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SOFTECH INC  
Form 10QSB  
January 17, 2006

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SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-QSB

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

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For the Quarter Ended  
November 30, 2005

Commission File Number  
0-10665

SOFTECH, INC.

State of Incorporation  
Massachusetts

IRS Employer Identification  
04-2453033

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

The number of shares outstanding of registrant's common stock at December 30, 2005 was 12,205,236 shares.

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SOFTECH, INC.

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PART I. Financial Information

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Item 1. Financial Statements

Consolidated Condensed Balance Sheets -

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS  
SOFTECH, INC. AND SUBSIDIARIES

-----  
CONSOLIDATED CONDENSED BALANCE SHEETS  
-----

	(dollars in thousands)	
	November 30, 2005	May 31, 2005
	-----	-----
ASSETS		
-----		
Cash and cash equivalents	\$ 434	\$ 399
Accounts receivable, net	1,633	1,618
Prepaid and other assets	301	346
	-----	-----
Total current assets	2,368	2,363
	-----	-----
Property and equipment, net	150	165
Capitalized software costs, net	3,987	4,968
Other intangible assets, net	-	183
Goodwill, net	4,598	4,598

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Notes receivable	134	134
Other assets	3	5
	-----	-----
TOTAL ASSETS	\$ 11,240	\$ 12,416
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		
-----		
Accounts payable	\$ 208	\$ 213
Accrued expenses	1,036	1,058
Deferred maintenance revenue	3,042	4,019
Current portion of long term debt	1,416	1,416
	-----	-----
Total current liabilities	5,702	6,706
	-----	-----
Long-term debt, net of current portion	12,044	11,785
	-----	-----
Stockholders' deficit	(6,506)	(6,075)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 11,240	\$ 12,416
	=====	=====

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES

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CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
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	(in thousands, ex Three
	-----
	November 30, 2005
	-----
Revenue	
Products	\$ 878

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Services	2,513
	-----
Total revenue	3,391
Cost of products sold: materials	69
Cost of product sold: amortization of capitalized software costs and other intangible assets	553
Cost of services provided	381
	-----
Gross margin	2,388
Research and development expenses	692
Selling, general and administrative	1,512
	-----
Income from operations before interest expense	184
Interest expense	286
	-----
Net loss	\$ (102)
	=====
Basic and diluted net loss per common share	\$ (0.01)
Weighted average common shares outstanding	12,205

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES  
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CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
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	(in thousands, ex Six M
	-----
	November 30, 2005
	-----
Revenue	
Products	\$ 1,717

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Services	4,742
	-----
Total revenue	6,459
Cost of products sold: materials	126
Cost of product sold: amortization of capitalized software costs and other intangible assets	1,164
Cost of services provided	781
	-----
Gross margin	4,388
Research and development expenses	1,370
Selling, general and administrative	2,925
	-----
Income (loss) from operations before interest expense	93
Interest expense	529
	-----
Net loss	\$ (436)
	=====
Basic and diluted net loss per common share	\$ (0.04)
Weighted average common shares outstanding	12,205

See accompanying notes to consolidated condensed financial statements.

SOFTECH, INC. AND SUBSIDIARIES  
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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
-----

	(dollar Six
	-----
	November 30, 2005
	-----
Cash flows from operating activities:	
Net loss	\$ (436)
	-----
Adjustments to reconcile net loss to	

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net cash used by operating activities:	
Depreciation and amortization	1,197
Change in current assets and liabilities:	
Accounts receivable	(15)
Prepaid expenses and other assets	47
Accounts payable and accrued expenses	(27)
Deferred maintenance revenue	(977)
	-----
Total adjustments	225
	-----
Net cash (used) provided by operating activities	(211)
	-----
Cash flows used by investing activities:	
Payments for business acquisition, net of cash acquired	-
Capital expenditures	(18)
	-----
Net cash used by investing activities	(18)
	-----
Cash flows from financing activities:	
Borrowings under line of credit agreements, net	259
	-----
Net cash provided by financing activities	259
	-----
Effect of exchange rates on cash	5
	-----
Increase in cash and cash equivalents	35
Cash and cash equivalents, beginning of period	399
	-----
Cash and cash equivalents, end of period	\$ 434
	=====

See accompanying notes to consolidated condensed financial statements.

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SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(A) The consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange

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Commission from the accounts of SofTech, Inc. and its wholly owned subsidiaries (the "Company") without audit; however, in the opinion of management, the information presented reflects all adjustments which are of a normal recurring nature and elimination of intercompany transactions which are necessary to present fairly the Company's financial position and results of operations. It is recommended that these consolidated condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's fiscal year 2005 Annual Report on Form 10-KSB.

### (B) SIGNIFICANT ACCOUNTING POLICIES

#### REVENUE RECOGNITION

The Company has adopted the provisions of Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2) as amended by SOP No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions" (SOP 98-9) in recognizing revenue from software transactions. Revenue from software license sales are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility has been determined. The Company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the elements using the residual method set forth in SOP 98-9. 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, primarily performed on a time and material basis, is recognized as those services are rendered.

#### CAPITALIZED SOFTWARE COSTS AND RESEARCH AND DEVELOPMENT:

The Company capitalizes certain costs incurred to internally develop and/or purchase software that is licensed to customers. Capitalization of internally developed software begins upon the establishment of technological feasibility. Costs incurred prior to the establishment of technological feasibility are expensed as incurred. Purchased software is recorded at cost. The Company evaluates the realizability and the related periods of amortization on a regular basis. Such costs are amortized over estimated useful lives ranging from three to ten years. The Company did not capitalize any internally developed software during the three or six month periods ended November 30, 2004 or 2005. Substantially all of the recorded balance represents software acquired from third parties. Amortization expense related to capitalized software costs for the three and six month periods ended November 30, 2005 were \$553,000 and \$1,164,000, respectively. Amortization expense related to capitalized software costs for the three and six month periods ended November 30, 2004 were \$610,000 and \$1,221,000, respectively.

#### ACCOUNTING FOR GOODWILL

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

As of May 31, 2005, the Company conducted its annual impairment test of

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goodwill by comparing fair value to the carrying amount of its underlying assets and liabilities. The Company determined that the fair value exceeded the carrying amount of the assets and liabilities, therefore no impairment existed as of the testing date.

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SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

LONG-LIVED ASSETS:

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

STOCK BASED COMPENSATION

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock option plans. Because the number of shares is known and the exercise price of options granted has been equal to fair value at date of grant, no compensation expense has been recognized in the statements of operations. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation - An Amendment of SFAS No. 123." Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards under these plans, consistent with the methodology prescribed under SFAS 123, the Company's net loss and loss per share would have approximated the pro forma amounts indicated below:

(in thousands, except per share data)	Three Month Periods Ended November 30,	
	2005	2004
Net loss - as reported	\$ (102)	\$ (90)
Stock based compensation determined under fair value based method	(1)	(3)
Net loss - pro forma	(103)	(93)
Loss per share - diluted - as reported	(.01)	(.01)
Loss per share - diluted - pro forma	(.01)	(.01)

Six Month Periods Ended



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(in thousands, except per share data)	November 30,	
	2005	2004
Net loss - as reported	\$ (436)	\$ (549)
Stock based compensation determined under fair value based method	(2)	(5)
Net loss - pro forma	(438)	(554)
Loss per share - diluted - as reported	(.04)	(.04)
Loss per share - diluted - pro forma	(.04)	(.04)

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123(R) is effective for public companies that file as small business issuers for annual periods beginning after June 15, 2005; accordingly, the Company will adopt SFAS 123(R) on June 1, 2006. The Company is currently evaluating the impact that this statement will have on its financial condition or results of operations.

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### SOFTECH, INC. AND SUBSIDIARIES

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#### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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#### FOREIGN CURRENCY TRANSLATION:

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

#### USE OF ESTIMATES:

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

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and the allowance for doubtful accounts. Actual results could differ from those estimates.

### RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current year presentation. Specifically, amortization of capitalized software and other intangible assets totaling \$610,000 and \$1,221,000 for the three and six month periods ended November 30, 2004, respectively, were classified on the face of the income statement as a separate line item under operating expenses. This non-cash expense resulting from acquisitions was reclassified to cost of products sold in these financial statements. This reclassification had no impact on the net loss or cash flow reported.

### (C) LIQUIDITY

The Company ended the first half of fiscal 2006 with cash of \$434,000, an increase of \$35,000 from May 31, 2005. Operating activities used \$211,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation together with a decrease in prepaid and other assets generated cash of about \$808,000. The reduction in accounts payable and accrued expenses and the cyclical reduction in deferred revenue utilized cash of about \$1 million during the first half of the fiscal year. During the first half of fiscal 2006 the Company borrowed \$259,000 in excess of its debt repayments from its line of credit and purchased approximately \$18,000 of capital equipment.

The Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow in fiscal 2006. The Company believes that the cash on hand together with cash flow from operations and its available borrowings under its credit facility will be sufficient for meeting its liquidity and capital resource needs for the next year. At November 30, 2005, the Company had available borrowings on its debt facilities of approximately \$3.2 million.

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### SOFTECH, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

### (D) BALANCE SHEET COMPONENTS

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

	November 30, 2005	May 31, 2005
	-----	-----
Property and equipment	\$ 3,952	\$ 3,934
Accumulated depreciation and amortization	(3,802)	(3,769)

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Property and equipment, net	\$ 150	\$ 165
Common stock, \$.10 par value	\$ 1,274	\$ 1,274
Capital in excess of par value	19,544	19,544
Accumulated deficit	(25,485)	(25,049)
Accumulated other comprehensive income	(278)	(283)
Less treasury stock	(1,561)	(1,561)
Stockholders' deficit	\$ (6,506)	\$ (6,075)

(E) LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed by dividing net loss by the weighted-average number of common and equivalent dilutive common shares outstanding. Options to purchase shares of common stock have been excluded from the denominator for the computation of diluted earnings per share for all periods presented in fiscal 2005 and 2004 because their inclusion would be antidilutive. The weighted average shares outstanding for each of the income statements included in this filing are presented below (000's):

	Three Month and Six Month Periods Ended November 30,	
	2005	2004
Basic weighted average shares outstanding	12,205	12,205
Effect of employee stock options outstanding	---	---
	12,205	12,205

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SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(F) COMPREHENSIVE LOSS

The Company's comprehensive loss includes accumulated foreign currency translation adjustments and unrealized gain (loss) on marketable securities. For the three and six month periods ended November 30, 2005 and 2004, the comprehensive loss was as follows (000's):

	Three Month Periods Ended November 30,	
	2005	2004

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Net loss	\$	(102)	\$	(90)
Changes in:				
Foreign currency translation adjustment		1		--
		-----		-----
Comprehensive loss	\$	(101)	\$	(90)
		=====		=====

		Six Month Periods Ended		
		November 30,		
		2005		2004
		-----		-----
Net loss	\$	(436)	\$	(549)
Changes in:				
Foreign currency translation adjustment		5		(10)
		-----		-----
Comprehensive loss	\$	(431)	\$	(559)
		=====		=====

(G) SEGMENT INFORMATION

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

		Three Months Ended	Three Months Ended
		November 30,	November 30,
Revenue:		2005	2004
		-----	-----
North America	\$	2,461	\$ 2,195
Asia		349	325
Europe		787	750
Eliminations		(206)	(49)
		-----	-----
Consolidated Total	\$	3,391	\$ 3,221
		-----	-----

		Six Months Ended	Six Months Ended
		November 30,	November 30,
Revenue:		2005	2004
		-----	-----
North America	\$	4,837	\$ 4,275
Asia		577	543
Europe		1,297	1,248
Eliminations		(252)	(68)
		-----	-----
Consolidated Total	\$	6,459	\$5,998
		-----	-----

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## SOFTECH, INC. AND SUBSIDIARIES

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### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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	November 30, 2005	May 31, 2005
Long Lived Assets:		
North America	\$ 8,721	\$ 9,901
Europe	151	152
Consolidated Total	\$ 8,872	\$ 10,053

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## SOFTECH, INC. AND SUBSIDIARIES

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

---

The statements made below with respect to SofTech's outlook for fiscal 2006 and beyond represent "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934 and are subject to a number of risks and uncertainties. These include, among other risks and uncertainties, general business and economic conditions, generating sufficient cash flow from operations to fund working capital needs, continued integration of acquired entities, potential obsolescence of the Company's technologies, maintaining existing relationships with the Company's lenders, successful introduction and market acceptance of planned new products and the ability of the Company to attract and retain qualified personnel both in our existing markets and in new territories in an extremely competitive environment.

#### CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

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

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

#### REVENUE RECOGNITION

The Company has adopted the provisions of Statement of Position No. 97-2,

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"Software Revenue Recognition" (SOP 97-2) as amended by SOP No. 98-9, "Modification of SOP 97-2 Software Revenue Recognition with Respect to Certain Transactions" (SOP 98-9) in recognizing revenue from software transactions. Revenue from software license sales are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility has been determined. The company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the elements using the residual method. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements. Revenue from engineering, consulting and training services, primarily performed on a time and material basis, is recognized as those services are rendered.

### VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS

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

### VALUATION OF GOODWILL

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

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### SOFTECH, INC. AND SUBSIDIARIES

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#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

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As of May 31, 2005, the Company conducted its annual impairment test of goodwill by comparing fair value to the carrying amount of its underlying assets and liabilities. The Company determined that the fair value exceeded the carrying amount of the assets and liabilities, therefore no impairment existed as of the testing date.

#### ESTIMATING ALLOWANCES FOR DOUBTFUL ACCOUNTS RECEIVABLE

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. We continuously

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monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. A significant change in the liquidity or financial position of any of our significant customers could have a material adverse effect on the collectibility of our accounts receivable and our future operating results.

### VALUATION OF DEFERRED TAX ASSETS

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

### RESULTS OF OPERATIONS

Revenue for the three and six month periods ended November 30, 2005 was \$3.4 million and \$6.5 million, respectively, as compared to \$3.2 million and \$6.0 million for the same periods in the prior fiscal year. This represents an increase of 5.3% for fiscal 2006 Q2 and 7.7% for the first half of fiscal 2006 as compared to the same periods in fiscal 2005. An increase in product revenue as detailed below was responsible for the increase in revenue for both periods.

Product revenue for the three and six month periods ended November 30, 2005 was approximately \$878,000 and \$1.7 million, respectively, as compared to \$687,000 and \$1.1 million for the same periods in the prior fiscal year. This represents an increase of 27.8% for fiscal 2006 Q2 and 55.4 % for the first half of fiscal 2006 as compared to the same periods in fiscal 2005. The primary reason for the increased product revenue for both the three and six month periods ended November 30, 2005 was related to our ProductCenter technology offering which increased by 59.3% and 110.6% for the three and six months ended November 30, 2005, respectively. The improved order flow for this technology is critical to our continued revenue growth.

Service revenue for the three and six month periods ended November 30, 2005 was approximately \$2.5 million and \$4.7 million, respectively, as compared to approximately \$2.5 million and \$4.9 million for the same period in fiscal 2005. This represents a decrease of .8% for fiscal 2006 Q2 as compared to the same period in fiscal 2005 and a decrease of 3.1% for the first half of fiscal 2006 compared to the same period in fiscal 2005. The decrease in service revenue for the six months of the current year compared to fiscal 2005 was due to a 15% decrease in consulting and training revenue and a 9% decrease in maintenance revenue from the AMT product line. The decrease in consulting and training revenue was due to the completion of a few large projects from fiscal 2005. The decrease in AMT maintenance revenue was due to a lower maintenance renewal rate for that product line.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS  
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Revenue generated in the U.S. accounted for 73% and 75% of total revenue for the three and six month periods ended November 30, 2005, respectively, as compared to 68% and 71% of total revenue for the same periods in the previous year. Revenue generated in Europe for the three and six month periods ended November 30, 2005 was 23% and 20% of total revenue, respectively, as compared to 23% and 21% of total revenue for the same period in fiscal 2005. Revenue generated in Asia for the three and six month periods ended November 30, 2005 was 10% and 9% of total revenue, respectively, as compared to 10% and 9% of total revenue for the same period in fiscal 2005. Revenue generated in the U.S. increased by about 12% and 13% for the three and six month periods ended November 30, 2005, respectively, as compared to the same periods in the prior fiscal year. Revenue generated in Europe increased by about 5% and 4% for the three and six month periods ended November 30, 2005 and revenue generated in Asia increased about 7% and 6% for the three and six month periods ended November 30, 2005, respectively, for the same periods. It is our expectation that revenue from Asia and Europe will continue to make up a significant portion of our total revenue.

Gross margin as a percentage of revenue was 70.4% and 67.9 % for the three and six month periods ended November 30, 2005, respectively, as compared to 67.8% and 65.9% for the same periods in fiscal 2005.

Research and development expenses ("R&D") were \$692,000 and \$1.37 million for the three and six month periods ended November 30, 2005, respectively, as compared to \$674,000 and \$1.35 million for the same periods in the prior fiscal year. This represents an increase of 2.7% and 1.4% for the three and six month periods ended November 30, 2005, respectively, as compared to the same period in the prior fiscal year.

Selling, general and administrative ("SG&A") expenses were \$1.51 million and \$2.93 million, respectively, for the three and six month periods ended November 30, 2005 as compared to \$1.38 million and \$2.68 million for the same period in fiscal 2005. This represents an increase of approximately 9.2% and 9.0% for the three and six month periods ended November 30, 2005, respectively, as compared to the same periods in the prior fiscal year. The increase for both periods is due primarily to increased headcount in our sales and marketing department and third party marketing expenditures as we attempt to capitalize on an improved technology spending environment in our target market areas.

The non-cash expenses related to the amortization of capitalized software and other intangible assets were \$553,000 and \$1.164 million for the three and six month periods ended November 30, 2005 as compared to \$610,000 and \$1.221 million for the same periods in fiscal 2005. The decrease is related to the completion of the amortization related to the intangible assets acquired in the acquisition of WTC in December 2002. The quarterly amortization for Q3 and Q4 of fiscal 2006 will be approximately \$380,000.

Interest expense for the three and six month periods ended November 30, 2005 was approximately \$286,000 and \$529,000, respectively, as compared to \$216,000 and \$466,000 for the same periods in fiscal 2005. This represents an increase of 32% for the second quarter of fiscal 2006 compared to the same period in the previous fiscal year and an increase of 14% for the six month period ended November 30, 2005 compared to the same period in the prior fiscal year. The average borrowings decreased to approximately \$13.3 million during the current quarter as compared to \$14.2 million for the same period in fiscal 2005, however, the interest rate on those borrowings increased to about 8.6% in the current quarter from 6.1% for the same period in fiscal 2005. The average borrowings decreased to approximately \$13.3 million during the first half of fiscal 2006 as compared to \$14.2 million for the same period in fiscal 2005, however, the interest rate on those borrowings increased to about 8.0% during the first half of fiscal 2006 as compared to 6.6% for the same period in fiscal



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2005. The changes in the interest rate on our borrowings in fiscal 2006 as compared to 2005 is due to the increase in the prime rate.

The net loss for the three and six month periods ended November 30, 2005 was \$(102,000) and \$(436,000), respectively, as compared to a net loss of \$(90,000) and \$(549,000) for the same period in the prior fiscal year. The loss per share for each of the three month periods ended November 30, 2004 and 2005 was \$(.01) and the loss per share for each of the six month periods ended November 30, 2004 and 2005 was \$(.04).

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### SOFTECH, INC. AND SUBSIDIARIES

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#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

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##### CAPITAL RESOURCES AND LIQUIDITY

The Company ended the first half of fiscal 2006 with cash of \$434,000, an increase of \$35,000 from May 31, 2005. Operating activities used \$211,000 of cash during the first six months of the fiscal year. The net loss adjusted for non-cash expenditures related to amortization and depreciation together with a decrease in prepaid and other assets generated cash of about \$808,000. The reduction in accounts payable and accrued expenses and the cyclical reduction in deferred revenue utilized cash of about \$1 million during the first half of the fiscal year. During the first half of fiscal 2006 the Company borrowed \$259,000 in excess of its debt repayments from its line of credit and purchased approximately \$18,000 of capital equipment.

The Company believes its current cost structure together with reasonable revenue run rates based on historical performance will generate positive cash flow in fiscal 2006. The Company believes that the cash on hand together with cash flow from operations and its available borrowings under its credit facility will be sufficient for meeting its liquidity and capital resource needs for the next year. At November 30, 2005, the Company had available borrowings on its debt facilities of approximately \$3.2 million.

##### FACTORS THAT MAY AFFECT FUTURE RESULTS

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

OUR QUARTERLY RESULTS MAY FLUCTUATE. The Company's quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Our quarterly revenue may fluctuate significantly for several reasons, including: the timing and success of introductions of our new products or product enhancements or those of our competitors; uncertainty created by changes in the market; difficulty in predicting the size and timing of individual orders; competition and pricing; and customer order deferrals as a result of general economic decline. Furthermore, the Company has often

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recognized a substantial portion of its product revenues in the last month of a quarter, with these revenues frequently concentrated in the last weeks or days of a quarter. As a result, product revenues in any quarter are substantially dependent on orders booked and shipped in the latter part of that quarter and revenues from any future quarter are not predictable with any significant degree of accuracy. We typically do not experience order backlog. For these reasons, we believe that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

WE MAY NOT GENERATE POSITIVE CASH FLOW IN THE FUTURE. During fiscal years 1998 through 2001 we generated significant cash losses from operations. The Company took aggressive cost cutting steps and reorganized its operations at the beginning of fiscal 2002. These actions have greatly reduced our fixed costs and resulted in positive cash flow from operations for the last four full fiscal years. It is our expectation that we can continue to improve on our recent success, however, there can be no assurances that the Company will continue to generate positive cash in the future.

DECLINE IN BUSINESS CONDITIONS AND INFORMATION TECHNOLOGY (IT) SPENDING COULD CAUSE A DECLINE IN REVENUE. Business conditions and the level of IT spending have improved in the recent past as evidenced by our revenue growth. However, there can be no assurance that this recent improvement will continue given the difficult to forecast economic environment. If IT spending declines the Company's revenues and profitability could be adversely impacted.

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SOFTECH, INC. AND SUBSIDIARIES  
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MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS  
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THE COMPANY IS DEPENDENT ON ITS LENDER FOR CONTINUED SUPPORT. We have a very strong relationship with our sole lender, Greenleaf Capital. They currently represent our sole source of financing and it is our belief that it would be difficult to find alternative financing sources in the event whereby the relationship with Greenleaf changed.

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

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ITEM 3. CONTROLS AND PROCEDURES

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

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

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(b) Reports on Form 8-K

The Company filed a Form 8-K on October 17, 2005 related to its press release announcing first quarter results for fiscal 2006.

SIGNATURES

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

SOFTECH, INC.

Date: January 17, 2006  
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/s/ Joseph P. Mullaney  
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Joseph P. Mullaney  
President and  
Chief Operating Officer