EMTEC INC/NJ
Form 10-Q
August 13, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2004

Commission file number: 0-32789

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

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

572 Whitehead Road, Bldg.# 1
Trenton, New Jersey 08619
(Address of principal executive offices, including zip code)

(609) 528-8500
(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). ( ) Yes (X) No

As of July 31, 2004, there were outstanding 7,380,498 shares of the registrant's common stock.

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2004

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

EMTEC, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2004 (unaudited)	March 31, 2004

Assets		
Current Assets		
Cash and cash equivalents	$ 802,549	$ 4,792
Receivables:		
Trade, net	18,789,437	15,206,972
Others	485,378	289,445
Inventories	1,797,479	1,599,166
Prepaid expenses	380,690	396,313
Deferred tax assets	186,368	186,368
Total Current Assets	22,441,901	17,683,056
Property and equipment, net	337,339	387,073
Investment in geothermal power unit, net	562,909	569,960
Deferred tax assets	103,813	103,813
Intangible assets	108,135	118,198
Other assets	37,065	46,512
Total Assets	$23,591,162	$18,908,612

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

EMTEC, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2004 (unaudited)	March 31, 2004
Liabilities and Shareholders' Equity		
Current Liabilities		

Line of credit	$ 2,685,860	$ 2,308,416
Accounts payable	12,851,227	9,295,882
Customer deposits	391,030	332,667
Income tax payable	344,758	279,397
Accrued liabilities	2,353,434	2,529,885
Deferred revenues	1,063,355	853,393
Total Current Liabilities	19,689,664	15,599,640
Deferred revenue	703,960	714,573
Deferred tax liability	25,924	25,924
Total Liabilities	20,419,548	16,340,137
Shareholders' Equity		
Common stock, $.01 par value; 25,000,000 shares authorized; 7,380,498 shares issued and outstanding	73,805	73,805
Additional paid-in capital	2,294,805	2,294,805
Retained earnings	803,004	199,865
Total Shareholders' Equity	3,171,614	2,568,475
Total Liabilities and Shareholders' Equity	$ 23,591,162	$ 18,908,612

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

EMTEC, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended: June 30, 2004	Three Months Ended: June 30, 2003
Revenues:		
Procurement services	$ 24,760,466	$ 23,730,729
Service and consulting	3,803,741	4,702,026
Geothermal	42,628	47,585
Total Revenues	28,606,835	28,480,340
Cost of Revenues:		
Procurement services	21,968,266	21,691,493
Service and consulting	2,653,471	3,067,780
Geothermal	17,785	17,484
Total Cost of Revenues	24,639,522	24,776,757
Gross Profit:		
Procurement services	2,792,200	2,039,236
Service and consulting	1,150,270	1,634,246
Geothermal	24,843	30,101
Total Gross Profit	3,967,313	3,703,583
Operating Expenses:		
Selling, general and administrative	2,980,344	3,205,245
Interest	38,830	99,166
Total Operating Expenses	3,019,174	3,304,411
Income Before Income Tax Expense	948,139	399,172
Income tax expense	345,000	41,281
Net Income	$ 603,139	$ 357,891
Net Income Per Share - Basic and Diluted	$ 0.08	$ 0.05
Weighted Average Number Of Shares Outstanding {Basic}	7,380,498	7,080,498
Weighted Average Number Of Shares Outstanding {Diluted}	7,538,255	7,396,983

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

EMTEC, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three Months Ended: June 30, 2004	Three Months Ended: June 30, 2003
Cash Flows From Operating Activities		
Net income for the three months	$ 603,139	$ 357,891
Adjustments to Reconcile Net Income To Net Cash Used In Operating Activities		
Depreciation and amortization	97,660	192,448
Deferred income tax	-	47,901
Changes In Operating Assets and Liabilities		
Increase in receivables	(3,778,398)	(2,664,794)
Increase in inventories	(198,313)	(72,627)
Decrease (Increase) in prepaid expenses	15,623	(152,349)
Decrease in other assets	9,448	413
Increase in accounts payable	3,555,345	2,130,810
Increase (Decrease) in customer deposits	58,363	(298,127)
Increase in income tax payable	65,361	-
Decrease in accrued liabilities	(176,451)	(41,449)
Increase (Decrease) in deferred revenue	199,349	(49,415)
Net Cash Provided By (Used In) Operating Activities	451,126	(549,298)
Cash Flows From Investing Activities		
Purchases of equipment	(30,813)	(37,426)
Cash Flows From Financing Activities		

Net increase (decrease) in line of credit	377,444	(155,045)
Net Increase(Decrease) in Cash and Cash Equivalents	797,757	(741,769)
Beginning Cash and Cash Equivalents	4,792	1,792,101
Ending Cash and Cash Equivalents	$ 802,549	$ 1,050,332

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

EMTEC, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED JUNE 30, 2004 AND 2003
(unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and note disclosures required by generally accepted accounting principles in the United States. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Quarterly results are not necessarily indicative of results for the full year. For further information, refer to the annual financial statements and notes thereto included in the Company's Form 10-K for the year ended March 31, 2004.

2. Stock-Based Compensation

The Company did not change to the fair value based method of accounting for stock-based employees' compensation. Accordingly, the adoption of SFAS No. 148 did not affect the Company's financial condition or results of operations. However, SFAS No. 148 requires that information be provided as if the Company had accounted for employee stock options under the fair value method of this statement, including disclosing pro forma information regarding net income (loss) and earnings (loss) per share. The Company accounts for stock-based compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," as permitted by SFAS No. 123. Compensation expense for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount the employee must pay to acquire the stock. No compensation cost has been recognized for any option grants in the accompanying consolidated statements of operations since the price of the options was set at the quoted market price of Company stock at dates of grant. The weighted average fair value of all of the employee options was estimated on the date of grant using the Black-Scholes model. The Company did not make any stock option grants during the three months ended June 30, 2004 and 2003. Therefore, had the Company applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation, the Company's net income (loss) and basic and diluted earnings (loss) per share would have been the same as reported amounts as follows:

Pro Forma:	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003
Net Income	$603,139	$357,891
Net Income Per Share - Basic and Diluted	$ .08	$ .05

Option activity is summarized in the following table:

Options outstanding - April 1, 2004	415,228
Activity for the three months ended June 30, 2004:	
Options granted	-
Options exercised	-
Options forfeited or expired	-
Options outstanding - June 30, 2004	415,228

3. Financing Arrangements

On November 21, 2001, the Company entered into a $10.0 million revolving credit facility with Fleet Capital Corporation, formerly Summit Business Capital Corporation ("Fleet") under which the Company may borrow on 85% of its eligible trade receivables. Interest on outstanding loans under the revolving credit facility with Fleet was charged monthly at a fluctuating rate per annum equal to 0.25% above the prime rate and, at the Company's option, interest on up to 50% of the outstanding loans may be charged at LIBOR plus 2.75%. The Fleet revolving credit facility is collateralized by a lien upon and security interest in substantially all of the Company assets. Since current credit facilities with two of the Company's primary trade vendors (GE Access and Ingram Micro.) were also collateralized by substantially all of the Company's assets, Fleet, GE Access and Ingram Micro have entered into intercreditor agreements, which provide that as regards to these vendors, debt obligations to Fleet are accorded priority. On November 21, 2001, the Company also entered into a Wholesale Financing Security Agreement with IBM. This credit facility, which is collateralized by a $750,000 letter of credit from Fleet in favor of IBM, affords the Company up to a like amount of credit to purchase products floored by IBM Global Financing. On January 9, 2002, Fleet issued a $250,000 letter of credit in favor of the Company's landlord for the Company's New York City office, as a security deposit for the building lease. On July 1, 2003, Fleet also issued a $250,000 letter of credit in favor of Selective Insurance Corporation, as collateral for the performance bond issued to The City of Philadelphia, one of the Company's customers. The maximum credit facility is reduced by the outstanding letters of credit.

On October 17, 2003, the Company and Fleet executed an amendment to loan and security agreement under which the Company may borrow on 80% of its eligible trade receivables up to $10 million through November 20, 2004. Interest on outstanding loans was charged monthly at a fluctuating rate per annum equal to 2.00% above the prime rate. The lending agreement contains financial covenants that require the Company to maintain a maximum leverage ratio, a minimum debt ratio, and a minimum EBITDA (earnings before interest, taxes, depreciation and amortization expense).

On April 16, 2004, the Company and Fleet executed another amendment to the loan and security agreement which permits the Company

to obtain up to a $1.0 million in surety bonding capacity from an insurance company. This amendment reduced the interest rate from 2.00% above the prime rate to 1.00% above the prime rate.

As of June 30, 2004, the Company was in compliance with all its financial covenants and had a $2,685,860 outstanding balance under the credit facility and an unused availability of $6,064,140.

4. Trade Receivables

The Company provides an allowance for losses on trade receivables based on a review of the current status of existing receivables and management's evaluation of periodic aging of the accounts. Trade accounts receivable consists of the following:

	June 30, 2004
Trade Receivable	$ 19,148,833
Allowance for doubtful accounts	(359,396)
Trade Receivable, net	$ 18,789,437

5. Inventory

Inventories are stated at lower of cost (first-in, first-out) or market. Cost is based on standard costs generated principally by the most recent purchase price. The Company provides an inventory reserve for obsolescence and deterioration based on management's review of product sales. Inventory is recorded on the balance sheet net of allowances for inventory valuation of $712,625 and $722,551 at June 30, 2004 and March 31, 2004, respectively.

6. Major Customers

Three major customers accounted for approximated 65%, and 67% of the Company's net sales in the quarter ended June 30, 2004 and 2003, respectively.

While the Company believes its relationship with these customers will continue, there can be no assurance that sales to these customers will continue at all or at the same level.

7. Segment Information

The Company has adopted Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information,". The Company's business activities are

considered to be in two business segments, our Information Technology Division and our Geothermal Division.

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

For the three months ended June 30:	2004	2003

Revenues		
Information Technology	$28,564,207	$28,432,755
Geothermal	42,628	47,585
Total Revenues	$28,606,835	$28,480,340
Operating Profit/(Loss)		
Information Technology	$ 935,185	$ 382,149
Geothermal	12,954	17,023
Net Segment Operating Income/(Loss)	$ 948,139	$ 399,172
Income Tax Expense	345,000	41,281
Net Income	$ 603,139	$ 357,891

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

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by, the unaudited financial statements, including the notes thereto, appearing elsewhere in this quarterly report on Form, 10-Q.

Critical Accounting Policies

Emtec's financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The methods, estimates, and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The Securities and Exchange Commission has defined critical accounting policies as policies that involve critical accounting estimates that require (i) management to make assumptions that are highly uncertain at the time the estimate is made, and (ii) different estimates that could have been reasonably used for the current period, or changes in the estimates that are reasonably likely to occur from period to period, which would have a material impact on the presentation of our financial condition, changes in financial condition or in result of operations. Based on this definition, our most critical policies include: revenue recognition, allowance for doubtful accounts, inventory valuation reserve, the assessment of recoverability of long-lived assets, the assessment of recoverability of goodwill and intangible assets, and valuation of deferred tax assets.

o Revenue Recognition

We recognize revenues based upon Staff Accounting Bulletin #101 (SAB 101). SAB 101 states that revenue recognition cannot occur until the earnings process is complete, evidenced by an agreement between us and the customer, there has been delivery and acceptance, collectibility is probable, and pricing is fixed and determinable. If significant obligations remain after delivery, revenue is deferred until such obligations are fulfilled. Procurement services represent sales of computer hardware and prepackaged software. Revenue from consulting and support service contracts are recognized ratably over the contract or service period. Revenues from manufacturer support service contracts where the manufacturer is responsible for fulfilling the service requirements of the customer are recognized immediately on their contract sale date. These contracts contain cancellation privileges that allow our customer to terminate a contract with 90 days written notice. In this event, the customer is entitled to a pro-rated refund based on the remaining term of the contract and we would owe the manufacturer a pro-rated refund of the cost of the contract. However, we have experienced no customer cancellations of any significance during our most recent 3-year history and do not expect cancellations of any significance in the future. We believe that net revenue reporting for manufacturer support service contracts is more appropriate.

o Trade Receivables

We maintain allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We base our estimates on the aging of our accounts receivable balances and our historical write-off experience, net of recoveries. If the

financial condition of our customers were to deteriorate, additional allowances may be required. We believe the accounting estimate related to the allowance for doubtful accounts is a "critical accounting estimate" because changes in it can significantly affect net income. Allowance for doubtful accounts was $359,396 and $363, 402 as of June 30, 2004 and March 31, 2004, respectively.

o Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Cost is based on standard costs generated principally by the most recent purchase prices. We provide an inventory reserve for obsolescence and deterioration based on management's review of the current status of the excess inventory, its age, and net realizable value based upon assumptions about future demand and market condition. At June 30, 2004, and March 31, 2004, inventory reserve was $712,625, and $722,551, respectively.

o Property and Equipment

We estimate the useful lives of property and equipment in order to determine the amount of depreciation and amortization expense to be recorded during any reporting period. The majority of our equipment is depreciated over three years. The estimated useful lives are based on the historical experience with similar assets as well as taking into account anticipated technological or other changes. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, the useful lives assigned to these assets may need to be accelerated, resulting in the recognition of increased depreciation and amortization expense in future periods. We evaluate the recoverability of our long-lived assets (other than intangibles and deferred tax assets) in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets,"(SFAS No. 144). Long-lived assets are reviewed for impairment under SFAS No. 144 whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. SFAS No. 144 requires recognition of impairment of long-lived assets in the event that the net book value of such assets exceeds the future undiscounted net cash flows attributable to such assets. Impairment, if any, is recognized in the period of identification to the extent the carrying amount of an asset exceeds the fair value of such asset. Property and equipment along with their components are as follows:

	Original Cost		Estimated Life
	June 2004	March 2004	(Years)
Computer equipment	$ 3,668,165	$ 3,643,052	3
Furniture and fixtures	360,205	357,845	5
Leasehold improvements	244,847	244,847	5
Vehicles	80,984	80,984	2
Total Property and Equipment	$ 4,354,201	$ 4,326,728	
Less: accumulated depreciation and amortization	(4,016,862)	(3,939,655)	
Net book value	$ 337,339	$ 387,073	

o Goodwill and Intangible Assets

We have adopted Statement of Financial Accounting Standards No. 141 "Business Combinations" and No. 142 "Goodwill and Other Intangible Assets". As a result, amortization of goodwill was discontinued. Based on the impairment tests performed during the fiscal year ended March 31, 2004 , we found no impairment of the remaining goodwill. The next annual impairment test shall be performed during the fourth quarter of the fiscal year 2005.

We were assigned a contract to supply computer hardware and services to the State of New Jersey in the August 12, 2002 acquisition of Acentra Technologies, Inc. This contract was valued at $100,000 in the acquisition. Amortization expense of $9,091, and $54,545 was expensed in the three months ended June 30, 2004 and the fiscal year ended March 31, 2004, respectively, based upon then contract term scheduled to end in May 2004. The contract, which is subject to annual renewal by mutual agreement, was instead extended by the State of New Jersey through December 2004. The net carrying value for this contract amounted to $0 and $9,091 at June 30, 2004 and March 31, 2004, respectively.

o Income Taxes

Income taxes are accounted for under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in Emtec's financial statements or tax returns. In estimating future tax consequences, Emtec generally considers all expected future events other than the enactment of changes in tax laws or rates. A valuation allowance is recognized if, on weight of available evidence, it is more likely than not that some portion or all the deferred tax assets will not be realized. Income tax expense, as a percentage of income before taxes, increased for the three months ended June 30, 2004, as compared to the three months ended June 30, 2003. This increase is a result of the utilization of approximately $850,000 of federal tax loss carryforwards during the year ended March 31, 2004. The Company had previously recorded significant valuation allowances for deferred tax assets, which effectively reduced the income tax expense percentage during the year ended March 31, 2004.

Results of Operations

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of our Results of Operations for the three months ended June 30, 2004, and 2003.

	Three Months Ended June 30, 2004	2003	Change	%
Revenues				
Procurement services	$24,760,466	$23,730,729	$1,029,737	4.34%
Service and consulting	3,803,741	4,702,026	$ (898,285)	-19.10%

Geothermal	42,628	47,585	$ (4,957)	-10.42%
Total Revenues	28,606,835	28,480,340	$ 126,495	0.44%
Cost of Revenues				
Procurement services	21,968,266	21,691,493	$ 276,773	1.28%
Service and consulting	2,653,471	3,067,780	$ (414,309)	-13.51%
Geothermal	17,785	17,484	$ 301	1.72%
Total Cost of Revenues	24,639,522	24,776,757	$ (137,235)	-0.55%
Percent of revenues	86.13%	87.00%		
Gross Profit				
Procurement services	2,792,200	2,039,236	$ 752,964	36.92%
Service and consulting	1,150,270	1,634,246	$ (483,976)	-29.61%
Geothermal	24,843	30,101	$ (5,258)	-17.47%
Total Gross Profit	3,967,313	3,703,583	$ 263,730	7.12%
Percent of revenue	13.87%	13.00%		
Operating Expenses				
Sales, General & Administrative Expenses	2,980,344	3,205,245	$ (224,901)	-7.02%
Interest Expense	38,830	99,166	$ (60,336)	-60.84%
Total Operating Expenses	3,019,174	3,304,411	$ (285,237)	-8.63%
Percent of revenue	10.55%	11.60%		
Income (Loss) Before Income Tax	948,139	399,172	$ 548,967	137.53%
Income Tax Expense (Benefit)	345,000	41,281	$ 303,719	735.74%
Net Income (Loss)	$ 603,139	$ 357,891	$ 245,248	68.53%
Income (Loss) Per Share {Basic And Diluted}	$ 0.08	$ 0.05		

Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2003.

Total Revenues

Total revenues for our IT business, which includes services and consulting revenue, and procurement revenues, increased by 0.5% or $131,452, to $28.56 million for the quarter ended June 30, 2004, compared to $28.43 million for the quarter ended June 30, 2003. This increase is primarily attributable to computer roll-out projects for the school districts in Georgia and Florida. Total IT revenue associated with these computer roll-out projects for the school districts in Georgia and Florida increased by $5.39 million, to $15.40 million for the quarter ended June 30, 2004, as compared with $10.01 million for the quarter ended June 30, 2003. Without these computer roll-out projects, total IT revenue would have decreased by 18.5%, or $5.26 million, to $23.22 million for the quarter ended June 30, 2004. This decrease is mainly due to an over-all decrease in our customer's IT spending particularly in various state agencies with the State of New Jersey, and our inability to attract new major customers.

Procurement revenues increased by 4.3%, or $1.03 million, to $24.76 million for the quarter ended June 30, 2004. This increase is also attributable to computer roll-out projects for the various school districts in Georgia and Florida.

Services and consulting revenue decreased by 19.1%, or $898,285, to $3.80 million for the quarter ended June 30, 2004 compared to $4.70 million for the quarter ended June 30, 2003. This decrease is mainly due to an over-all decrease in our customer's IT spending particularly with various state agencies in the State of New Jersey, and our inability to attract new major customers.

Three major customers accounted for in the aggregate approximately 65% and 67% of our revenues for the quarter ended June 30, 2004 and 2003, respectively. We anticipate that these customer concentrations will continue for the foreseeable future. The loss of any of these customers may cause results of operations to vary materially from those anticipated.

Geothermal revenues decreased by 10.4%, or $4,957, to $42,628 for the quarter ended June 30, 2004. This decrease is mainly due to lower production of steam.

Gross Profit

Aggregate gross profit for our IT business increased by 7.3%, or $268,988, to $3.94 million for the quarter ended June 30, 2004. This increase is mainly attributable to computer roll-out projects for the school districts in Georgia and Florida. Measured as a percentage of total revenues for our IT business, our overall gross profit margin increased to 13.8% of total revenues for the quarter ended June 30, 2004 from 12.9% for the quarter ended June 30, 2003.

Gross profit for product sales increased by 36.9%, or $752,964, to $2.79 million for the quarter ended June 30, 2004 as compared with $2.04 million for the quarter ended June 30, 2003. This increase is mainly attributable to $5.39 million increase in computer roll-out projects for the school districts in Georgia and Florida. Measured as a percentage of procurement revenues, our gross profit margin increased to 11.3% of procurement revenue for the quarter ended June 30, 2004 from 8.6% for the quarter ended June 30, 2003. This percentage increase is primarily attributable to greater selling efforts and favorable price drops by manufacturers. We can not predict that price drops like these are going to repeat in the future.

Gross profit for service and consulting decreased by 29.6%, or $483,976, to $1.15 million for the quarter ended June 30, 2004 as compared with $1.63 million for the quarter ended June 30, 2003. This decrease is due to an over-all decrease in our customer's IT spending particularly with various state agencies in the State of New Jersey, and our inability to attract new major customers. Measured as a percentage of service and consulting revenue, our gross margin attributable to service and consulting revenue decreased to 30.2% of service and consulting revenue for the quarter ended June 30, 2004 from 34.8% for the quarter ended June 30, 2003. This decrease in services and consulting gross margin was mainly due to lower billing rates (total revenue generated divided by total billable hours available during the period) and utilization rates (billable hours divided by paid hours) of engineers during this quarter.

We must continue to manage billing rates and utilization rates effectively to remain competitive. During July 2004, we outsourced our NOC (Network Operation Center) and Help Desk operations to a third party. By outsourcing this part of our business, we are able to continue to offer these strategic services while allowing us to change the high fixed cost structure of the business to a variable cost structure. We expect that this transition will have a positive impact on our gross profit for service and consulting starting July 2004. Our NOC and Help Desk revenues were approximately $29,000, and $108,000 for the quarter ended June 30, 2004, and 2003, respectively.

The geothermal gross profit of $24,843 for the quarter ended June 30, 2004 decreased by 17.5%, or $5,258, as compared with $30,101 for the quarter ended June 30, 2003. This decrease is mainly due to lower production of steam during this quarter.

Sales, General, and Administrative Expenses

Sales, general and administrative expenses decreased by 7.0%, or $224,901, to $2.98 million for the quarter ended June 30, 2004. This decrease is primarily attributable to continuous cost containment measures taken by us including the following:

- Elimination of non-productive sales staff;
- Eliminated duplication of non-essential administrative support services.

Also, during the quarter ended June 30, 2004, we consolidated all of our operations, administrative and inventory warehousing functions from Mt. Laurel, NJ and Cranford, NJ to Trenton, NJ. We anticipate this consolidation will result in an approximate cost savings of $380,000 annually.

In spite of vigorous cost containment efforts, various factors, such as retention of employees, costs associated with marketing and selling activities, costs associated with new Securities and Exchange Commission rules, and insurance markets may increase our sales, general and administrative expenses and this could have a negative impact on fiscal year 2005.

Interest expense

Interest expense decreased by 60.8%, or $60,336, to $38,830 the quarter ended June 30, 2004 as compared with $99,166 for the quarter ended June 30, 2003. This decrease is primarily attributable to a lower balance on our line of credit, and lower days sales outstanding during the period.

Income Taxes

Income tax expense, as a percentage of income before income taxes, increased for the quarter ended June 30, 2004 to $345,000, as compared to $41,281 for the quarter ended June 30, 2003. This increase is a result of the utilization of approximately $850,000 of federal tax loss carryforwards during the year ended March 31, 2004. We had previously recorded significant valuation allowances for deferred tax assets, which effectively reduced the income tax expense percentage during the year ended March 31, 2004.

Net Income

For the three months ended June 30, 2004, net income was $603,139 compared to net income of $357,891 for the comparable period in 2003, an increase of 68.5%.

As discussed, the increase in net income is mainly attributable to computer roll-out projects for the school districts in Georgia and Florida as well as continuous cost containment efforts undertaken by the Company.

Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the "SEC"). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called "forward-looking statements" by words such as "may," "will," "should," expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue" or the negative of those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks discussed in this Annual Report for the year ended March 31, 2004 and other reports or documents that we file from time to time with the SEC. Those factors may cause our actual results to differ materially from any of our forward-looking statements. All forward-looking statements attributable to us or a person acting on our behalf are expressly qualified in their entirety by this cautionary statement.

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

Factors That May Affect Future Results

Our future operating results may be affected by a number of factors, including uncertainties relative to national economic conditions, especially as such factors affect interest rates, business insurance industry factors, our ability to successfully increase business, and effectively manage expense margins.

Since our inception, we have funded our operations primarily from borrowings under our credit facility. We are in compliance with the covenants contained in our loan and security agreement at June 30, 2004. Although we expect to remain in compliance with the financial covenants, no assurance can be given.

Our credit facilities as of the current date with our primary trade vendors, GE Access, Ingram Micro, and Tech Data are $5.0 million, $9.0 million and $3.0 million, respectively. Under these credit lines, we are obligated to pay each invoice within 30 days from the date of such invoice. These credit lines could be reduced or eliminated without a notice, and this action could have a material adverse affect our business, result of operations, and financial condition.

We must continue to effectively manage expenses in relation to revenues by directing new business development towards markets that complement or improve our existing service lines. Management must also continue to emphasize operating efficiencies through cost containment strategies, reengineering efforts, and improved service delivery techniques. The most significant cost relating to the services component of our business is personnel expense, which consists of salaries, benefits, and payroll related expenses. Thus, the financial performance of our service business is based primarily upon billing margins (billable hourly rates less the costs to us of service personnel on an hourly basis) and utilization rates (billable hours divided by paid hours). The future success of the services component of our business will depend in large part upon our ability to maintain high utilization rates at profitable billing margins. The competition for quality technical personnel has continued to intensify, resulting in increased personnel costs. This intense competition has caused our billing margins to be lower than they might otherwise have been. Our utilization rates for service personnel likely will also be adversely affected during periods of rapid and concentrated hiring.

Emtec is a systems integrator focused on providing technology solutions that enable its customers to effectively use and manage their data to grow their businesses. Our areas of specialization in information technology ("IT") services include enterprise computing, data communications, data access, network design, enterprise backup and storage consolidation, managed services and staff augmentation. While we have offered IT services to our customers since 1983, our major emphasis on IT consulting and services began in 1995. We have limited experience in developing, marketing, or providing these services. We cannot assure that we will be able to successfully market such services to either new or existing customers, that our services will achieve market acceptance, or that we will be able to effectively hire, integrate, and manage additional technical personnel to enable us to perform these services to our customers' expectations This industry has been characterized by rapid technological advances that have resulted in frequent introductions of new products, product enhancements and aggressive pricing practices, which also impacts pricing of service activities. Our operating results could be adversely affected by industry-wide pricing pressures, the ability to recruit, train and retain personnel integral to our operations and the presence of competitors with greater financial and other resources. Also, our operating results could also be adversely impacted should our company be unable to effectively achieve the revenue growth necessary to provide profitable operating margins in various operations. Our plan for growth includes marketing efforts, acquisitions that expand market share. There can be no assurances these efforts will be successful, or if successful the timing thereof.

Liquidity and Capital Resources

Cash and cash equivalents at June 30, 2004 of $802,549 represented an increase of $797,757 from $4,792 at March 31, 2004. We are a net borrower; consequently, we believe our cash and cash equivalents balance must be viewed along with the available balance on our line of credit. At June 30, 2004, our working capital was increased to $2.75 million from $2.08 as of March 31, 2004. This increase in working capital was primarily attributable to net earnings for the quarter ended June 30, 2004.

Since our inception, we have funded our operations primarily from borrowings under our credit facility. On November 21, 2001, we entered into a $10.0 million revolving credit facility with Fleet Capital Corporation, formerly Summit Business Capital Corporation ("Fleet"), under which we may borrow on 85% of our eligible trade receivables. Interest on outstanding loans under the revolving credit facility with Fleet was charged monthly at a fluctuating rate per annum equal to 0.25% above the prime rate and, at our option, interest on up to 50% of the outstanding loans may be charged at LIBOR plus 2.75%. The Fleet revolving credit facility is collateralized by a lien upon and security interest in substantially all of our assets. Since current credit facilities with two of our primary trade vendors (GE Access and Ingram Micro.) were also collateralized by substantially all of our assets, Fleet, GE Access and Ingram Micro have entered into intercreditor agreements, which provide that as regards to these vendors, debt obligations to Fleet are accorded priority. On November 21, 2001, we also entered into a Wholesale Financing Security Agreement with IBM. This credit facility, which is collateralized by a $750,000 letter of credit from Fleet in favor of IBM, affords us up to a like amount of credit to purchase products floored by IBM Global Financing. On January 9, 2002, Fleet issued a $250,000 letter of credit in favor of our landlord for our New York City office, as a security deposit for the building lease. On July 1, 2003, Fleet also issued a $250,000 letter of credit in favor of Selective Insurance Corporation, as collateral for the performance bond issued to The City of Philadelphia, one of our customers. The maximum credit facility is reduced by the outstanding letters of credit.

On October 17, 2003, Emtec and Fleet executed an amendment to the loan and security agreement under which we may borrow on 80% of our eligible trade receivables up to $10 million through November 20, 2004. Interest on outstanding loans was charged monthly at a fluctuating rate per annum equal to 2.00% above the prime rate. Prior to October 17, 2003, we were charged monthly at a fluctuating rate per annum equal to 0.25% above the prime rate.

On April 16, 2004, Emtec and Fleet executed another amendment to the loan and security agreement which permits us to obtain up to a $1.0 million in surety bonding capacity from an

insurance company. This amendment reduced our interest rate from 2.00% above the prime rate to 1.00% above the prime rate.

As of June 30, 2004, we were in compliance with all of our financial covenants and we had a $2,685,860 outstanding balance under the credit facility and unused availability of $6,064,140.

At June 30, 2004, our credit facilities with our primary trade vendors, GE Access, Ingram Micro, and Tech Data were as follows:

- Our credit line with GE Access was $4.0 million, with an outstanding principal balance of $3.5 million.

- Our credit line with Ingram Micro was $9.0 million, with an outstanding principal balance of $4.6 million.

- Our credit line with Tech Data was $3.0 million, with an outstanding balance of $2.7 million.

Under these credit lines, we are obligated to pay each invoice within 30 days from the date of such invoice.

Capital expenditures of $30,811 during three months ended June 30, 2004 were primarily for the purchase of computer equipment for internal use, and furniture and fixtures. We anticipate our capital expenditures for fiscal year ending March 31, 2005 will be approximately $400,000.

Emtec has no arrangements or other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources.

We believe that funds generated from operations and bank borrowings should be sufficient to meet our current operating cash requirements through the next twelve months, although there can be no assurance that all of the aforementioned sources of cash can be realized.

Item 3. Quantitative and Qualitative Information About Market Risk

We do not engage in trading market risk sensitive instruments and do not purchase hedging instruments or "other than trading" instruments that are likely to expose us to market risk, whether interest rate, foreign currency exchange, commodity price or equity price risk. We have issued no debt instruments, entered into no forward or future contracts, purchased no options and entered into no swaps. Our primary market risk exposures are those of interest rate fluctuations. A change in interest rates would affect the rate at which we could borrow funds under our revolving credit facility. Our balance on the line of credit at June 30, 2004 was approximately $2.6 million. Assuming no material increase or decrease in such balance, a one percent change in the interest rate would change our interest expense by approximately $26,000 annually.

Item 4. Controls and Procedures

Our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of June 30, 2004. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There has not been any change in our internal control over financial reporting in connection with the evaluation required by Rule 13a-15(d) under the Exchange Act that occurred during the quarter ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 31.1 - Rule 13a-14(a)/15 d-14(a) Certification of John P. Howlett, Principal Executive Officer, of Emtec, Inc. dated August 13, 2004.

Exhibit 31.2 - Rule 13a-14(a)/15 d-14(a) Certification of Sam Bhatt, Principal Financial Officer, of Emtec, Inc. dated August 13, 2004.

Exhibit 32.1 - Section 1350 Certificate of John P. Howlett, Principal Executive Officer, of Emtec, Inc. dated August 13, 2004.

Exhibit 32.2 - Section 1350 Certificate of Sam Bhatt, Principal Financial Officer, of Emtec, Inc. dated August 13, 2004

(b) Reports on Form 8-K filed during the quarter ended June 30, 2004:

Form 8-K filed on April 1, 2004, reported under Item 5 of the Form 8-K, Other Events and Required FD Disclosure, the relocation of our corporate operations and administrative functions.

Form 8-K filed on June 28, 2004, reported under Item 12 of the Form 8-K, Result of Operations and Financial Condition, the issuance of a press release announcing our financial results for the year ended March 31, 2004.

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

EMTEC, INC.

By: /s/ JOHN P. HOWLETT

John P. Howlett
Chairman, and Chief
Executive Officer
(Principal Executive Officer)

By: /s/ SAM BHATT

Sam Bhatt
Vice President - Finance
(Principal Financial and
Accounting Officer)

Date: August 13, 2004

STATEMENT OF DIFFERENCES

The section symbol shall be expressed as............................. 'SS'