|---|
| | November 30, 2013 | November 30, 2012 |
| Cash flows from operating activities: | | |
| Net income (loss) | $ (310) | $ 425 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 111 | 102 |
| Gain on CADRA sale | (91) | - |
| Stock-based compensation | 4 | 4 |
| Non-cash interest expense | 6 | - |
| Change in fair value of warrant liability | (6) | - |
| Change in current assets and liabilities: | | |
| Accounts receivable | (196) | (303) |
| Prepaid expenses and other assets | 159 | 48 |
| Restricted cash | (1,306) | - |
| Accounts payable, accrued expenses and other liabilities | 402 | (2) |
| Deferred maintenance revenue | (538) | (630) |
| Net cash used in operating activities | (1,765) | (356) |
| Cash flows from investing activities: | | |
| Proceeds from sale of product line, net of direct cash expenses | 2,432 | - |
| Capital expenditures | (37) | (2) |
| Capitalized software development costs | (57) | (159) |
| Capitalized patent costs | (2) | (6) |
| Net cash provided by (used in) investing activities | 2,336 | (167) |
| Cash flows from financing activities: | | |
| Cost of treasury shares | (63) | - |
| Capitalized debt issuance costs | (32) | - |
| Proceeds from issuance of redeemable common stock, net of issuance costs | - | 98 |
| Repayment under debt agreements | - | (360) |
| Borrowing under debt agreements | - | 300 |
| Repayments under capital lease | (8) | (4) |
| Net cash provided by (used in) financing activities | (103) | 34 |
| Effect of exchange rates on cash | (44) | 3 |
| Increase (decrease) in cash and cash equivalents | 424 | (486) |
| Cash and cash equivalents, beginning of period | 1,188 | 595 |
| Cash and cash equivalents, end of period | $ 1,612 | $ 109 |

| | | | | |
|---|---|---|---|---|
| Supplemental disclosures of cash flow information: | | | | |
| Interest paid | $ | 153 | $ | 84 |
| Taxes paid | $ | 14 | $ | 2 |
| | | | | |
| Noncash investing and financing activities: | | | | |
| Issuance of warrants | $ | 51 | $ | - |
| Purchase of property and equipment under capital lease | $ | - | $ | 53 |
| Accretion of redeemable common stock | $ | - | $ | 36 |

See accompanying notes to unaudited consolidated financial statements

**SOFTECH, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**A.**

**Description of the Business and Basis of Presentation**

SofTech, Inc. (the Company ) was formed in Massachusetts on June 10, 1969. The Company is engaged in the development, marketing, distribution and support of computer software solutions that serve the Product Lifecycle Management ( PLM ) industry. The Company s operations are organized geographically with offices in the U.S. and European sales and customer support offices in Germany and Italy. The Company also has resellers in Asia and Europe.

Since the Recapitalization Transaction described hereunder, the Company has also been actively engaged in acquiring and filing new U.S. patents, evaluating alternatives for monetizing its existing patents and investigating the acquisition of specific patents already awarded that might enhance our value. It is expected that this kind of activity will become an increasing area of focus and investment over the coming years.

The consolidated financial statements of the Company include the accounts of SofTech, Inc. and its wholly-owned subsidiaries, Information Decisions, Inc., Workgroup Technology Corporation, SofTech, GmbH and SofTech, Srl. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission 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 Annual Report on Form 10-K for the fiscal year ended May 31, 2013.

*CADRA Sale*

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services (the CADRA Sale ), to Mentor Graphics Corporation ( Mentor ), pursuant to an Asset Purchase Agreement dated August 30, 2013 (the Asset Purchase Agreement ). The aggregate consideration for the CADRA Sale is up to $3.95 million, which is comprised of (i) $3.2 million, $2.88 million of which was paid on the closing date and $320,000 (representing a 10% holdback) of which will be paid on the one year anniversary of the closing date (subject to any indemnification claims), and (ii) earn-out payments of up to an aggregate $750,000 over the three-year period subsequent to the closing date, based on 10% of the net revenue generated by the CADRA business, subject to the terms of the Earn-Out Agreement dated August 30, 2013 (the Earn-Out Agreement ).

The Company will continue to offer the CADRA technology as a reseller throughout Europe (except Germany) and for a one-year period from the closing of the transaction to Sikorsky Aircraft, the largest CADRA user in the United States. Due to the significant continued involvement in the sale and support of CADRA product line subsequent to the sale, the transaction does not qualify for presentation as a discontinued operation.

*Recapitalization Transaction*

In March 2011, the current management team (CEO and VP of Business Development) completed a transaction (the Recapitalization Transaction ) in which a group of eight investors purchased 39% of the Company s common stock, arranged for debt facilities of $3.2 million and negotiated for a $7.6 million debt reduction from Greenleaf Capital, Inc. ( Greenleaf ), at that time, the Company s sole lender and largest shareholder. As part of that Recapitalization Transaction, Greenleaf accepted a payment of $2.7 million in cash and note for $250,000 in full satisfaction of the $10.6 million of indebtedness. The former CEO resigned after a short transition period, a new four person Board of Directors was appointed and the existing Board members resigned. In addition, Greenleaf gave the Company s new Board of Directors voting control over its shares for a three year period immediately following the Recapitalization Transaction.

*Refinancing of Debt*

In May 2013, the Company entered into a new three year, $2.7 million loan agreement (the Loan Agreement ) as detailed in Note F that replaced the Company s prior debt facilities that were to expire in February 2014. The Loan Agreement required quarterly principal payments of $135,000 beginning on October 1, 2014 and carried a 14% interest rate due in arrears each calendar quarter beginning July 1, 2013.

The Loan Agreement was amended in July 2013 to allow the Company to repurchase 170,000 shares of common stock from Greenleaf and to increase a specified financial covenant ratio for Q4 of fiscal 2013 and Q1 and Q2 of fiscal 2014. In December 2013 the Loan Agreement was again amended pursuant to an agreement with the Lenders in connection with their consent to the CADRA Sale.

*Stock Purchase Agreement with Greenleaf Capital and affiliates*

In June 2013, the Company purchased 170,000 shares of common stock from Greenleaf, The Ronda E. Stryker and William D. Johnston Foundation, and The L. Lee Stryker 1974 Irrevocable Trust fbo Ronda E. Stryker, for a purchase price of $62,900 or $0.37 per share as detailed in Note K to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 2013. The agreement provides an option for the Company to either make an offer to purchase the remaining 101,411 shares held by Greenleaf at $0.37 per share or to provide Greenleaf with registration rights with respect to the remaining shares as set forth in the Registration Rights Agreement dated March 8, 2011. Greenleaf is under no obligation to accept the Company s offer to purchase the remaining shares on the terms set forth above, however, if the offer is made by the Company and rejected by Greenleaf, the Company will no longer be obligated to provide Greenleaf with registration rights with respect to the remaining shares. As part of the agreement, Greenleaf agreed not to sell or transfer the shares for a one year period from the purchase date.

**B.**

**Significant Accounting Policies**

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 pertain to revenue recognition, the allowance for doubtful accounts receivable, and the valuation of long term assets including goodwill, intangibles, capitalized software development costs and deferred tax assets. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Company follows the provisions of the Accounting Standards Codification ( ASC ) 985, *Software* for transactions involving the licensing of software and software support services. Revenue from software license sales is recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectability has been determined. The Company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the undelivered elements based upon vendor specific objective evidence ( VSOE ) of their fair values, with the residual amount recognized as revenue for the delivered elements, using the residual method set forth in ASC 985. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements, typically one year. Revenue from engineering, consulting and training services is recognized as those services are rendered using a proportional performance model.

The Company follows the provisions of ASC 605, *Revenue Recognition* for transactions that do not involve the licensing of software or software support services as in the case of the recent sale of our patents. Revenue from the sale of patents is recorded when persuasive evidence of an arrangement exists, delivery has taken place and a fixed fee and collectability has been determined. These conditions are no different from those when we license software. For multiple element arrangements, however, under ASC 605, total fees are allocated to each of the elements based upon the relative selling price method. Under that method the allocation of fees to the undelivered elements is based on VSOE, or if it doesn t exist, then based on third party evidence of selling price. If neither exists, then the allocation is based on management s best estimate of the selling price.

SOFTWARE DEVELOPMENT COSTS

The Company accounts for its software development costs in accordance with 985-20, *Costs of Computer Software to Be Sold, Leased or Marketed.* Costs that are incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software development costs are capitalized until the product is available for general release to customers. Such costs are amortized using the straight-line method over the estimated economic life of the product, generally three years. The Company evaluates the realizability of the assets and the related periods of amortization on a regular basis. Judgment is required in determining when technological feasibility of a product is established as well as its economic life.

During the three and six months ended November 30, 2013, the Company capitalized approximately $18,000 and $57,000, respectively, of software development costs related to new products, as compared to approximately $48,000 and $159,000 for the comparable periods in the prior fiscal year. Amortization expense related to capitalized software development for the three and six months ending November 30, 2013 was approximately $24,000 and $49,000, respectively, as compared to approximately $16,000 and $28,000 for the comparable periods in the prior fiscal year.

DEBT ISSUANCE COSTS

The Company capitalizes the direct costs associated with entering into debt agreements and amortizes those costs over the life of the debt agreement.  Total direct costs incurred in establishing this debt agreement were approximately $291,000. These costs have been capitalized and are being amortized over the three year life of the loan. Unamortized debt issuance costs related to the Company  s previous debt agreement as of May 10, 2013 totaled approximately $108,000 and were expensed in Q4 of fiscal 2013. Amortization expense related to debt issuance costs for the three and six months ending November 30, 2013 were approximately $22,000 and $43,000, respectively, as compared to approximately $29,000 and $59,000 for the comparable periods in the prior fiscal year.

ACCOUNTING FOR GOODWILL

The Company accounts for goodwill pursuant to the provisions of the ASC 350, *Intangibles    Goodwill and Other*. This requires that goodwill be reviewed annually, or more frequently as a result of an event or change in circumstances, for possible impairment with impaired assets written down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified within the statement  s criteria.

The Company operates in a single reporting unit.  Goodwill has been allocated to the CADRA product line based upon the estimated fair value of the CADRA product line based on the transaction with Mentor as compared to the estimated fair value of the Company as a whole. Goodwill allocated to the CADRA product line included in the derivation of the gain on sale was approximately $3.2 million.

As of May 31, 2013, the Company conducted its annual impairment test of goodwill by comparing the fair value of the reporting unit to the carrying amount of the underlying assets and liabilities of its single reporting unit. The Company determined that the fair value of the reporting unit exceeded the carrying amount of the assets and liabilities, therefore no impairment existed as of the testing date. The Company concluded that no facts or circumstances arose during the six months ended November 30, 2013 to warrant an interim impairment test.

CAPITALIZED PATENT COSTS

Costs related to patent applications are capitalized as incurred and are amortized once the patent application is accepted or are expensed if the application is finally rejected. Patent costs are amortized over their estimated economic lives under the straight-line method, and are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable through the estimated undiscounted future cash flows from the use of the associated patent. Capitalized patent costs for the three and six month periods ending November 30, 2013 were approximately $ and $2,000, respectively, as compared to $ - and $6,000, respectively, for the three and six month periods ending November 30, 2012.

LONG-LIVED ASSETS

The Company periodically reviews the carrying value of all intangible 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. As of November 30, 2013, the Company does not have any long-lived assets it considers to be impaired.

STOCK BASED COMPENSATION

Stock-based compensation expense for all stock-based payment awards made to employees and directors is measured based on the grant-date fair value of the award. The Company estimated the fair value of each share-based award using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. The Company recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the award.

The Company s 1994 Stock Option Plan provided for the granting of stock options at an exercise price not less than fair market value of the stock on the date of the grant and with vesting schedules as determined by the Board of Directors. No new options could be granted under the Plan after fiscal year 2004 and all stock options had vested prior to May 31, 2009. During fiscal 2012, all options awarded under the 1994 Stock Option Plan had expired. In May 2011, the 2011 Equity Incentive Plan (the 2011 Plan ) was approved by the Company s shareholders, pursuant to which 150,000 shares of our common shares are reserved for issuance. Additionally, any future shares subject to any award under the 2011 Plan that expires, is terminated unexercised or is forfeited will be available for awards under the 2011 Plan. The Company may grant stock options, restricted stock, restricted stock units, stock equivalents and awards of shares of common stock that are not subject to restrictions or forfeiture under the 2011 Plan. As of November 30, 2013, 10,000 options were awarded and outstanding under the 2011 Plan.

The following table summarizes option activity under the 1994 Stock Option Plan and 2011 Plan:

| | Number of Options | Weighted Average Exercise Price Per Share | Weighted-Average Remaining Life (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding options at May 31, 2012 | 10,000 | $ 2.40 | 9.02 | $ - |
| Granted | - | - | - | - |
| Exercised | - | - | - | - |
| Forfeited or expired | - | - | - | - |
| Outstanding options at May 31, 2013 | 10,000 | 2.40 | 8.02 | - |
| Granted | - | - | - | - |
| Exercised | - | - | - | - |
| Forfeited or expired | - | - | - | - |
| Outstanding options at November 30, 2013 | 10,000 | $ 2.40 | 7.52 | $ - |
| Exercisable at November 30, 2013 | 8,056 | $ 2.40 | 7.52 | $ - |

The Company determined the volatility for options granted using the historical volatility of the Company s common stock. The expected life of options has been determined utilizing the simplified method as prescribed in ASC 718 *Compensation, Stock Compensation*. The expected life represents an estimate of the time options are expected to remain outstanding. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of the stock options. The Company has not paid, and does not anticipate paying, cash dividends on its common stock; therefore, the expected dividend yield is assumed to be zero.

For each of the three and six month periods ended November 30, 2013 and 2012, the Company expensed approximately $2,000 and $4,000, respectively, of stock-based compensation.

REDEEMABLE COMMON STOCK

During the year ending May 31, 2013, the Company issued 50,000 shares of common stock, $.10 par value (the Common Stock ) at a purchase price of $5.00 per share to accredited investors (collectively, the Investors ) in separate private placement transactions for total proceeds of $250,000. These transactions were completed pursuant to a Securities Purchase Agreement (the Agreement ) which the Company entered into with each of the respective Investors. In lieu of registration rights, each $25,000 investment entitles the Investors to a fee of $6,000 (the Fee ) to be paid in six equal quarterly installments during the eighteen month period (the Payment Period ) following the investment. The Agreement also provides the Investors with the right to require the Company to redeem the Common Stock held by such Investors (the Put Option ) for $5.50 per share in cash for a 30 day period following the Payment Period.

The Company first assessed the redeemable Common Stock to determine if the instrument should be accounted for as a liability in accordance with ASC 480. In that the Put Option is optionally redeemable by the holder, the Common Stock was not required to be accounted for as a liability. Next, the Company assessed the Put Option within the redeemable Common Stock as a potential embedded derivative pursuant to the provisions of ASC 815, *Derivatives and Hedging,* and concluded that the Put Option did not meet the net settlement criteria within the definition of a derivative. Therefore, the Company has accounted for the Common Stock issued pursuant to the Agreement in accordance with ASC 480-10-S99-3A, *Classification and Measurement of Redeemable Securities*, which provides that securities that are optionally redeemable by the holder for cash or other assets are classified outside of permanent equity in temporary equity. The 50,000 shares of Common Stock issued pursuant to the Agreement were recorded as redeemable common stock at an initial carrying value of $163,000. This amount is equal to the gross proceeds of $250,000, less $27,000 in issuance costs related to legal fees and the $60,000 Fee, which has been included in other liabilities. The Company elected to record the Common Stock at its redemption value of $275,000 immediately and accordingly recorded accretion of $112,000 to additional paid in capital during fiscal year 2013.

FOREIGN CURRENCY TRANSLATION

The functional currency of the Company s foreign operations (Germany and Italy) is the Euro. 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 were included in the statements of operations. For the three and six month periods ended November 30, 2013, the Company recorded a net gain from foreign currency related transactions of approximately $14,000, and $22,000, respectively, as compared to approximately $8,000 and $11,000 for the comparable periods in the prior fiscal year, to Other (income) expense in the Consolidated Condensed Statements of Operations.

INCOME TAXES

The provision for income taxes is based on the earnings or losses reported in the consolidated financial statements. The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in the Company s financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. The Company provides a valuation allowance against deferred tax assets if it is more likely than not that some or all of the deferred tax assets will not be realized.

BALANCE SHEET COMPONENTS

Details of certain balance sheet captions are as follows:

| | November 30, 2013 | May 31, 2013 |
|---|---|---|
| | (Amounts in thousands) | |
| Property and equipment | $ 1,095 | $ 1,869 |
| Accumulated depreciation and amortization | (1,025) | (1,816) |
| Property and equipment, net | $ 70 | $ 53 |

<u>NET INCOME (LOSS) PER COMMON SHARE</u>

Basic and diluted net income (loss) per share are computed by dividing the net income (loss) by the weighted-average number of common shares outstanding. Diluted net income per share is computed by dividing net income (loss) by the weighted-average number of common and equivalent dilutive common shares outstanding. For periods in which losses are reported potentially dilutive common stock equivalents are excluded from the calculation of diluted loss per share because the effect is antidilutive.

The following table details the derivation of weighted average shares outstanding used in the calculation of basic and diluted net income (loss) for each period:

| | For the Three Months Ended | | | |
|---|---|---|---|---|
| | November 30, 2013 | | November 30, 2012 | |
| | (amounts in thousands) | | | |
| Net income (loss) available to common shareholders | $ | (44) | $ | 252 |
| Weighted average number of common shares outstanding used in calculation of basic earnings per share | | 875,135 | | 995,468 |
| Incremental shares from the assumed exercise of dilutive stock options | | - | | 2,283 |
| Weighted average number of common shares outstanding used in calculating diluted earnings per share | | 875,135 | | 997,751 |

| | For the Six Months Ended | | | |
|---|---|---|---|---|
| | November 30, 2013 | | November 30, 2012 | |
| | (amounts in thousands) | | | |
| Net income (loss) available to common shareholders | $ | (310) | $ | 425 |
| Weighted average number of common shares outstanding used in calculation of basic earnings per share | | 888,140 | | 995,295 |
| Incremental shares from the assumed exercise of dilutive stock options | | - | | 1,277 |
| Weighted average number of common shares outstanding used in calculating diluted earnings per share | | 888,140 | | 996,572 |

For the three and six month periods ended November 30, 2013, 10,000 options to purchase common shares were anti-dilutive and were excluded from the above calculation. For the three and six month periods ended November 30, 2012, all options were included in the above calculation.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company s financial instruments consist of cash equivalents, accounts receivable, warrants to purchase shares of common stock, accounts payable and notes payable. The estimated fair values have been determined through information obtained from market sources and management estimates. The estimated fair value of certain financial instruments including cash equivalents, accounts receivable and account payable, approximate the carrying value due to their short-term maturity. The Company s warrant liability is recorded at fair value.

*Fair Value Measurements*

The fair value of the Company s financial assets and liabilities are measured using inputs from the three levels of fair value hierarchy which are as follows:

| | |
|---|---|
| Level 1 | Quoted prices in active markets for identical assets or liabilities. |
| Level 2 | Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. |
| Level 3 | Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. |

The following summarizes the Company s assets and liabilities measured at fair value as of November 30, 2013:

| | | Fair Value Measurements at Reporting Date Using: | | |
|---|---|---|---|---|
| Description (amounts in thousands) | Balance as of November 30, 2013 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities | | | | |
| Warrant liability | $ 45 | $ | $ | $ 45 |
| Total Liabilities | $ 45 | $ | $ | $ 45 |

Activity for liabilities classified as Level 3:

| | Subordinated Convertible Note |
|---|---|
| Balance at May 31, 2013 | $ - |
| Issuance of warrant liability | 51 |
| Change in fair value | (6) |
| Fair value at November 30, 2013 | $ 45 |

Fair values for the Company s warrant liability are determined by utilizing widely accepted valuation techniques including the Black-Scholes Pricing Model. The methods and significant inputs and assumptions utilized in estimating the fair value of the warrant liabilities as of the November 30, 2013 balance sheet date are discussed below. The warrants are categorized as Level 3 within the fair value hierarchy. In December 2013, the Company agreed to repurchase the outstanding warrant to purchase 25,000 shares of common stock at an exercise price of $1.00 per share in exchange for $19,000 (see Note I).

The Company estimated the fair value of each share-based award using the Black-Scholes option valuation model. The Black-Scholes Pricing Model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield.

| Input | July 9, | November 30, |
|---|---|---|

| | 2013 | 2013 |
|---|---|---|
| Stock Price | $ 2.11 | $ 1.90 |
| Exercise Price | 1.00 | 1.00 |
| Expected Life (in years) | 7.00 | 6.61 |
| Stock Volatility | 138% | 138% |
| Risk-Free Interest Rate | 2.28% | 2.10% |
| Dividend Rate | 0% | 0% |

The following are significant assumptions utilized in developing the inputs:

o

Shares of the Company s common stock are traded on the OTC Bulletin Board. The stock price input is based upon bid prices as of the valuation dates due to the extremely thin trading volume, broker-driven market (vs. exchange market) and the wide bid/ask spread as of the valuation date;

o

Stock volatility was estimated by considering (i) the annualized monthly volatility of the Company s stock price during the historical period preceding the respective valuation dates and measured over a period corresponding to the remaining life of the instruments (monthly data set is more relevant given the extremely thin trading volume of the Company s common stock). Historical prices of the Company s common stock were used to estimate volatility as the Company did not have traded options as of the valuation dates;

o

Based upon the Company s historical operations and management s expectations for the foreseeable future, the Company s stock was assumed to be a non-dividend-paying; and

o

The risk-free interest rate is based on the U.S. Treasury yield curve in effect as of the valuation date for the expected term.

**C. Segment Information**

The Company operates in one reportable segment and is engaged in the development, marketing, distribution and support of computer aided design and product data management and collaboration computer solutions. The Company s operations are organized geographically with offices in the U.S. and foreign offices in 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 (in thousands):

| | Three Month Periods Ended | | | |
|---|---|---|---|---|
| Revenue: | November 30, 2013 | | November 30, 2012 | |
| North America | $ | 1,255 | $ | 1,215 |
| Europe | | 290 | | 604 |
| Asia | | 330 | | 120 |
| Eliminations | | (461) | | (167) |
| Consolidated Total | $ | 1,414 | $ | 1,772 |

| | Six Month Periods Ended | | | |
|---|---|---|---|---|
| Revenue: | November 30, 2013 | | November 30, 2012 | |
| North America | $ | 2,259 | $ | 2,413 |
| Europe | | 604 | | 937 |
| Asia | | 493 | | 286 |
| Eliminations | | (566) | | (294) |
| Consolidated Total | $ | 2,790 | $ | 3,342 |

| | As of November 30, | | As of May 31, | |
|---|---|---|---|---|
| Long Lived Assets: | 2013 | | 2013 | |
| North America | $ | 1,922 | $ | 5,119 |
| Europe | | 43 | | 113 |

| | | | | |
|---|---|---|---|---|
| Consolidated Total | $ | 1,965 | $ | 5,232 |

**D. Note Receivable**

Joseph Mullaney, the Company s CEO, was extended a non-interest bearing note in the amount of $134,000 related to a stock transaction in May, 1998. The note is partially secured by the Company stock acquired in that transaction. The Company has accounted for the note as a fixed arrangement.

**E. Sale of Patents**

In June 2012, the Company sold to an unrelated third party (the Buyer ) its rights, title and interests in three of its U.S. patents (the Patents ) all entitled Method and System for Design and Drafting in exchange for a non-refundable, initial royalty payment of $200,000 (the Initial Payment ). These Patents were derived from the Company s development work related to the Company s CADRA product line and the inventions are a key, time saving feature within that technology offering. The Company received a limited, non-exclusive, royalty-free license under the Patents to make, use, offer to sell, or sell the Company s products or services.

In September 2012, the Patent agreement was amended to include two other U.S. patents ( Additional Patents ) both entitled Product Development System and Method Using Integrated Process and Data Management. These Additional Patents were derived from the development work related to the Company s ProductCenter product line and are a core and essential capability within that product offering. The Company received a limited, non-exclusive, royalty-free license under the Additional Patents to make, use, offer to sell or sell the Company s products or services. As a result of the amendment, the Initial Payment was increased by $100,000.

The agreement gives the Buyer complete control over what, if any, actions shall be taken in the future to monetize the Patents through licensing, sale, enforcement or other means. In the event whereby monies are derived from the Patents, the Company is due 30% of the net proceeds (the Net Proceeds ), as defined in the agreement. The Initial Payment shall be reimbursable from Net Proceeds to the extent any are due. There can be no assurance that the Company will derive any additional monies from the Patents, however.

The sale of the Patents is a multiple element arrangement as defined under ASC 605 and, as such, the Company allocated the Initial Payment between the sale of the Patents that were delivered during the fiscal quarter and support services that were undelivered. Support services include being available to the Buyer to assist them should they require such assistance in licensing or pursuing other means of monetizing the Patents to third parties. The allocation of the Initial Payment to the patent and support services elements was based on management s best estimate of the selling price of each element. The Initial Payment was allocated as follows: Patents - $290,000; and Support Services - $10,000. Additional monies due the Company in the form of royalties from its 30% share of Net Proceeds will be recorded in the quarterly period in which the Buyer notifies the Company such payments are due. Such notification and payment, if any, are due thirty calendar days after the end of each calendar quarter. The revenue allocated to support services has been deferred and will be recognized as revenue when the services are performed. There can be no assurance that the Company will derive any other monies from the Additional Patents, however.

The Company retained its U.S. patent applications that it acquired or filed since the Recapitalization Transaction in March 2011. These patent applications were not included in the above described agreement. The Company expects to be actively engaged with the U.S. Patent and Trademark Office for the foreseeable future with regard to those filings.

**F. Debt**

On May 10, 2013, the Company entered into the Loan Agreement with Prides Crossing Capital, L.P. and Prides Crossing Capital-A, L.P., ( Lenders ). The Loan Agreement provided for a $2.7 million, three-year term Loan with interest only until October 1, 2014.

The Loan Agreement was amended on July 9, 2013 as described below to, among other things, allow the Company to repurchase 170,000 common shares from its largest shareholder as described in Note G below. On December 5, 2013, the Loan Agreement was again amended as described in Note I below. The December 2013 amendment was necessitated by the CADRA Sale.

As of November 30, 2013, the Loan Agreement as amended on July 9, 2013 was in full force and effect and, as such, the balance sheet reflects the terms and conditions of that amended agreement which is described hereafter.

Prior to the amended and restated Loan Agreement in December 2013 as described in Note I, the Loan was to mature on May 1, 2016 and carried an interest rate of 14% paid in arrears on a calendar quarter basis commencing on July 1, 2013 and continuing throughout the life of the Loan. Commencing on October 1, 2014, and continuing on the last day of each calendar quarter thereafter through May 1, 2016, the Company was to make quarterly principal payments of $135,000 with the remaining principal balance to be due and payable on May 1, 2016.

The Company agreed to secure all of its obligations under the Loan by granting the Lenders a first priority security interest in all of the Company s assets, including the Company s intellectual property and pledges of (i) one hundred percent (100%) of the Company s equity interests in its domestic subsidiaries and (ii) sixty-five percent (65%) of the Company s equity interests in its foreign subsidiaries. In connection with the grant of the security interest in favor of the Lenders in the Company s intellectual property, the Company had entered into an intellectual property security agreement with the Lenders and a source code escrow agreement with the Lenders and an independent third party. In addition, the Company s CEO provided the Lenders with a personal guaranty of up to $500,000 secured by his equity interests in the Company. The Company agreed to pay the CEO $80,000 in consideration for extending that personal guaranty. This payment was included as a part of capitalized debt issuance costs.

The Loan Agreement contained customary representations, warranties and covenants, including covenants by the Company limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans, sale and leasebacks, transactions with affiliates and fundamental changes in its business. In addition, the Loan Agreement contained financial covenants by the Company that establish (i) a maximum ratio of indebtedness to recurring revenue; (ii) a maximum ratio of indebtedness to EBITDA; and (iii) a minimum liquidity test (defined as the Company s cash plus amounts available under a line of credit of up to $250,000). The Loan Agreement also imposed limits on capital expenditures for each calendar year during the term of the Loan Agreement.

The Loan Agreement provided for events of default customary for credit facilities of this type, including but not limited to non-payment, defaults on other debt, misrepresentation, breach of covenants, representations and warranties, insolvency and bankruptcy. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the Loan would become immediately due and payable and the Lenders commitments would be automatically terminated. Upon the occurrence and continuation of any other event of default, the Lenders could accelerate payment of all obligations and terminate the Lenders commitments under the Loan Agreement.

On July 9, 2013, the Loan Agreement was amended (the Amended Loan Agreement No. 1 ) to allow the Company to repurchase 170,000 of its shares from Greenleaf and to increase the maximum ratio of indebtedness to EBITDA from 2.25:1 to 2.60:1 for the quarters ended May 31, 2013, August 31, 2013 and November 30, 2013. In consideration for entering into the Amended Loan Agreement No. 1, the Company issued the Lenders warrants to purchase 25,000 shares of common stock at an exercise price of $1.00 per share. The warrants were to vest monthly over three years, with accelerated vesting under certain circumstances including if the Loan was repaid prior to maturity, and terminate if not exercised on or before July 9, 2020.

Upon issuance, the warrants did not meet the requirements for equity classification, because such warrants provide a cash-out election allowing the holder to a one time right to require the Company to repurchase all or a portion of the warrants. Therefore these warrants were required to be accounted for as a liability. Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Other income.

The Company determined the fair value of the warrants using the Black-Scholes valuation model. The grant date fair value of the warrant of approximately $51,000 was recorded a liability, with a corresponding discount recorded on the debt. The debt discount was to be accreted through the remaining term of the Loan Agreement using the effective interest rate method. Accretion recorded as interest expense during the three and six months ended November 30, 2013 was approximately $4,000 and $6,000, respectively. As of November 30, 2013 the warrants were adjusted to fair value of $45,000 resulting in $6,000 of other income recorded during the six months ended November 30, 2013.

In December 2013, the Company paid a pre-payment penalty of $81,000 and agreed to repurchase the outstanding warrant to purchase 25,000 shares of common stock at an exercise price of $1.00 per share in exchange for $19,000. (see Note I).

**G.**

**Stock Purchase Agreement**

In June 2013, the Company purchased 170,000 shares of common stock from Greenleaf, The Ronda E. Stryker and William D. Johnston Foundation, and The L. Lee Stryker 1974 Irrevocable Trust fbo Ronda E. Stryker, for a purchase price of $62,900 or $0.37 per share as detailed in Note G to the consolidated financial statements as of May 31, 2013. The agreement provides an option for the Company to either make an offer to purchase the remaining 101,411 shares held by Greenleaf at $0.37 per share or to provide Greenleaf with registration rights with respect to the remaining shares as set forth in the Registration Rights Agreement dated March 8, 2011. Greenleaf is under no obligation to accept the Company s offer to purchase the remaining shares on the terms set forth above, however, if the offer is made by the Company and rejected, the Company will no longer be obligated to provide Greenleaf with registration rights with respect to the remaining shares. As part of the agreement, Greenleaf agreed not to sell or transfer the shares for a one year period from the transaction date.

**H.**

**CADRA Sale**

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services, to Mentor, pursuant to an Asset Purchase Agreement dated August 30, 2013. The aggregate consideration for the CADRA Sale is up to $3.95 million, which is comprised of (i) $3.2 million, $2.88 million of which was paid on the closing date and $320,000 (representing a 10% holdback) of which will be paid on the one year anniversary of the closing date (subject to any indemnification claims), and (ii) earn-out payments of up to an aggregate $750,000 over the three-year period subsequent to the closing date, based on 10% of the net revenue generated by the CADRA business (the Earn-Out Payments ), subject to the terms of the Earn-Out Agreement dated August 30, 2013.

The Company will continue to sell and support the CADRA technology throughout Europe (except Germany) and, for a one year period from the closing, will retain the rights to sell and support the technology to the largest U.S. CADRA user, Sikorsky Aircraft.

The transaction generated a gain during the current quarter which was composed of the following (000 s):

| | | |
|---|---|---|
| Proceeds from the sale of the CADRA technology | $ | 3,200 |
| Liabilities assumed by Mentor related to deferred maintenance obligations | | 607 |
| Professional fees and other expenses related to the transaction | | (448) |
| Goodwill allocated to the CADRA product line | | (3,261) |
| Net book value of equipment transferred in the sale | | (7) |
| Gain on sale of CADRA product line | $ | 91 |

Any additional Earn-Out Payments received by the Company will be recorded during the periods in which Mentor reports amounts due under the Earn-Out Agreement so long as collectability has been determined.

**I.**

**Subsequent Events**

The Company has evaluated all events and transactions that occurred after the balance sheet and through the date that the financial statements were available to be issued. On December 5, 2013, the Company entered into an amended and restated loan agreement (the Amended Loan Agreement No. 2 ) between the Company, as borrower and Prides Crossing Capital Funding, L.P., (the Lender ) whereby the parties agreed to amend and restate the Company s existing $2.7 million Loan Agreement following the CADRA Sale. The Lender was the successor to Prides Crossing Capital, L.P. and Prides Crossing Capital-A, L.P., the Lenders under the Loan Agreement. Under the terms of the Amended Loan Agreement No. 2, the Company agreed to pay down the principal of the Loan Agreement from $2.7 million to $1.0 million (the Term Note ) using a portion of the proceeds from the CADRA Sale. In addition, the Company paid a pre-payment penalty of $81,000 and agreed to repurchase the outstanding warrant to purchase 25,000 shares of common stock at an exercise price of $1.00 per share in exchange for $19,000.

The amended and restated Term Note matures on January 1, 2015 and bears an interest rate of 14% payable in arrears on a monthly basis throughout the life of the loan commencing on January 1, 2014. The Term Note may be repaid in full at any time but partial voluntary pre-payments are not allowed. If a pre-payment is made on or prior to September 30, 2014, the Company shall pay a yield maintenance fee equal to the interest that would have accrued under the Term Note from the date of pre-payment through September 30, 2014. No yield maintenance fee is due for a pre-payment made subsequent to September 30, 2014.

The Company agreed to secure all of its obligations under the Term Note by granting the Lender a first priority security interest in all of the Company s assets, including the Company s intellectual property and pledges of (i) one hundred percent (100%) of the Company s equity interests in its domestic subsidiaries and (ii) sixty-five percent (65%) of the Company s equity interests in its foreign subsidiaries. In connection with the grant of the security interest in favor of the Lender in the Company s intellectual property, the Company has entered into an intellectual property security agreement with the Lender and will enter into a source code escrow agreement with the Lender and an independent third party on a post-closing basis. In addition, the Company s Chief Executive Officer has provided the Lender with a personal guaranty of up to $500,000 secured by his equity interests in the Company.

The Amended Loan Agreement No. 2 contains customary representations, warranties and covenants, including covenants by the Company limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans, sale and leasebacks, transactions with affiliates and fundamental changes in its business. In addition, the Amended Loan Agreement No. 2 contains financial covenants by the Company that establish (i) a month-end minimum consolidated cash balance of $1.0 million of which no less than $750,000 must be held in the Company s main operating account that is subject to a deposit account control agreement; (ii) a minimum of $750,000 of consolidated cash at all times; (iii) a quick ratio covenant, which provides that on the last day of each fiscal quarter the ratio of the Company s cash plus accounts receivable divided by accounts playable plus accrued expenses shall not be less than 2.7:1; and (iv) a covenant that provides that the Company s earnings before interest, taxes, depreciation and amortization ( EBITDA ) for Q3 and Q4 of fiscal 2014 shall not exceed a loss of $200,000 for each of those fiscal quarters and shall be greater than positive EBITDA of $100,000 for each subsequent fiscal quarter. The Amended Loan Agreement No. 2 also imposes limits on capital expenditures for each fiscal year during the term of the Amended Loan Agreement No. 2. As part of the Amended Loan Agreement No. 2 the Company, the Lender and First Republic Bank entered into a deposit account control agreement pursuant to which the Lender will perfect its security interest in the assets held in the Company s main operating account at First Republic Bank.

The Amended Loan Agreement No. 2 provides for events of default customary for credit facilities of this type, including but not limited to non-payment, defaults on other debt, misrepresentation, breach of covenants, representations and warranties, insolvency and bankruptcy. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the Amended Loan Agreement No. 2 will become immediately due and payable and the Lender commitment will be automatically terminated. Upon the occurrence and continuation of any other event of default, the Lender may accelerate payment of all obligations and terminate the Lender s commitments under the Amended Loan Agreement No. 2.

**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**

This report includes forward-looking statements. These forward-looking statements are often identified by words such as may, will, should, could, would, expect, intend, plan, anticipate, believe, estimate, proj similar expressions. These statements are only predictions and involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual results could differ materially from those contained in forward-looking statements due to a number of factors, including our ability to:

.

generate sufficient cash flow from our operations or other sources to fund our working capital needs and growth initiatives;

.

maintain good relationships with our lender;

.

comply with the covenant requirements of our loan agreement;

.

successfully introduce and attain market acceptance of any new products and/or enhancements of existing products;

.

attract and retain qualified personnel;

.

prevent obsolescence of our technologies;

.

maintain agreements with our critical software vendors;

.

secure renewals of existing software maintenance contracts, as well as contracts with new maintenance customers; and

.

secure new business, both from existing and new customers.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. References in this prospectus to the Company, we, our, and us refer to the registrant, SofTech, Inc., and its wh owned subsidiaries.

*The following discussion and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in the previously filed Form 10-K. This discussion includes forward-looking statements that involve risk and uncertainties.*

**Overview**

We operate in one reportable segment and are engaged in the development, marketing, distribution and support of computer software solutions that enable companies to manage the entire lifecycle of their products from conception through design and manufacture, to service and disposal, all of which is known in the industry as Product Lifecycle Management ( PLM ). These solutions include software technology offerings for Computer Aided Design ( CAD ), Product Data Management ( PDM ) and Collaboration technologies, all of which fit under the broadly defined PLM industry. Pursuant to the terms of the sale of the CADRA product line on October 18, 2013, we will continue to sell and support that technology in certain limited markets. Our operations are organized geographically in the U.S. and Europe. We have sales and customer support offices in the U.S., Germany and Italy. We also operate through resellers in Europe and Asia. Components of revenue and long-lived assets by geographic location are outlined in Note E to the consolidated financial statements for the fiscal year ended May 31, 2013.

Since the Recapitalization Transaction described in Note A to the condensed Consolidated Financial Statements herein, the Company has also been actively engaged in acquiring and filing new patent applications, evaluating alternatives for monetizing its existing patents and investigating the acquisition of specific patents already awarded that might enhance our value. It is expected that this kind of activity will become an increasing area of focus and investment over the coming years.

Revenue from our ProductCenter technology has been experiencing year over year revenue declines for six consecutive fiscal years due to several factors. In July 2007, Parametric Technology Corporation PTC informed us that it would not renew its partnership agreement with us when the agreement expired in January 2008. We had been a member of the PTC partnership program for 12 years. The PTC partnership agreement, among other things, provided us with the right to distribute certain information that allowed for our technology to directly interface with PTC s proprietary CAD tools. The non-renewal has essentially prevented us from marketing our ProductCenter solution to new customers that utilize PTC s technology and has negatively impacted our product revenue from this technology offering. In addition to the PTC partnership termination, ProductCenter revenue has been negatively affected by: (i) an increased number of competitive offerings in the marketplace, (ii) elongation of purchase decisions by customers of a technology that already has a long sales cycle, and (iii) uncertain economic conditions. Since PTC s decision we have focused on offering ProductCenter to the mid-range CAD market and we are exploring other opportunities to broaden the addressable market for this product.



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For more than a decade through fiscal 2010, we had also experienced revenue declines in our CADRA product line. CADRA, which we acquired in 1998, is a 2D technology that was first introduced in the early 1980 s. The revenue declines were due to the age of the product, the introduction of robust 3D solutions for less than $5,000 per unit and the dominance of AutoCAD in the 2D market, a product offered by Autodesk. However, in fiscal years 2011 and 2012 the CADRA revenue increased as compared to the immediately preceding fiscal year primarily driven by our existing non-maintenance CADRA customers that have had to repurchase licenses due to the upgrade of their operating system. Older versions of CADRA do not function properly on the Windows 7 operating system. Fiscal 2013 CADRA revenue declined by about 1% as compared to fiscal 2012.

**Refinancing of Debt**

In May 2013, the Company entered into a new three year, $2.7 million loan agreement (the Loan Agreement ) that replaced the Company s prior debt facilities that were to expire in February 2014. The Loan Agreement required quarterly principal payments of $135,000 beginning on October 1, 2014 and carried a 14% interest rate due in arrears each calendar quarter beginning July 1, 2013.

On July 9, 2013, the Loan Agreement was amended (the Amended Loan Agreement No. 1 ) to allow the Company to repurchase 170,000 of its shares from Greenleaf and to increase the maximum ratio of indebtedness to EBITDA from 2.25:1 to 2.60:1 for the quarters ended May 31, 2013, August 31, 2013 and November 30, 2013. In consideration for entering into Amended Loan Agreement No. 1, the Company issued the Lenders warrants to purchase 25,000 shares of common stock at an exercise price of $1.00 per share. The warrants vest monthly over three years, with accelerated vesting under certain circumstances including if the loan was repaid prior to maturity, and terminate if not exercised on or before July 9, 2020.

Furthermore, on December 5, 2013, the Loan Agreement was again amended (the Amended Loan Agreement No. 2 ) in accordance with a prior agreement with the Lenders in connection with their consent to the sale of the CADRA product line. The terms of Amended Loan Agreement No. 2 are detailed in Note I and in the Liquidity and Capital Resources section below.

**CADRA Sale**

On October 18, 2013, SofTech sold its CADRA product line to Mentor Graphics Corporation ( Mentor ) for a purchase price of $3.2 million (subject to any indemnification claim), plus potential earn-out payments of up to an additional $750,000 based on 10% of CADRA revenue generated by Mentor in the three year period following the closing (the CADRA Sale ).

The assets sold related to the CADRA product line include (i) rights to, and interest in, all computer software; (ii) specified physical assets; (iii) all customer information; and (iv) purchase orders in backlog and customer support agreements. The liabilities to be assumed by Mentor are limited to customer support obligations. Specifically excluded from the sale and retained by SofTech are all remaining assets and liabilities not specifically identified and all billed accounts receivable of the CADRA product line through the closing date.

We are in the process of restructuring our business subsequent to the CADRA Sale to enable us to successfully operate as a significantly smaller company and to seek new sources of revenue and possible new strategic initiatives. We currently contemplate pursuing the activities described below and other strategic initiatives that the board of directors may subsequently determine are in the best interests of the shareholders.

**Activities following the CADRA Sale**

*PLM Business*

Subsequent to the completion of the CADRA Sale, we will continue to offer our ProductCenter and Connector technologies to design and manufacturing companies. Our ProductCenter technology manages the engineering data and electronic files of discrete parts designed in third party proprietary design technologies offered primarily by SolidWorks, PTC and Autodesk. The Connector platform is a technology that allows for a direct interface between Aras Innovator a PLM solution which features modern, web-based technology, and various well-established CAD technologies. The Aras technology is offered under a subscription revenue model as is our Connector technology. We entered into a partnership agreement with Aras in 2012, pursuant to which we provide distribution and consulting services, as further described below. For a description of the risks related to our PLM business, see Risk Factors Risks Related to Our Business in our Form 10-K for fiscal year 2013.

Recently, SofTech has developed for one of its largest customers an easy to use product offering combining a third party analysis solution with a 2D solution that allows a mechanical design engineer to simulate the movement of his or her design with limited training. Giving the mechanical design engineer the ability to detect design flaws and correct them with this easy to use technology represents an advancement, we believe, and one we hope to capitalize on in the coming years. We will seek to further develop this solution and introduce it to our customers over the coming fiscal year.

*Distribution Activity*

In connection with the CADRA Sale, we entered into a distribution agreement with Mentor to market and support the CADRA technology throughout Europe (except Germany), for a minimum of one year following the sale, through its wholly-owned subsidiary in Italy, SofTech, Srl.   In addition, pursuant to the terms of the distribution agreement, for a period of one year from the closing, we will be the account representative for Sikorsky Aircraft, the largest CADRA user in the United States. The margin to be earned by SofTech for this distribution activity will be consistent with the margin earned by distributors in the industry.  In addition, we will continue to market and distribute third party technologies from Aras and SpaceClaim as we have since 2012.

*Consulting*

SofTech has been engaged in the PLM market since 1993. Our consulting group is composed of deeply experienced, long tenured experts solving very complex problems relating to data migration, customization, data control, access, version control, connectivity between proprietary systems and a myriad of other problems encountered by our customers. Our revenue from consulting activities for fiscal year 2013 was about $875,000, representing an increase of 19% over the prior year period.  For the first six months of fiscal 2014, our consulting revenue increased by 6% as compared to the same period in fiscal 2013. This increase in consulting revenue was driven partly by our new partnership agreement with Aras, a rapidly growing PLM company that is disrupting the status quo. We intend to continue to grow and invest in our consulting business following the CADRA Sale.

*Exploring Strategic Initiatives*

A core tenet of the management team s strategy following the recapitalization transaction in 2011 has been to actively consider ways to monetize some or all of SofTech s assets and to pursue new strategic initiatives, such as potential business combinations, sale transactions or strategic partnerships.

*Developing Remaining Patent Estate*.  The Company has filed three provisional patents and purchased the rights to one provisional patent since March 2011. These patents remain in process at the United States Patent and Trademark Office, and the Company intends to continue to pursue the resolution to these filings.  These patents generally relate to methods of accumulating buyers  information in a database in ways that allow the information to be shared with sellers so as to allow the sellers to make targeted, relevant offers to the buyers. While these patents, which could generally be considered eCommerce related, pertain to technologies that are not directly related to our historical revenue producing business activities, we believe they may have applications in those areas.

Analyzing the potential of the technologies described in these patents and the business case for us to invest in efforts to commercialize any of them is part of an ongoing evaluation. It is possible that our efforts will be limited to securing the patent awards and monetizing the patents as we did in fiscal year 2013 for our five patents in the PLM space. While many of these businesses would be new to us, we believe that we possess underlying competencies from our existing businesses, such as strong engineering and software capabilities especially in database technologies, and other attributes, such as numerous long-term client relationships with technology companies that may be complementary to developing new businesses around these technologies. However, any investment by us to attempt to commercialize the technologies described in these patents could be costly and prove to be unsuccessful.

*Strategic Transactions*. We will continue to evaluate business combinations and other sale opportunities. We believe that, in addition to our remaining businesses and prospects described above, our status as a publicly traded company and tax attributes could make us an attractive strategic partner. As of May 31, 2013, SofTech had approximately $20 million in federal tax attributes and approximately $7 million in state tax attributes. We expect to generate taxable income in fiscal year 2014 from the CADRA Sale, which we believe will be significantly or completely offset from federal and state taxation by use of these tax assets. We will continue to seek strategic transactions for the benefit of our shareholders, but there can be no assurances in this regard.

*Other*

*Deferred CADRA Purchase Price*. The sale of the CADRA assets includes a contingent earn-out payment equal to 10% of Mentor s revenue derived from the CADRA technology up to a maximum of $750,000 over the three year period following completion of the transaction. Therefore, SofTech has a direct financial interest in the continued success of the CADRA technology subsequent to the sale. These contingent payments are due on or before April 1, 2014, 2015, 2016 and 2017 based on the revenue recorded during Mentor s fiscal years ending January 31, 2014, 2015, 2016 and 2017.

*Contingent Rights with Respect to Transferred Patents*. In addition to our technology offerings, the Company retained its financial interest in the patents sold to Acacia Research Group ( Acacia ) in June 2012. In December 2012, Acacia filed infringement lawsuits in East Texas against Dassault Systemes SolidWorks ( Dassault ), Autodesk and Siemens seeking treble damages for the unauthorized use of the technology described in those patents. SofTech received $300,000 as a non-recoverable advance payment against 30% of the net proceeds received by Acacia. A trial date has been set for November 2015. We believe there are other technology companies other than the three that have been sued that are also using the ideas protected by these patents. Acacia has complete control with regard to actions it may take or not take with regard to enforcing these patents. SofTech has a contractual obligation to support Acacia in its legal proceedings. In July 2013, Dassault filed a third party claim against SofTech in connection with the above described suit by Acacia against them. Dassault alleges that SofTech promised an arrangement that would protect Dassault from claims of infringement of the patents in question. Among other things, Dassault is seeking reimbursement from SofTech of any amounts it may have to pay for infringing the patents, including legal fees. SofTech believes that Dassault s claims are without merit and intends to vigorously defend itself against them.

The foregoing are the currently anticipated activities of the Company following the CADRA Sale. There can be no assurances that our pursuit of these activities will be successful. Furthermore, we may pursue other opportunities that we subsequently determine to be in the best interests of the Company.

**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.

Our significant accounting policies are described in Note B to the consolidated financial statements for the fiscal year ended May 31, 2013 included in our previously filed Form 10-K. There have been no material changes to the accounting policies for the six months ended November 30, 2013.

**Results of Operations**

Three and Six Months Ended November 30, 2013, as Compared to Three and Six Months Ended November 30, 2012

The table below presents the comparative income statements for the three month periods ended November 30, 2013 and November 30, 2012 along with the dollar and percentage change amounts for each revenue and expense item (expressed in thousands, except percentages):

| | November 30, 2013 | November 30, 2012 | Change in $ | Change in % |
|---|---|---|---|---|
| Revenue: | | | | |
| Products | $ 376 | $ 478 | $ (102) | (21.3)% |
| Services | 1,038 | 1,194 | (156) | (13.1) |
| Royalties from sale of patents | - | 100 | (100) | (100.0) |
| Total revenue | 1,414 | 1,772 | (358) | (20.2) |
| | | | | |
| Cost of revenue: | | | | |
| Products | 28 | 24 | 4 | 16.7 |
| Services | 264 | 323 | (59) | (18.3) |
| Total cost of revenue | 292 | 347 | (55) | (15.9) |
| | | | | |
| Gross margin | 1,122 | 1,425 | (303) | (21.3) |
| | | | | |
| Research and development expenses | 304 | 323 | (19) | (5.9) |
| Selling, general and administration expenses | 866 | 789 | 77 | 9.8 |
| Gain on sale of product line | (91) | - | (91) | - |
| | | | | |
| Operating income | 43 | 313 | (270) | (86.3) |
| | | | | |
| Interest expense | 104 | 69 | 35 | 50.7 |
| | | | | |
| Other income | (17) | (8) | (9) | 112.5 |
| | | | | |
| Net income (loss) | $ (44) | $ 252 | $ (296) | (117.5)% |

The table below presents the comparative income statements for the six month periods ended November 30, 2013 and November 30, 2012 along with the dollar and percentage change amounts for each revenue and expense item (expressed in thousands, except percentages):

| | November 30, 2013 | November 30, 2012 | Change in $ | Change in % |
|---|---|---|---|---|
| Revenue: | | | | |
| Products | $ 618 | $ 693 | $ (75) | (10.8)% |
| Services | 2,172 | 2,359 | (187) | (7.9) |
| Royalties from sale of patents | - | 290 | (290) | (100.0) |
| Total revenue | 2,790 | 3,342 | (552) | (16.5) |
| Cost of revenue: | | | | |
| Products | 62 | 49 | 13 | 26.5 |
| Services | 572 | 631 | (59) | (9.4) |
| Total cost of revenue | 634 | 680 | (46) | (6.8) |
| Gross margin | 2,156 | 2,662 | (506) | (19.0) |
| Research and development expenses | 639 | 567 | 72 | 12.7 |
| Selling, general and administration expenses | 1,747 | 1,547 | 200 | 12.9 |
| Gain on sale of product line | (91) | - | (91) | - |
| Operating income (loss) | (139) | 548 | (687) | (125.4) |
| Interest expense | 199 | 134 | 65 | 48.5 |
| Other income | (28) | (11) | (17) | 154.5 |
| Net income (loss) | $ (310) | $ 425 | $ (735) | (172.9)% |

The table below presents the relationship, expressed as a percentage, between income and expense items and total revenue, for the three month periods ended November 30, 2013 and November 30, 2012:

| | Items as a percentage of revenue | |
|---|---|---|
| | **November 30, 2013** | **November 30, 2012** |
| Revenue: | | |
| Products | 26.6% | 27.0% |
| Services | 73.4 | 67.4 |
| Royalties from sale of patents | - | 5.6 |
| Total revenue | 100.0 | 100.0 |
| Cost of revenue: | | |
| Products | 2.0 | 1.4 |
| Services | 18.7 | 18.2 |
| Total cost of revenue | 20.7 | 19.6 |
| Gross margin | 79.3 | 80.4 |
| Research and development expenses | 21.5 | 18.2 |
| Selling, general and administrative expenses | 61.2 | 44.5 |
| Gain on sale of product line | (6.4) | - |
| Operating income | 3.0 | 17.7 |
| Interest expense | 7.4 | 3.9 |
| Other income | (1.2) | (0.5) |
| Net income (loss) | (3.1)% | 14.2% |

The table below presents the relationship, expressed as a percentage, between income and expense items and total revenue, for the six month periods ended November 30, 2013 and November 30, 2012:

| | Items as a percentage of revenue | |
|---|---|---|
| | November 30, 2013 | November 30, 2012 |
| Revenue: | | |
| Products | 22.2% | 20.7% |
| Services | 77.8 | 70.6 |
| Royalties from sale of patents | - | 8.7 |
| Total revenue | 100.0 | 100.0 |
| Cost of revenue: | | |
| Products | 2.2 | 1.5 |
| Services | 20.5 | 18.9 |
| Total cost of revenue | 22.7 | 20.3 |
| Gross margin | 77.3 | 79.7 |
| Research and development expenses | 22.9 | 17.0 |
| Selling, general and administrative expenses | 62.6 | 46.3 |
| Gain on sale of product line | (3.3) | - |
| Operating income (loss) | (5.0) | 16.4 |
| Interest expense | 7.1 | 4.0 |
| Other income | (1.0) | (0.3) |
| Net income (loss) | (11.1)% | 12.7% |

*Revenue*

Total revenue for the three month periods ended November 30, 2013 and 2012 was approximately $1.4 million and $1.8 million, respectively. The following table summarizes total revenue by product line for the three month periods ended November 30, 2013 and November 30, 2012 (in thousands, except percentages):

| | November 30, 2013 | November 30, 2012 | $ Change | % Change |
|---|---|---|---|---|
| **Product Line** | | | | |
| ProductCenter | $ 731 | $ 766 | $ (35) | (4.6)% |
| CADRA | 637 | 898 | (261) | (29.1) |

| | | | | |
|---|---|---|---|---|
| Royalties from sale of patents | - | 100 | (100) | (100.0) |
| Other | 46 | 8 | 38 | 475.0 |
| Total | $ 1,414 | $ 1,772 | $ (358) | (20.2)% |

Total revenue for the six month periods ended November 30, 2013 and 2012 was approximately $2.8 million and $3.3 million, respectively. The following table summarizes total revenue by product line for the six month periods ended November 30, 2013 and November 30, 2012 (in thousands, except percentages):

| | **November 30,** | | | |
|---|---|---|---|---|
| | **2013** | **2012** | **$ Change** | **% Change** |
| **Product Line** | | | | |
| ProductCenter | $ 1,469 | $ 1,482 | $ (13) | (0.9)% |
| CADRA | 1,265 | 1,536 | (271) | (17.6) |
| Royalties from sale of patents | - | 290 | (290) | (100.0) |
| Other | 56 | 34 | 22 | 64.7 |
| Total | $ 2,790 | $ 3,342 | $ (552) | (16.5)% |

The product line revenue is further broken down by revenue type hereunder with explanations for changes in the current periods compared to the same periods in fiscal 2013.

*Product Revenue*

Product revenue for the three and six month periods ended November 30, 2013 was approximately $376,000 and $618,000, respectively, as compared to approximately $478,000 and $693,000, respectively, for the same periods in the prior fiscal year.

The table below details product revenue by product line for the three month periods ended November 30, 2013 and 2012 (in thousands, except percentages):

| | November 30, | | | |
|---|---|---|---|---|
| | **2013** | **2012** | **$ Change** | **% Change** |
| **Product Line** | | | | |
| ProductCenter | $ 43 | $ 45 | $ (2) | (4.4)% |
| CADRA | 325 | 433 | (108) | (24.9) |
| Other | 8 | - | 8 | - |
| Total | $ 376 | $ 478 | $ (102) | (21.3)% |

The table below details product revenue by product line for the six month periods ended November 30, 2013 and 2012 (in thousands, except percentages):

| | November 30, | | | |
|---|---|---|---|---|
| | **2013** | **2012** | **$ Change** | **% Change** |
| **Product Line** | | | | |
| ProductCenter | $ 110 | $ 62 | $ 48 | 77.4% |
| CADRA | 500 | 613 | (113) | (18.4) |
| Other | 8 | 18 | (10) | (55.6) |
| Total | $ 618 | $ 693 | $ (75) | (10.8)% |

Our product revenue for ProductCenter experienced an improvement for the first half of fiscal year 2014 as compared to the same period in fiscal 2013. The increase which occurred in the first quarter was significant as a percentage but only because the comparative fiscal year results were so low, and does not signal a strengthening in demand for this technology. This product line s challenges both from a macro-economic and from a competitive standpoint as detailed above make it difficult to reliably forecast receipt of purchase orders from customers.

Product revenue from our CADRA technology declined in the current quarter as compared to the same period in the prior fiscal year. The CADRA Sale occurred in the middle of the second quarter of fiscal 2014 and is responsible for the decline in product revenue for that technology for both the three and the six month periods ended November 30, 2013 as compared to the prior fiscal year.

*Service Revenue*

Our service revenue is composed of both annual software maintenance contracts for previously licensed technology for both of our product lines and consulting revenue generated primarily from our ProductCenter technology. The table below summarizes service revenue by product line for the three months ended November 30, 2013 and 2012, (in thousands, except percentages):

| | 2013 | 2012 | $ Change | % Change |
|---|---|---|---|---|
| **Product Line** | | | | |
| ProductCenter | $ 688 | $ 721 | $ (33) | (4.6)% |
| CADRA | 312 | 465 | (153) | (32.9) |
| Other | 38 | 8 | 29 | 362.5 |
| Total | $ 1,038 | $ 1,194 | $ (157) | (13.1)% |

The table below summarizes service revenue by product line for the six months ended November 30, 2013 and 2012, (in thousands, except percentages):

| Product Line | 2013 | 2012 | $ Change | % Change |
|---|---|---|---|---|
| ProductCenter | $ 1,359 | $ 1,420 | $ (61) | (4.3)% |
| CADRA | 764 | 923 | (159) | (17.2) |
| Other | 49 | 16 | 33 | 206.3 |
| Total | $ 2,172 | $ 2,359 | $ (187) | (7.9)% |

Maintenance revenue was approximately $795,000 and $1.7 million for the three and six month periods ended November 30, 2013, as compared to $1.0 and $2.0 million for the same periods in the prior fiscal year. The CADRA Sale at the mid-point of the second quarter of fiscal year 2014 was primarily responsible for the maintenance revenue declines for the current year as compared to fiscal year 2013. ProductCenter maintenance revenue was down approximately 5.8% and 6.7% for the three and six month periods ended November 30, 2013, respectively, compared to the same periods in the prior fiscal year. The decline was due to non-renewal of maintenance contracts in fiscal 2013 at a slightly higher rate than we have experienced in the recent past. New licenses that are always sold with one-year maintenance contracts were insufficient to offset the non-renewals.

Consulting revenue was approximately $242,000 and $442,000 for the three and six month periods ended November 30, 2013, an increase of approximately 8% and 6%, respectively, from the same periods in the prior fiscal year. The current year increases follow an increase of almost 19% in fiscal 2013 as compared to fiscal year 2012. Over the last few years the Company has expanded its consulting opportunities by partnering with other technology companies such as Aras and Spaceclaim.

*Royalties from sale of patents*

During the three and six months ended November 30, 2013, there were no royalties received from the sale of patents. Royalties from sale of patents was approximately $100,000 and $290,000 for the three and six months ended November 30, 2012, respectively.

Since the Recapitalization Transaction described hereunder, the Company has been actively engaged in acquiring and filing U.S. patents applications, evaluating alternatives for monetizing its existing patents and investigating the acquisition of specific patents already awarded that might enhance our value. It is expected that this kind of activity will become an increasing area of focus and investment over the coming years.

In June 2012 the Company sold its rights, title and interests in three of its U.S. patents ( Patents ) in exchange for a non-refundable, initial royalty payment of $200,000 (the Initial Payment ) and in September 2012, the agreement was amended to include two other U.S. patents ( Additional Patents ) and the Initial Payment was increased by $100,000. The agreement gives the Buyer complete control over what, if any, actions shall be taken in the future to monetize the Patents through licensing, sale, enforcement or other means. In the event whereby monies are derived from the Patents, the Company is due 30% of the net proceeds (the Net Proceeds ), as defined in the agreement. The Initial Payment shall be reimbursable from Net Proceeds to the extent any are due. There can be no assurance that the Company will derive any additional monies from the Patents, however.

The sale of the Patents is a multiple element arrangement as defined under ASC 605 and, as such, the Company allocated the Initial Payment between the sale of the Patents that were delivered during the fiscal quarter and support services that were undelivered. Support services include being available to the Buyer to assist them should they require such assistance in licensing or pursuing other means on monetizing the "Patents" to third parties. The allocation of the Initial Payment to the patent and support services elements was based on management s best estimate of the selling price of each element. The Initial Payment was allocated as follows: Patents - $290,000; and Support Services - $10,000. The revenue allocated to support services has been deferred and will be recognized as revenue when the services are performed.

*Gross Margin*

Gross margin as a percentage of revenue was 79.3% and 77.3% for the three and six month periods ended November 30, 2013, respectively, as compared to 80.4% and 79.7% in the same periods in the prior fiscal year. The decrease in gross margin was due to a 20.2% and 16.5% reduction in revenue in the three and six month periods ending November 30, 2013 as compared to the same periods in the prior fiscal year. As noted above, during the three and six month periods ended November 30, 2012, the Company sold three of its Patents resulting in $100,000 and $290,000, respectively, of revenue recorded in the prior fiscal year. In addition, revenue declined as a result of the CADRA Sale during the second quarter of fiscal 2014.



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*Research and Development Expenses*

Research and development expenses were approximately $304,000 and $639,000 for the three and six month periods ended November 30, 2013, respectively, as compared to approximately $323,000 and $567,000 in the comparable periods in fiscal 2013. The majority of the increase in R&D expenses for the six month periods ended November 30, 2013 as compared to the prior fiscal year was the result of more development resources being allocated towards upgrading and maintaining our ProductCenter and CADRA product offerings in the current fiscal year, activities that are expensed as incurred, as compared to new product development in fiscal 2013, activities that are subject to capitalization. Specifically, capitalized software development expenditures were $48,000 and $159,000 for the three and six month periods ended November 30, 2012, respectively, as compared to $18,000 and $57,000 for the three and six month periods ended November 30, 2013, respectively. The CADRA Sale and the resulting reduction in R&D personnel in the current quarter offset the impact of the change in capitalized costs.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses were approximately $866,000 and $1.7 million for the three and six month periods ended November 30, 2013, respectively, as compared to approximately $789,000 and $1.5 million for the comparable periods in fiscal year 2013. These increased expenses were due primarily to professional fees related to the SolidWorks legal proceedings (see PART II. OTHER INFORMATION), the debt amendments as described in Notes F and I, and the negotiation of our headquarters office lease.

*Gain on sale of product line*

The Company recorded a gain on the sale of CADRA product line of approximately $91,000 which was completed on October 18, 2013. The Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services. The purchase price was $3.2 million of which the Company received $2.88 million at the close and will receive an additional $320,000 on October 18, 2014 subject to offset for any indemnification claims Mentor may have under the Asset Purchase Agreement. In addition, Mentor assumed contractual obligations related to maintenance contracts totaling approximately $607,000. Goodwill totaling $3.26 million was allocated to the CADRA product line and was included in the derivation of the gain on sale of the product line. Professional fees and other expenses related to the transaction totaled approximately $448,000. Finally, tangible assets with a net book value of approximately $7,000 were transferred to Mentor. Any contingent payments of up to $750,000 based on 10% of the revenue generated by Mentor from CADRA over the next three years will be recorded as earned.

The Company will continue to market and support the CADRA technology throughout Europe (except Germany) and for a specified customer in the U.S. for at least one year from the transaction date under a Distribution Agreement signed on October 18, 2013 between the Company and Mentor. The Distribution Agreement is subject to renewal thereafter by mutual agreement. Due to the material nature of the Company s continued involvement, the transaction did not qualify for discontinued operations treatment.

*Interest Expense*

Interest expense for the three and six month periods ended November 30, 2013 was approximately $104,000 and $199,000, respectively, as compared to approximately $69,000 and $134,000 for the comparable periods in the prior fiscal year. This increase was due to an increased balance outstanding on our term loan as of a result of refinancing our debt facility in May 2013. The average debt outstanding for the three and six month periods ended November 30, 2013 was $2.7 million as compared to $1.8 million for the comparable periods in fiscal year 2013, an increase of 50%.

*Net Income*

Net income (loss) for the three and six month periods ended November 30, 2013 was approximately ($44,000) and ($310,000) or ($.05) and ($.35) per share as compared to approximately $252,000 and $425,000 or $0.25 and $0.43 per share for the comparable periods in the prior fiscal year.

**Liquidity and Capital Resources**

During the six month period ended November 30, 2013 operating activities used approximately $1.8 million in cash. Approximately $1.3 million of the proceeds from the CADRA Sale was placed in a restricted cash account for the benefit of the Lender pending an amendment to the Loan Agreement. The liability related to deferred maintenance revenue used cash of approximately $538,000. This decrease is the normal cycle as the majority of the annual contracts renew in Q3 and Q4. Receivables increased by approximately $196,000 due to a significant CADRA order received under the Distribution Agreement with Mentor. Accounts payable, accrued expenses and other liabilities increased by approximately $402,000 thereby partially offsetting the aforementioned cash uses primarily as a result of the large CADRA order taken as a reseller and certain accruals related to the CADRA Sale.

During the comparable period in fiscal year 2013, operating activities used $356,000. Net income adjusted for non-cash expenses provided $531,000 which was more than offset by an increase in accounts receivable that used $303,000 and a seasonal decrease in deferred maintenance revenue that used $630,000. These uses of cash in fiscal 2013 are consistent with the uses in fiscal 2014 as described above.

Net cash provided by investing activities for the six months ended November 30, 2013 was approximately $2.3 million primarily composed of the proceeds from the CADRA Sale net of transaction costs.

Net cash used in financing activities totaled approximately $103,000 composed primarily of $63,000 of costs associated with the buyback of 170,000 Treasury shares during the first quarter of fiscal 2014 as described in Note G herein.

**Our Credit Facility**

As of November 30, 2013, we had $2.7 million of outstanding indebtedness under our Loan Agreement with Prides Crossing Capital. The terms of that Loan Agreement are detailed in Note F to the financial statements herein. On December 5, 2013, the Loan Agreement was amended in accordance with an agreement with our Lenders in connection with their consent to the CADRA Sale. Under the terms of the Amended Loan Agreement No. 2 we agreed to pay down the principal of the Loan Agreement from $2.7 million to $1.0 million (the Term Note ) using a portion of the proceeds from the CADRA Sale. In addition, we paid a pre-payment penalty of $81,000 and agreed to repurchase 25,000 warrants with an exercise price of $1.00 per share in exchange for $19,000.

The amended and restated Term Note matures on January 1, 2015 and bears an interest rate of 14% payable in arrears on a monthly basis throughout the life of the loan commencing on January 1, 2014. The Term Note may be repaid in full at any time but partial voluntary pre-payments are not allowed. If a pre-payment is made on or prior to September 30, 2014, we shall pay a yield maintenance fee equal to the interest that would have accrued under the Term Note from the date of pre-payment through September 30, 2014. No yield maintenance fee is due for a pre-payment made subsequent to September 30, 2014.

We agreed to secure all of its obligations under the Term Note by granting the Lender a first priority security interest in all of our assets, including our intellectual property and pledges of (i) one hundred percent (100%) of our equity interests in its domestic subsidiaries and (ii) sixty-five percent (65%) of our equity interests in its foreign subsidiaries. In connection with the grant of the security interest in favor of the Lender in our intellectual property, we entered into an intellectual property security agreement with the Lender and will enter into a source code escrow agreement with the Lender and an independent third party on a post-closing basis. In addition, our Chief Executive Officer has provided the Lender with a personal guaranty of up to $500,000 secured by his equity interests in the Company.

The Amended Loan Agreement No. 2 contains customary representations, warranties and covenants, including covenants by us limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans, sale and leasebacks, transactions with affiliates and fundamental changes in our business. In addition, the Amended Loan Agreement No. 2 contains financial covenants by us that establish (i) a month-end minimum consolidated cash balance of $1.0 million of which no less than $750,000 must be held in our main operating account that is subject to a deposit account control agreement; (ii) a minimum of $750,000 of consolidated cash at all times; (iii) a quick ratio covenant, which provides that on the last day of each fiscal quarter the ratio of our cash plus accounts receivable divided by accounts playable plus accrued expenses shall not be less than 2.7:1; and (iv) a covenant that provides that our earnings before interest, taxes, depreciation and amortization ( EBITDA ) for Q3 and Q4 of fiscal 2014 shall not exceed a loss of $200,000 for each of those fiscal quarters and shall be greater than positive EBITDA of $100,000 for each subsequent fiscal quarter. The Amended Loan Agreement No. 2 also imposes limits on capital expenditures for each fiscal year during the term of the Amended Loan Agreement No. 2. As part of the Amended Loan Agreement No. 2 we entered into a deposit account control agreement pursuant to which the Lender will perfect its security interest in the assets held in our main operating account at First Republic Bank.

The Amended Loan Agreement No. 2 provides for events of default customary for credit facilities of this type, including but not limited to non-payment, defaults on other debt, misrepresentation, breach of covenants, representations and warranties, insolvency and bankruptcy. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the Amended Loan Agreement No. 2 will become immediately due and payable and the Lender commitment will be automatically terminated. Upon the occurrence and continuation of any other event of default, the Lender may accelerate payment of all obligations and terminate the Lender s commitments under the Amended Loan Agreement No. 2.

We believe that our cash together with our new credit facility and cash provided by operations will be sufficient to meet our capital needs for at least the next twelve months.

**Sources of Cash**

As of November 30, 2013, we had cash on hand of approximately $3.0 million, of which approximately $1.4 million was restricted in an escrow account for the benefit of our Lender pursuant to the amendment to the Loan Agreement. This represents an increase of approximately $1.7 million from May 31, 2013 resulting primarily from the CADRA Sale offset by cash used in operating, investing and financing activities the most significant of which are described above.

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of the SEC s Regulation S-K.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

This Item is not applicable because we are a smaller reporting company, as defined by applicable SEC regulation.

**Item 4. Controls and Procedures**

Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and we necessarily were required to apply our judgment in evaluating the cost-benefit relationship of possible changes or additions to our controls and procedures.

As of the end of the period covered by this report (November 30, 2013), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting. There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

On July 19, 2013, Dassault Systemes SolidWorks Corporation ( SolidWorks ) filed a complaint (the Complaint ) against the Company in the United States District Court for the Eastern District of Texas Tyler Division alleging fraud and false assurances. The Complaint is connected to a patent infringement suit brought by Auto-Dimensions LLC, a wholly-owned subsidiary of Acacia Research Group, against SolidWorks in December 2012. The Company owned those patents in question and sold them to Auto-Dimensions LLC in June 2012. SolidWorks is seeking reimbursement from the Company of attorneys fees and any judgments or settlement monies it may incur under the infringement suit, as well as punitive and multiple damages. The Company believes the Complaint is without merit and is vigorously defending itself in this action.

**Item 1A. Risk Factors**

*In addition to the other information set forth in this report and the risk factors below, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors" in our Annual Report on Form 10-K for the year ended May 31, 2013, which could materially affect our business, financial condition or future results. Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in the Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Any factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.*

**General Risks**

***Failure to comply with financial covenants in our Amended Loan Agreement No. 2 could adversely affect us.***

Our Amended Loan Agreement No. 2 includes enhanced financial covenants which require us to maintain compliance with certain financial ratios during the term of the agreement and other restrictions on our use of cash, such as maintaining a month-end minimum consolidated cash balance of $1.0 million, of which no less than $750,000 must be held in our main operating account that is subject to a deposit account control agreement with our Lender. Failure to comply with the financial covenants or other restrictions is an event of default under the agreement. In an event of default, the Lender has the right to accelerate repayment of all sums due and take any and all action, at its sole option, to collect monies owed to it, including to enforce and foreclose on its security interest on all of our assets. If our Lender were to accelerate our debt payments, our assets may not be sufficient to fully repay the debt and we may not be able to obtain capital from other sources at favorable terms or at all.

***We may not have sufficient funds to repurchase common stock pursuant to the put right feature in our recent private placement if exercised when we are required to do so.***

Investors in our private placement in Q2 and Q3 of fiscal year 2013 have certain contractual rights, such as the right to require us to repurchase the common stock for an aggregate purchase price of $275,000 for a 30-day period commencing in May 2014 and the right to receive quarterly fees. Funds required to repurchase the common stock, if the repurchase right is exercised by investors, must be generated from a combination of cash flow from operations and cash on hand while maintaining liquidity levels required under our Amended Loan Agreement No. 2. There can be no assurance that the Company will generate positive cash flow from operations to meet this cash requirement while also remaining in compliance with its debt agreement.

**Risks Related to SofTech Following the Sale of the CADRA business**

***Following the sale of the CADRA business, we will need to restructure our business to enable us to successfully operate as a significantly smaller company and to seek new sources of revenue and possible new strategic initiatives. SofTech operating results subsequent to the sale of the CADRA business may not be profitable, and we may be unsuccessful in developing new business opportunities.***

The CADRA business was responsible for about half of the consolidated revenue in fiscal 2013 and the majority of the profitability and cash flow. The importance of the CADRA business to the consolidated results in fiscal 2013 was similar in at least the two immediately preceding fiscal years. The remaining product lines following the CADRA Sale, namely ProductCenter and the Connector technologies, are product lines that have historically been less profitable than the CADRA business, have fewer customers and have a more complex sales cycle. It is likely that the Company will need to reduce spending in order to achieve profitability, and ultimately will need to find new strategic directions and find new sources of business revenue in order to meaningfully increase the size of its business. The new product ideas that the management team has interest in pursuing as described in the patent filings over the last few years are speculative in that the products are still in development and the management team may not have the depth of experience required to be successful in those new markets.

***A portion of the purchase price is contingent and we may not receive those payments.***

A portion of the purchase price, an amount equal to $320,000, will be held back by the Mentor to secure any indemnification claims under the Asset Purchase Agreement. If indemnification claims are asserted, we may not receive all or any of the $320,000 payable to us.

In addition, up to $750,000 of the total purchase price is subject to an earn-out arrangement relating to the revenues generated by the CADRA business during the three-year period following the asset sale. The Asset Purchase Agreement also allows Mentor to withhold monies due under the earn-out arrangement if indemnification claims are asserted. Mentor has broad discretion to operate its post-closing business, and may choose to do so in a manner which may or may not result in the payment of all of the CADRA royalties pursuant to the Earn-Out Agreement.

***We will continue to incur the expenses of complying with public company reporting requirements following the closing of the CADRA Sale.***

After the CADRA Sale, we will continue to be required to comply with the applicable reporting requirements of the Securities Exchange Act of 1934, as amended, even though compliance with such reporting requirements is economically burdensome and will represent an even greater percentage of our expenses post-closing as we will be a significantly smaller company following the sale of the CADRA business.

**Risks Related to the Asset Purchase Agreement**

***Buyer is not assuming any of the excluded liabilities under the Asset Purchase Agreement.***

Under the Asset Purchase Agreement, Mentor is not assuming all of the liabilities associated with the CADRA business. Certain liabilities will remain with the Company post-closing. For example, Mentor is only assuming customer support obligations and obligations for performance under the certain assigned contracts that arise after the closing, and is not assuming liability for any obligation or breach by the Company occurring or arising prior to the closing. While the Company believes that it has adequately accrued for these liabilities or is adequately insured against certain of the risks associated with such excluded liabilities, there can be no assurances that additional expenditures will not be incurred in resolving these liabilities.

***The Asset Purchase Agreement may expose us to contingent liabilities.***

We have agreed to indemnify Mentor for certain breaches of representations, warranties or covenants made by us in the Asset Purchase Agreement up to $3.95 million. Significant indemnification claims by the Mentor could materially and adversely affect our business, financial condition and results of operations.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

## Item 3. Defaults Upon Senior Securities

None

**Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other Information**

Not Applicable

**Item 6. Exhibits**

See Exhibit Index on page 37.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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|---|---|
| | SOFTECH, INC. |
| Date: January 14, 2014 | */s/ Amy E. McGuire*<br>Amy E. McGuire<br>Chief Financial Officer |
| Date: January 14, 2014 | */s/ Joseph P. Mullaney*<br>Joseph P. Mullaney<br>President & Chief Executive Officer |

**Exhibit Index**

| Exhibit No. | Description of Document |
|---|---|
| 2.1 | Asset Purchase Agreement, dated as of August 30, 2013, between Mentor Graphics Corporation and the Company (incorporated by reference to Exhibit 2.1 to the Company s Form 8-K, filed on September 6, 2013). |
| 2.2 | Earn-Out Agreement, dated August 30, 2013, between Mentor Graphics Corporation and the Company (incorporated by reference to Exhibit 2.2 to the Company s Form 8-K, filed on September 6, 2013). |
| 3.1 | Articles of Organization, as amended through October 12, 1988 (incorporated by reference to Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q for the quarter ended February 29, 2008, filed on April 14, 2008). |
| 3.1.1 | Articles of Amendment to Articles of Organization, dated April 15, 2011 (incorporated by reference to Exhibit 3.1.1 to the Company s Registration Statement on Form S-1, filed on June 9, 2011). |
| 3.1.2 | Articles of Amendment to Articles of Organization, effective June 7, 2011 (incorporated by reference to Exhibit 3.1.2 to the Company s Registration Statement on Form S-1, filed on June 9, 2011). |
| 3.2 | By-laws (incorporated by reference to Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q for the quarter ended February 29, 2008, filed on April 14, 2008). |
| 10.1 | Consent to the Sale of Assets and Amendment to Loan, Pledge and Security Agreement, dated October 17, 2013, between Prides Crossing Capital, L.P., Prides Crossing Capital-A, L.P., Joseph P. Mullaney and the Company. |
| 10.2 | Amended and Restated Loan, Pledge and Security Agreement, dated December 5, 2013, by and among Prides Crossing Capital Funding, L.P. and the Company |
| 31.1 | Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of the Principal Financial Officer and Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema Document |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document |
| ** | XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections. |