

EMTEC INC/NJ
Form 10-Q
January 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended November 30, 2012

or

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

Commission file number: 0-32789

EMTEC, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation or organization)

87-0273300
(I.R.S. Employer Identification No.)

11 Diamond Road
Springfield, New Jersey 07081
(Address of principal executive offices, including zip code)

(973) 376-4242
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 the definitions of "large accelerated filer," "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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes
o No x

As of January 12, 2013, there were outstanding 18,164,437 shares of the registrant's common stock.

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

EMTEC, INC.
FORM 10-Q FOR THE QUARTER ENDED NOVEMBER 30, 2012

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except per Share and Share Data)

| | November 30, 2012 (Unaudited) | August 31, 2012 |
|--|-------------------------------------|--------------------|
| Assets | | |
| Current Assets | | |
| Cash | \$1,063 | \$1,769 |
| Receivables: | | |
| Trade, net of allowance for doubtful accounts | 30,562 | 24,381 |
| Other | 522 | 1,356 |
| Inventories, net | 2,488 | 2,346 |
| Prepaid expenses and other | 3,397 | 3,004 |
| Deferred tax asset - current | 1,298 | 1,032 |
| Total current assets | 39,330 | 33,888 |
| Property and equipment, net | 3,349 | 3,538 |
| Intangible assets, net | 9,825 | 10,457 |
| Goodwill | 13,307 | 13,307 |
| Deferred tax asset-long term | 836 | 743 |
| Other assets | 1,750 | 1,771 |
| Total assets | \$68,397 | \$63,704 |
| Liabilities, Put Options and Stockholders' Equity | | |
| Current Liabilities | | |
| Line of credit | \$14,048 | \$12,004 |
| Current portion of capital lease obligations | 196 | 85 |
| Accounts payable | 18,383 | 16,314 |
| Income taxes payable | 766 | 144 |
| Accrued liabilities | 9,230 | 9,061 |
| Current portion earn-out liabilities | 3,150 | 2,251 |
| Put option liability in connection with acquisition | 700 | 700 |
| Deferred revenue | 1,612 | 1,610 |
| Total current liabilities | 48,085 | 42,169 |

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| | | |
|---|-----------------|-----------------|
| Deferred tax liability | 141 | 589 |
| Earn-out liabilities, net of current portion | 2,573 | 2,570 |
| Warrant liabilities | 2,426 | 2,414 |
| Put option and restricted stock liability in connection with acquisition of Dinero | 246 | 229 |
| Capital lease obligations, net of current portion | 29 | 189 |
| Subordinated debt, net of original issue discount | 12,583 | 12,555 |
| Accrued liabilities | 163 | 163 |
| Total liabilities | 66,246 | 60,878 |
| Commitments and contingencies (Note 13) | | |
| Put options in connection with acquisitions | 1,428 | 1,428 |
| Stockholders' Equity | | |
| Common stock \$0.01 par value; 30,000,000 shares authorized; 17,616,437 shares issued and outstanding at November 30, 2012 and August 31, 2012. | 177 | 177 |
| Additional paid-in capital | 16,993 | 16,915 |
| Accumulated deficit | (16,261) | (15,516) |
| Accumulated other comprehensive loss, foreign currency translation adjustments, net of tax | (186) | (179) |
| Total stockholders' equity | 723 | 1,397 |
| Total liabilities, put options and stockholders' equity | \$68,397 | \$63,704 |

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except per Share and Share Data)

| | For the Three Months Ended November 30, | |
|--|--|---------------|
| | 2012 | 2011 |
| Revenues | | |
| Consulting and outsourcing | \$24,579 | \$25,614 |
| Procurement services | 33,626 | 46,416 |
| Total Revenues | 58,205 | 72,030 |
| Cost of Revenues | | |
| Cost of consulting and outsourcing | 18,082 | 19,479 |
| Cost of procurement services | 29,628 | 40,655 |
| Total Cost of Revenues | 47,710 | 60,134 |
| Gross Profit | | |
| Consulting and outsourcing | 6,497 | 6,135 |
| Procurement services | 3,998 | 5,761 |
| Total Gross Profit | 10,495 | 11,896 |
| Operating expenses: | | |
| Selling, general, and administrative expenses | 7,871 | 9,405 |
| Restructuring charge | 582 | - |
| Stock-based compensation | 95 | 160 |
| Warrant liability adjustment | 12 | (608) |
| Earnout liability adjustment | 902 | 168 |
| Depreciation and amortization | 1,027 | 1,360 |
| Total operating expenses | 10,489 | 10,485 |
| Operating income | 6 | 1,411 |
| Other expense (income): | | |
| Interest income – other | (5) | (62) |
| Interest expense | 752 | 835 |
| Other | 11 | (2) |
| Income (loss) before income tax expense (benefit) | (752) | 640 |
| Income tax expense (benefit) | (6) | 185 |
| Net income (loss) | \$(746) | \$455 |

| | | |
|-------------------------------------|------------|------------|
| Net income (loss) per common share | | |
| Basic | \$(0.04 |) \$0.03 |
| Diluted | \$(0.04 |) \$0.02 |
| Weighted Average Shares Outstanding | | |
| Basic | 16,856,650 | 16,331,823 |
| Diluted | 16,856,650 | 19,107,221 |

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In Thousands)

| | For the Three Months Ended | |
|---|----------------------------|---------|
| | November 30, | |
| | 2012 | 2011 |
| Net income (loss) | \$(746 |) \$455 |
| Foreign currency translation adjustment, net of taxes | (7 |) (268 |
| Total comprehensive income (loss) | \$(753 |) \$187 |

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

| | For the Three Months Ended November 30, | |
|--|--|-----------|
| | 2012 | 2011 |
| Cash Flows From Operating Activities | | |
| Net income (loss) | \$(746 |) \$455 |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Used In Operating Activities | | |
| Depreciation and amortization | 1,027 | 1,360 |
| Amortization of original issue discount associated with subordinated debt | 28 | 25 |
| Deferred income tax benefit | (808 |) (514 |
| Stock-based compensation | 95 | 160 |
| Earnout liability adjustment | 902 | 168 |
| Warrant liability adjustment | 12 | (608 |
| Changes In Operating Assets and Liabilities | | |
| Receivables | (5,347 |) (16,986 |
| Inventories | (142 |) (520 |
| Prepaid expenses and other assets | (372 |) (59 |
| Accounts payable | 2,069 | 14,992 |
| Income taxes payable | 622 | (108 |
| Accrued liabilities | 168 | (2,383 |
| Deferred revenue | 2 | (451 |
| Net Cash Used In Operating Activities | (2,490 |) (4,469 |
| Cash Flows From Investing Activities | | |
| Purchases of property and equipment | (203 |) (336 |
| Net Cash Used In Investing Activities | (203 |) (336 |
| Cash Flows From Financing Activities | | |
| Net increase in line of credit | 2,043 | 3,683 |
| Repayments under capital lease | (49 |) (55 |
| Net Cash Provided by Financing Activities | 1,994 | 3,628 |
| Effect of exchange rates on cash | (7 |) (132 |
| Net Decrease in Cash | (706 |) (1,309 |
| Beginning Cash | 1,769 | 4,039 |
| Ending Cash | \$1,063 | \$2,730 |
| Supplemental Disclosure of Cash Flow Information | | |
| Cash paid during the period for: | | |
| Income taxes | \$16 | \$41 |
| Interest | \$593 | \$775 |

The Accompanying Notes are Integral Parts of these Consolidated Financial Statements.

EMTEC, INC AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included in the accompanying unaudited consolidated financial statements. 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 Annual Report on Form 10-K for the fiscal year ended August 31, 2012.

2. General

Description of Business

Emtec, Inc., a Delaware corporation ("Emtec"), is an information technology ("IT") services provider delivering consulting, application services and infrastructure services to public sector and commercial clients. The Company's client base is comprised of departments of the U.S. and Canada's federal, state/provincial and local governments, schools and commercial businesses throughout the U.S. and Canada.

Principles of Consolidation

The consolidated financial statements include the accounts of Emtec and its wholly-owned subsidiaries after elimination of intercompany balances and transactions.

Segment Reporting

Effective June 2012, the Company realigned its reportable segments as follows:

- Federal - provides IT consulting and procurement services to various agencies of the U.S. federal government.

·Commercial, State & Local and Education ("CSLED")

In addition, the Company also has a "Corporate" segment which reports costs consisting of our executive departments, employee benefit administration, accounting support, IT services, recruiting, and any other shared services, operating, and administrative expenses that are not directly attributable to the reporting segments. For purposes of performance measurement, the Company charges certain expenses directly attributable to the reporting segment and allocates costs reflected in the Corporate segment. Identifiable assets of the reporting unit exclude Corporate segment assets liabilities. Corporate segment assets consist principally of cash, prepaid expenses, non-trade accounts receivables, property and equipment, other assets, deferred taxes, other liabilities and general corporate borrowings.

Reclassifications

Certain reclassifications have been made to prior year balances in order to conform to current presentations.

FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles

The Company identifies the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC" or "ASC") as the authoritative source of GAAP. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under federal securities laws are also sources of authoritative GAAP for SEC registrants.

Accounting Estimates

The preparation of financial statements in conformity with GAAP 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 financial statements and the reported amounts of revenues and expenses during the reporting period, including, but not limited to, receivable valuations, impairment of goodwill and other long-lived assets, income taxes and valuations of warrants, put instruments and earnouts. Management's estimates are based on historical experience, facts and circumstances available at the time and various other assumptions that are believed to be reasonable under the circumstances. The Company reviews these matters and reflects changes in estimates as appropriate. Actual results could differ materially from those estimates.

Fair Value of Financial Instruments

The fair value of cash and cash equivalents and trade receivables approximates their carrying values due to their short maturities. The fair value of non-current financial instrument assets and liabilities approximate their carrying value unless otherwise stated.

In accordance with FASB ASC 820 Fair Value Measurement, the estimated fair values of amounts reported in the consolidated financial statements have been determined using available market information and valuation methodologies, as applicable. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Entities are required to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value based upon the following fair value hierarchy:

Level 1 — Quoted prices in active markets for identical assets or liabilities;

Level 2 — Observable inputs other than Level 1 prices, 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; and

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 carrying value of the PNC Credit Facility (Note 7) approximated its fair value due to its variable interest rate. In addition, the carrying value of the subordinated debt approximates its fair value as there have been no changes to the credit markets or the Company's financial position since the issuance dates that would impact the fair value of the subordinated debt in any material respect. The PNC Credit Facility and subordinated debt are Level 3 measurements in the fair value hierarchy.

As of November 30, 2012 and August 31, 2012, the book and fair values of the Company's line of credit and subordinated debt (excluding original issue discount) were as follows (in thousands):

| | November 31, 2012 | | November 31, 2012 | |
|-------------------|-------------------|------------|-------------------|------------|
| | Book Value | Fair Value | Book Value | Fair Value |
| Line of Credit | \$14,048 | \$14,048 | \$12,004 | \$12,004 |
| Subordinated Debt | \$13,000 | \$13,000 | \$13,000 | \$13,000 |

Fair Value on a Recurring Basis: The following table summarizes the financial liabilities measured at fair value on a recurring basis as of November 30, 2012 and August 31, 2012 (in thousands):

| | Level | November 30, 2012 | August 31, 2012 |
|--|-------|----------------------|--------------------|
| Warrant liabilities | 2 | \$2,426 | \$2,414 |
| Put option in connection with acquisition of SDI | 2 | \$700 | \$700 |
| Line of credit | 3 | \$14,048 | \$12,004 |
| Subordinated debt excluding original discount | 3 | \$13,000 | \$13,000 |
| Earn-out liabilities | 3 | \$5,723 | \$4,821 |

The warrant liabilities were recorded at fair value based on upon valuation models that utilize relevant factors such as expected life, volatility of the Company's stock price, and the risk free interest rate.

On June 4, 2010, Emtec Federal, Inc. a wholly-owned subsidiary of the Company acquired all of the outstanding shares of Secure Data, Inc. ("SDI") for cash and equity. The equity consisted of the fair value of the "puttable" restricted common stock of the Company as of June 4, 2010. The "put" feature embedded in the restricted common stock allows each former shareholder of SDI a one-time election to put all of their restricted common stock to the Company at a fixed price on the third anniversary of the acquisition date. Management calculated the fair value of the put using a Black-Scholes valuation model. In accordance with SEC Accounting Series Release No. 268 Presentation in Financial Statements of Redeemable Preferred Stocks, the puttable stock is subject to equity accounting and was initially classified on the Company's balance sheet as temporary equity.

The Company believes that is more likely than not that the former shareholders of SDI will exercise the one-time election to put all their restricted common stock to the Company at a fixed price on the third anniversary of the acquisition date, June 4, 2013. Accordingly, the Company has calculated the fair value of the amount due the former shareholders of SDI associated with the put option and reflected this amount as a current liability as of November 30, 2012 and August 31, 2012.

The following table summarizes the changes in earn out liabilities for the three months ended November 30, 2012 (in thousands):

| | Earnout Liabilities |
|------------------------------|------------------------|
| Balance at August 31, 2012 | \$4,821 |
| Valuation adjustments | 902 |
| Additions | - |
| Payments | - |
| Balance at November 30, 2012 | \$5,723 |

The earn out liabilities were recorded at fair value based on valuation models that utilize relevant factors such as expected life and estimated probabilities of the acquired companies achieving the performance targets throughout the earn out periods. Unobservable inputs used in the valuation of the earn out liabilities included discount rates, ranging from 19% to 21%, and probabilities, ranging from 10% to 100%, associated with the achievement of the earn out targets in future years.

A significant increase (decrease) in the discount rate, in isolation, would result in a significantly lower (higher) fair value measurement, and a significant increase (decrease) in any of the probabilities, in isolation, would result in a significantly higher (lower) fair value measurement.

Financing Costs

Financing costs incurred are amortized over the life of the associated financing arrangements. Amortization expense totaled approximately \$112,000 and \$73,000 for the three months ended November 30, 2012 and 2011, respectively.

Goodwill

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired companies. The changes in the carrying amount of goodwill by reportable segment for the three months ended November 30, 2012 are as follows (in thousands):

| | August 31, 2012 | | Impairment, Translation, and Other Adjustments | November 30, 2012 |
|----------------|--------------------|-----------|---|----------------------|
| | Gross Balance | Additions | | Gross Balance |
| Federal | \$1,495 | \$- | \$- | \$1,495 |
| CSLED | 11,812 | - | - | \$11,812 |
| Total goodwill | \$13,307 | \$- | \$- | \$13,307 |

In accordance with ASC 350 Intangibles - Goodwill and Other, goodwill is not amortized but tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. Goodwill is tested for impairment at one level below an operating segment (also known as a component) in accordance with the guidance of ASC 350. These reporting units are comprised of Federal Infrastructure, Federal Applications, State, Local and Education (“SLED”) and Commercial. The Company has set an annual impairment testing date of June 1.

An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount. The impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of the reporting unit and compares it to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with ASC Topic 805 Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

The Company's stock does not trade frequently and thus management believes the inherent value of the Company is not and has not been accurately reflected by the current or historical stock market valuation of the Company. Accordingly, the Company continues to believe that the income approach is the most appropriate valuation method.

In accordance with ASC 350, the Company performed its annual impairment testing as of June 1, 2012. To assist in this process, the Company engaged an external valuation firm. Based on its annual impairment testing, the Company does not currently believe that there was an indication of goodwill impairment at June 1, 2012, with the exception of the goodwill associated with the Federal Infrastructure and Commercial reporting units where impairment charges of \$521,000 and \$4.8 million, respectively, were taken in the fourth quarter of fiscal 2012. See Note 17 to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for fiscal year ended August 31, 2012 for further discussion of the goodwill impairment associated with the Federal Infrastructure and Commercial reporting units. If current market conditions change and the Company's estimated value under the income approach is affected, then it is possible that the Company could have to take a goodwill impairment charge against earnings in a future period.

Identifiable Intangible Assets

The changes in the carrying amount of identifiable intangible assets by reporting segment for the three months ended November 30, 2012 are as follows (in thousands):

| | August 31, 2012 | | | | Impairment, Translation, and Other Adjustments | November 30, 2012 | |
|--------------------------------|-----------------|-----------------------------|-----------|--------------|---|-------------------|-----------------------------|
| | Balance | Accumulated Amortization | Additions | Amortization | | Balance | Accumulated Amortization |
| Customer relationships: | | | | | | | |
| Federal | \$1,682 | \$ 663 | | \$ 54 | | \$1,682 | \$ 717 |
| CSLED | 15,769 | 9,128 | | 367 | (1) | 15,768 | 9,495 |
| Total customer relationships | 17,451 | 9,791 | - | 421 | (1) | 17,450 | 10,212 |
| Noncompete agreements: | | | | | | | |
| Federal | 45 | 34 | | 4 | | 45 | 38 |
| CSLED | 2,376 | 796 | | 118 | | 2,376 | 914 |
| Total noncompete agreements | 2,421 | 830 | - | 122 | - | 2,421 | 952 |
| Software technology - | | | | | | | |
| CSLED | 12 | 6 | | 1 | | 12 | 7 |
| Trademarks - CSLED | 1,546 | 458 | | 9 | | 1,546 | 467 |
| Tradenames: | | | | | | | |

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| | | | | | | | |
|-------------------------------|--------|--------|-----|--------|---------|----------|-----------|
| Federal | 182 | 82 | | 9 | | 182 | 91 |
| CSLED | 21 | 9 | | 69 | | 21 | 78 |
| Total tradenames | 203 | 91 | - | 78 | - | 203 | 169 |
| <hr/> | | | | | | | |
| Total other intangible assets | 21,633 | 11,176 | \$- | \$ 631 | \$ (1) | \$21,632 | \$ 11,807 |

Long-lived assets, including customer relationships and property and equipment, are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable in accordance with ASC 350, Intangibles- Goodwill and Other, and FASB ASC 360, Property, Plant and Equipment. Recoverability of long-lived assets is assessed by a comparison of the carrying amount to the estimated undiscounted future net cash flows expected to result from the use of the assets and their eventual disposition. If estimated undiscounted future net cash flows are less than the carrying amount, the asset is considered impaired and a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the asset.

Customer relationships represent the fair value ascribed to customer relationships in connection with acquisitions by the Company. The amounts ascribed to customer relationships are being amortized on a straight-line basis over 5-15 years.

Noncompete agreements represent the value ascribed to covenants not to compete in employment and acquisition agreements with certain members of the management teams of acquired companies, entered into at the time of the respective acquisitions. The amounts ascribed to noncompete agreements are being amortized on a straight-line basis over 3-5 years.

Software technology represents the value ascribed to software developed by an acquired entity. The amounts ascribed to software technology are being amortized on a straight-line basis over 3 years.

Trademarks represent the value ascribed to trademarks owned by an acquired entity. The amount ascribed to trademarks is being amortized on a straight-line basis over 5 years.

Trade names represent the value ascribed to trade names owned by acquired entities. The amount ascribed to trade names is being amortized on a straight-line basis over 5 years.

Amortization expense related to intangible assets was \$631,000 and \$987,000 for the three months ended November 30, 2012 and 2011, respectively. We currently expect future amortization to be as follows (in thousands):

| | | |
|-------------------------|------------|---------|
| Years ending August 31, | | |
| | 2013 | \$2,388 |
| | 2014 | \$2,134 |
| | 2015 | \$2,013 |
| | 2016 | \$1,710 |
| | 2017 | \$710 |
| | Thereafter | \$953 |

Foreign Currency Translation and Other Comprehensive Income (Loss)

The financial statements of the Company's foreign subsidiaries are translated into U.S. dollars for consolidation and reporting purposes. The functional currency for the Company's foreign operations is the local currency. Current rates of exchange are used to translate assets and liabilities. Adjustments to translate those statements into U.S. dollars are recorded in accumulated other comprehensive income.

Earnings Per Share

Basic earnings per share amounts are computed by dividing net income available to common stockholders (the numerator) by the weighted average shares outstanding during the period (the denominator). Shares issued during the period are weighted for the portion of the period that they were outstanding.

The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive options, restricted stock awards, stock appreciation rights and warrants had been exercised as of the end of the period and cash received from the exercise were used to repurchase shares in the open market (the "Treasury Share Method"). Potentially dilutive shares consist of stock options, restricted stock awards and warrants totaling 2,192,424 and 2,775,398 at November 30, 2012 and 2011. Diluted shares for the three months ended November 30, 2012 were not included in the calculation of diluted net loss per share because the effect of the inclusion would be anti-dilutive. In addition, outstanding warrants to purchase 1,401,733 common shares as of November 30, 2012 and 2011, were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price of the Company's common shares over those periods.

Income Taxes

The Company conducts business in the U.S., Canada and India. With respect to its U.S. operations, the Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. The Company accounts for income taxes in accordance with ASC 740 Income Taxes. The Company files a federal consolidated tax return that includes all U.S. entities. The Company also files several combined/consolidated state tax returns and several separate state tax returns. Deferred taxes result from temporary differences, which are the differences between the financial reporting and tax bases of assets and liabilities. Tax loss carry forwards are recognized as deferred tax assets. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Deferred taxes result from timing differences primarily relating to net operating losses, bad debts, inventory reserves, deferred revenue, fixed asset depreciation, compensation expenses and intangible asset amortization.

With a few exceptions, the Company is no longer subject to federal, state or local income tax examinations for tax returns filed for fiscal years 2009 and prior.

Reconciliation of liabilities for unrecognized tax benefits for the three months ended November 30, 2012 and 2011 (in thousands) are as follows:

| | 2012 | 2011 |
|--|--------|--------|
| Balance at September 1, 2012 and 2011 | \$ 197 | \$ 197 |
| Unrecognized tax positions of prior periods: | | |
| Increase | - | - |
| Decrease | - | - |
| Unrecognized tax positions for the three months: | | |
| Increase | - | - |
| Decrease | - | - |
| Decrease in Unrecognized tax benefits due to settlements | - | - |
| Decrease in Unrecognized tax benefits due to lapse of statute of limitations | - | - |
| Balance at November 30, 2012 and 2011 | \$ 197 | \$ 197 |

| | For the Three Months Ended November 30, | |
|--|--|--------|
| | 2012 | 2011 |
| Total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate | \$ 86 | \$ 86 |
| Accrued interest and penalties for unrecognized tax benefits | \$ 138 | \$ 117 |
| Interest and penalties classified as income tax expense | \$ 5 | \$ 5 |

3. Liquidity

The Company incurred a significant net loss in fiscal 2012 from non-cash charges and a net loss for the three months ended November 30, 2012 due to restructuring charges and non-cash charges. The Company generated sufficient cash from operations in fiscal 2012, however, to meet all of its obligations when due and paid down over \$2 million of its debt balance during the year. Net availability under the revolving portions of the PNC Credit Facility as of November 30, 2012 and August 31, 2012 was \$3.8 million and 4.2 million, respectively. However, the Company had a working capital deficit at November 30, 2012 and August 31, 2012, and is dependent on its line of credit to finance its working capital needs.

The Company believes that its existing resources together with available borrowings under its PNC Credit Facility and expected cash flow from operations will provide sufficient liquidity for at least the next 12 months.

4. Restructuring Costs

In November 2012, the Company approved a restructuring plan (the "Restructuring Plan") of its procurement operations organization and certain related functions. As part of the Restructuring Plan, the Company's Springfield, New Jersey facility will be shutdown and certain functions handled by this facility will be further distributed to other facilities within the Company. The costs associated with the Restructuring Plan include severance for terminated employees,

primarily located at the Springfield facility and real estate exit and related costs related to closing the Springfield facility. However, the Restructuring Plan provision does not include the real estate exit and related costs as of November 30, 2012. After vacating the Springfield facility, the Company will increase the Restructuring Plan provision these costs. Once the restructuring plan is completed, the Company expects annual savings of approximately \$2.0 million.

The following table summarizes the Restructuring Plan provision, activity and ending balances included in “Other accrued expenses” in the consolidated balance sheet for the three months ended November 30, 2012 by cost type (in thousands):

| | August 31, 2012 | | | November 30, 2012 |
|--------------------------------------|--------------------|--------------|----------------|----------------------|
| | Balance | Additions | Cash Payments | Balance |
| Employee severance and related costs | \$- | \$582 | \$(42) | \$540 |
| Real estate exit and related costs* | - | - | - | - |
| Total | \$- | \$582 | \$(42) | \$540 |

* The Company will increase the Restructuring Plan provision in the second quarter of fiscal 2013 once its Springfield, New Jersey facility is vacated.

5. Stock-Based Compensation

The second amendment to the Company’s 2006 Stock-Based Incentive Compensation Plan (the “2006 Plan”) was approved by the Company’s stockholders on January 20, 2011. The 2006 Plan authorizes the granting of stock options, restricted stock, deferred stock, stock appreciation rights and other stock-based awards to directors and eligible associates. The second amendment increased the aggregate number of shares of Common Stock available for issuance under the 2006 Plan from 2,543,207 shares to 9,543,207 shares. Options under the 2006 Plan may not be granted with an exercise price that is less than 100% of the fair value of the Company’s common stock on the date of grant (110% in the case of an incentive stock option granted to a stockholder owning more than 10% of the common stock of the Company or any of its subsidiaries). Options under the 2006 Plan have terms from 7 to 10 years. Certain options vest immediately and others vest over a term of up to 3 to 5 years.

Stock Options

The Company measures the fair value of options on the grant date using the Black-Scholes option valuation model. The Company estimated the expected volatility using the Company’s historical stock price data over the expected term of the stock options. The Company also used historical exercise patterns and forfeiture behaviors to estimate the options, expected term and our forfeiture rate. The risk-free interest rate is based on the U.S. Treasury zero-coupon yield curve in effect on the grant date. Both expected volatility and the risk-free interest rate are based on a period that approximates the expected term. Since our stock is thinly traded, the stock price used on the date of vesting for the Black-Scholes model is the last trade that occurred.

A summary of stock options for the three months ended November 30, 2012 and 2011 is as follows:

| For the Three Months Ended November 30, 2012 | Shares | Weighted Average Exercise Price | Weighted Average Remaining Term | Aggregate Intrinsic Value * |
|---|-----------|--|------------------------------------|-----------------------------------|
| Options Outstanding - September 1, 2012 | 466,833 | \$ 1.17 | | |
| Options Granted | 70,000 | \$ 1.49 | | |
| Options Exercised | - | - | | |
| Options Forfeited or Expired | (15,000) | \$ 1.31 | | |
| Options Outstanding - November 30, 2012 | 521,833 | \$ 1.21 | 5.03 years | \$67,117 |
| Options Exercisable - November 30, 2012 | 406,469 | \$ 1.07 | 4.53 years | 67,117 |

* Represents the total pre-tax intrinsic value based on the Company's average closing stock prices for the three months ended November 30, 2012.

| For the Three Months Ended November 30, 2011 | Shares | Weighted Average Exercise Price | Weighted Average Remaining Term | Aggregate Intrinsic Value * |
|---|----------|--|------------------------------------|-----------------------------------|
| Options Outstanding -September 1, 2011 | 416,333 | \$ 1.12 | | |
| Options Granted | 20,000 | \$ 0.44 | | |
| Options Exercised | - | - | | |
| Options Forfeited or Expired | (8,500) | \$ 0.79 | | |
| Options Outstanding - November 30, 2011 | 427,833 | \$ 1.10 | 5.05 years | \$17,725 |
| Options Exercisable - November 30, 2011 | 385,333 | \$ 1.09 | 4.68 years | 17,725 |

* Represents the total pre-tax intrinsic value based on the Company's average closing stock prices for the three months ended November 30, 2011.

There were 70,000 and 20,000 stock options issued during the three months ended November 30, 2012 and 2011, respectively. The following assumptions were used to value stock options issued during each of the three months ended November 30, 2012 and 2011.

| | 2012 | 2011 |
|-----------------------------|--------|-------------|
| Weighted-Average Fair Value | \$0.92 | \$0.37 |
| Assumptions | | |
| Expected Volatility | 120.7% | 114.50% |
| Expected Term (in years) | 5 | 5 |
| Expected Forfeiture Rate | 10.9% | 0% |
| Dividend Yield | 0% | 0% |
| Risk-Free Interest Rate | 0.67%- | 0.79% 1.07% |

Non-vested Stock (Restricted Stock)

The following tables summarize the Company's restricted stock activity during the three months ended November 30, 2012 and 2011:

| For the Three Months Ended November 30, 2012 | Shares | Weighted Average Grant Date Fair Value | Fair Value | |
|--|-----------|--|------------|-----|
| Nonvested - September 1, 2012 | 729,999 | \$ 0.63 | | |
| Granted | - | - | | |
| Vested | (36,875) | \$ 0.93 | \$ 42,381 | (a) |
| Forfeited | - | - | | |
| Nonvested - November 30, 2012 | 693,124 | \$ 0.69 | \$ 793,570 | (b) |

(a) The fair value of vested restricted stock shares represents the total pre-tax fair value, based on the closing stock price on the day of vesting, if there was a stock trade, which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date. If there was no stock trade on the date of vesting, then the pre-tax fair value of the stock is deemed to be the last price at which the stock traded.

(b) The aggregate fair value of the non-vested restricted stock shares expected to vest represents the total pre-tax fair value, based on the Company's average closing stock price for the three months ended November 30, 2012 which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date.

| For the Three Months Ended November 30, 2011 | Shares | Weighted Average Grant Date Fair Value | Fair Value | |
|--|-----------|--|------------|-----|
| Nonvested - September 1, 2011 | 1,222,369 | \$ 0.71 | | |
| Granted | - | - | | |
| Vested | (34,375) | \$ 0.97 | \$ 14,438 | (a) |
| Forfeited | - | - | | |
| Nonvested - November 30, 2011 | 1,187,994 | \$ 0.70 | \$ 593,997 | (b) |

(a) The fair value of vested restricted stock shares represents the total pre-tax fair value, based on the closing stock price on the day of vesting, if there was a stock trade, which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date. If there was no stock trade on the date of vesting, then the pre-tax fair value of the stock is deemed to be the last price at which the stock traded.

(b) The aggregate fair value of the non-vested restricted stock shares expected to vest represents the total pre-tax fair value, based on the Company's average closing stock price for the three months ended November 30, 2011 which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date.

The Company recognizes compensation expense associated with the issuance of such shares using the closing price of the Company's common stock on the Over-the-Counter Bulletin Board market on the date of grant over the vesting period on a straight-line basis.

Stock Options and Non-vested Stock

Stock-based compensation costs related to the 2006 Plan totaled \$95,000 and \$131,000 during the three months ended November 30, 2012 and 2011, respectively. As of November 30, 2012, the Company had \$205,000 of unrecognized compensation cost related to the 2006 Plan. The unrecognized compensation cost is expected to be recognized over a remaining period of 4 years.

Stock Appreciation Rights

On May 12, 2012, Mr. Gregory P. Chandler, the Company's Chief Financial Officer, was granted a stock appreciation right award under the 2006 Plan covering 657,542 shares of Common Stock, with a per share base price of \$1.75 (the "Chandler Award"). On August 10, 2012, the Company granted Mr. Sunil Misra, the Company's Chief Strategy & Delivery Officer, a stock appreciation right award under the 2006 Plan covering 657,542 shares of Common Stock, with a per share base price of \$1.75 (the "Misra Award"). Collectively the Chandler Award and the Misra Award are called "the Awards," and Mr. Chandler and Mr. Misra are each individually referred to as an "Awardee".

The purpose of the Company's stock appreciation rights program, pursuant to which the Awards were granted, is to motivate the Company's management team to substantially increase the value of the Company in a manner that will allow all stockholders to realize an increase in stock price. The Awards will have no value unless our Common Stock value exceeds \$1.75 per share in a liquidity event, which is substantially higher than the trading price of our Common Stock as of each of the grant dates.

The Awards will become vested upon the occurrence of a liquidity event if one of the two following conditions is satisfied: (i) the Awardee is employed by the Company on the date of such liquidity event; or (ii) if such liquidity event is a change in control and the Awardee's employment is terminated without cause or for good reason; in either case, after the date on which a letter of intent relating to the change in control that is binding with respect to exclusivity has been executed and the change in control that is the subject of such letter of intent is consummated within 180 days after the date of such termination of employment. Notwithstanding the foregoing, in the event that the per share equity value upon the occurrence of a liquidity event is not greater than \$1.75, then no portion of the Awards shall become vested in connection with such liquidity event and the entire Award (whether or not vested) will be immediately forfeited. In the event that a liquidity event does not occur on or before August 31, 2017, then the entire Award, whether or not vested, will be immediately forfeited.

To the extent vested, the Awards will become exercisable immediately prior to the occurrence of a liquidity event. Upon the exercise of the Awards, the Awardee is entitled to receive a number of shares of Common Stock having a fair market value on the date of exercise equal to the product of (x) the difference between the fair market value of one share of Common Stock on the date of exercise and the base price and (y) the number of shares of Common Stock with respect to which the Awards are then being exercised.

In the event of any Awardee's termination of employment for cause, the entire Award, whether or not vested, will be immediately forfeited. In the event of any Awardee's termination of employment for any reason other than for cause, the unvested portion of the Awardee's Award will generally be immediately forfeited and the vested portion of the Awardee's Award will remain outstanding and, to the extent not then exercisable, will be eligible to become exercisable upon the occurrence of a liquidity event.

FASB ASC 718, Compensation - Stock Compensation, prescribes accounting and reporting standards for all stock-based payments awarded to employees, including stock appreciation rights. Under ASC 718, accruals of compensation cost for an award with a performance condition should be based on the probable outcome of that performance condition - compensation cost should be accrued if it is probable that the performance condition will be achieved and should not be accrued if it is not probable that the performance condition will be achieved.

As of November 30, 2012, the Company has not recorded compensation expense associated with either Award. However, if the Company determines that a liquidity event is probable, compensation expense associated with Awards will be recorded at that time.

6. Warrants

DARR Westwood LLC

On August 2, 2010, the Company entered into a letter agreement (the "Letter Agreement") with DARR Westwood LLC (the "Investor"), pursuant to which, among other things, (a) the Investor agreed (i) to certain transfer restrictions on shares of Common Stock owned by the Investor, which are described below, and (ii) to transfer to the Company for cancellation the existing warrant owned by the Investor to purchase 8% of the outstanding Common Stock on a fully diluted basis, and (b) the Company issued to the Investor a warrant (the "Warrant") to purchase up to an aggregate of 1,401,733 shares of common stock, par value \$.01 per share, of the Company ("Common Stock") at an exercise price of \$2.11 per share. The Investor's sole member is Dinesh R. Desai, the Company's Chairman, Chief Executive Officer and President.

Under the terms of the Letter Agreement, the Investor is prohibited during the specified restricted period from transferring or publicly announcing any intention to transfer, in either case without the unanimous approval of the disinterested members of the Company's board of directors, (a) all or any portion of the Warrant or the Investor's rights under the Warrant or (b) any shares of Common Stock currently or in the future owned by the Investor. However, this prohibition does not apply to any transfer of shares of Common Stock pursuant to which both (x) the transferee is an independent third party and (y) the price paid by the transferee is equal to or greater than \$5.00 per share in cash. The restricted period specified in the Letter Agreement commenced on August 2, 2010 and terminates on the earlier to occur of (a) August 2, 2015 or (b) the date on which both (i) the average of the daily volume weighted average price per share of Common Stock over the immediately preceding 45 trading days that at least one share of Common Stock was traded is \$5.00 or more, and (ii) the average daily trading volume of shares of Common Stock over the 45 consecutive trading days (regardless of whether any shares of Common Stock were traded on any such trading day) immediately preceding such date is 10,000 or more.

The Letter Agreement also requires that if the Company causes its Common Stock to become listed on a national securities exchange, the Company will also list and maintain the listing of the shares of Common Stock underlying the Warrant on such national securities exchange. In addition, subject to certain conditions, the Company is required under the Letter Agreement to provide prior notice to the Investor if, at any time before the Warrant has been exercised in full, the Company effects certain specified corporate actions, including selecting a record date for dividends or distributions or effecting a reorganization, reclassification, merger, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up involving the Company.

The Warrant entitles the Investor to purchase 1,401,733 shares of Common Stock at \$2.11 per share and expires on August 2, 2015. The Warrant also contains provisions for cashless exercise and weighted average anti-dilution protection for subsequent issuances or deemed issuances of Common Stock by the Company for consideration per share less than the per share exercise price of the Warrant in effect immediately prior to such issuance or deemed issuance. In connection with this issuance of warrants and compliance with ASC 815, Derivatives and Hedging, the Company recorded a liability on August 2, 2010 of \$916,000. At November 30, 2012 and August 31, 2012, the net liability recorded on the balance sheet was \$1.1 million. The Company recorded income on its consolidated results of operations of \$-0- and \$337,000 for the three months ended November 30, 2012 and 2011, respectively, as a result of adjusting the warrant liability to fair value. As a result of volatility in the Company's stock price, there may continue to be adjustments associated with determining the fair value of the warrant liability in future periods.

NewSpring

In connection with the entry into a Subordinated Loan Agreement (as defined in Note 8) with NewSpring, which is described in more detail in Note 8 – Subordinated Debt, on August 15, 2011 the Company issued to NewSpring a Common Stock Purchase Warrant (the “NewSpring Warrant”) to purchase the number of shares of Common Stock equal to 5.0% of the Common Stock outstanding at the time of, and after giving effect to, the exercise of the NewSpring Warrant. As of November 30, 2012 and August 31, 2012, the NewSpring Warrant would be exercisable into 903,606 shares of Common Stock. On December 30, 2011, in connection with the entry into the PNC Credit Facility with PNC and Peachtree becoming a lender under the Subordinated Loan Agreement, the Company amended and restated the NewSpring Warrant (as so amended and restated, the “Amended and Restated NewSpring Warrant”) and granted a warrant (the “Peachtree Warrant,” and together with the Amended and Restated NewSpring Warrant, the “Warrants”) to Peachtree to purchase 1.5% of our Common Stock

In connection with the issuance of the NewSpring Warrant and in compliance with ASC 470-20 Debt with Conversion and Other Options, the subordinated note issued to NewSpring under the Subordinated Loan Agreement has been discounted by the fair value of the NewSpring Warrant, calculated to be \$484,000 at time of issuance. This amount is being amortized as additional interest expense and accretes the note to face value on the Company's balance sheet at maturity. The Company determined the fair value of the NewSpring Warrant by using the Black-Scholes pricing model. At November 30, 2012 and August 31, 2012, the liability recorded on the Company's balance sheet was \$1.0 million. The Company recorded (income) expense on its consolidated statements of operations of \$9,000 and (\$268,000) for the three months ended November 30, 2012 and 2011, respectively, as a result of adjusting the warrant liability to fair value. As a result of volatility in the Company's stock price, there may continue to be adjustments associated with determining the fair value of the liability related to the NewSpring Warrant in future periods.

Peachtree

In connection with the entry into the Subordinated Loan Agreement, on December 30, 2011, the Company issued Peachtree the Peachtree Warrant, which allows Peachtree to purchase the number of shares of Common Stock equal to 1.5% of the Common Stock outstanding at the time of, and after giving effect to, the exercise of the Peachtree Warrant (based on the “treasury stock method”) in accordance with GAAP and determined using the same principles, assumptions and estimates that are used by the Company in the preparation of its financial statements and assuming the exercise or conversion of all securities that are directly or indirectly exercisable for or convertible into Common Stock). As of November 30, 2012 and August 31, 2012, the Peachtree Warrant would be exercisable into 271,926 shares of Common Stock. The exercise price for the Common Stock is \$0.01 per share, which may be paid through a cashless exercise. The Peachtree Warrant expires on December 30, 2021.

In connection with the issuance of the Peachtree Warrant and in compliance with ASC Topic 470-20 Debt with Conversion and Other Options, the subordinated note issued to Peachtree under the Subordinated Loan Agreement has been discounted by the fair value of the Peachtree Warrant, calculated to be \$73,000 at time of issuance. This amount is being amortized as additional interest expense and accretes the note to face value on the Company's balance sheet at maturity. The Company determined the fair value of the Peachtree Warrant by using the Black-Scholes pricing model. At November 30, 2012 and August 31, 2012, the liability recorded on the Company's balance sheet was \$314,000 and \$311,000, respectively. The Company recorded expense on its consolidated statements of operations of \$3,000 and \$-0- for the three months ended November 30, 2012 and 2011, respectively, as a result of adjusting the warrant liability to fair value. As a result of volatility in the Company's stock price, there may continue to be adjustments associated with determining the fair value of the liability related to the Peachtree Warrant in future periods.

7. Line of Credit

On December 30, 2011, Emtec NJ, Emtec LLC, Emtec Federal, EGS LLC, Luceo, eBAS, Aveeva, EIS-US, KOAN-IT US, SDI, Dinero, Covelix and Emerging, (collectively the "Borrower") entered into a Revolving Credit and Security Agreement (the "PNC Loan Agreement") with PNC Bank, National Association ("PNC"), as lender and agent. The PNC Loan Agreement provides for a senior secured revolving credit facility in an amount not to exceed (i) \$30.0 million for the period from February 1 through August 31 each year during the term of the facility and (ii) \$45.0 million for the period from September 1 through January 31 each year during the term of the facility (the "PNC Credit Facility"). The PNC Credit Facility also includes a \$7.0 million sublimit for the issuance of letters of credit. The proceeds of the PNC Credit Facility were used to refinance all of the Borrower's outstanding indebtedness under its then existing senior credit facility with De Lage Landen Financial Services, Inc. ("DLL") pursuant to which DLL provided a revolving credit loan and floorplan loan (the "DLL Credit Facility"), to pay off all indebtedness of EIS-Canada under a loan agreement with De Lage Landen Financial Services Canada Inc. ("DLL Canada") pursuant to which DLL Canada provided EIS-Canada with a revolving credit line of C\$5 million, to pay related costs and expenses and for working capital and other general corporate purposes. The PNC Loan Agreement will remain in effect until December 29, 2014, unless sooner terminated by the Borrower or PNC.

Borrowings under the PNC Loan Agreement will bear regular interest at a rate equal to the Alternate Base Rate (as defined in the PNC Loan Agreement) plus 1.0% or the Eurodollar Rate (as defined in the PNC Loan Agreement) plus 3.0% on the outstanding principal amount. As of November 30, 2012, the interest rate was 4.25%.

The PNC Loan Agreement contains certain customary affirmative and negative covenants, including, among other things: (i) affirmative covenants requiring the Borrower to provide certain financial statements and schedules to PNC, maintain their legal existence, keep their collateral in good condition, and provide certain notices to PNC; and (ii) negative covenants that provide for limitations on other indebtedness, liens, amendments of organizational documents, asset sales, capital expenditures, issuance of capital stock, investments, and transactions with affiliates.

The PNC Loan Agreement also contains certain customary representations and warranties and events of default, including, among other things, failure to pay interest, principal or fees due under the PNC Loan Agreement, any material inaccuracy of any representation and warranty, any default having occurred under any Subordinated Debt (as such term is defined in the PNC Loan Agreement), and the occurrence of bankruptcy or other insolvency events. Certain of the events of default are subject to exceptions and materiality qualifiers. If an event of default shall occur and be continuing under the PNC Loan Agreement, PNC may, among other things, accelerate the repayment of the Borrower's obligations under the PNC Credit Facility.

To secure the payment of the obligations under the PNC Loan Agreement, the Borrower granted to PNC a security interest in, and a lien upon, all of its respective interests in its respective assets, including receivables, equipment, general intangibles, inventory, investment property, subsidiary stock, leasehold interests, goods, deposit accounts, letter of credit rights, commercial tort claims and insurance proceeds. All such security interests are subject to the terms of a Subordination Agreement, dated December 30, 2011 among PNC, NewSpring SBIC Mezzanine Capital II, L.P. ("NewSpring"), Peachtree II, L.P., (NewSpring and Peachtree, collectively, the "Investors") and the Borrower, as amended on March 20, 2012 (the "Subordination Agreement").

On March 20, 2012, the Borrower and EIS - Canada entered into a First Amendment and Joinder to Loan Documents with PNC, pursuant to which PNC agreed to make certain amendments to the PNC Loan Agreement and the Other Documents (as such term is defined in the PNC Loan Agreement and together with the PNC Loan Agreement, the "PNC Loan Documents"), including (1) joining EIS -Canada to the PNC Loan Documents, (2) amending the definition of EBITDA to revise certain add-backs and deductions thereto and (3) revising the covenants and representations and warranties included in the PNC Loan Agreement to include certain customary covenants and representations and warranties relating to EIS - Canada.

To secure the payment of the obligations of EIS-Canada under the PNC Loan Agreement, EIS-Canada granted to PNC a security interest in, and a lien upon, all of its interests in its assets, including accounts, securities entitlements, securities accounts, futures accounts, futures contracts and investment property, deposit accounts, instruments, documents, chattel paper, inventory, goods, equipment, fixtures, agricultural liens, as-extracted collateral, letter of credit rights and intangibles of every kind. All such security interests are subject to the terms of the Subordination Agreement.

On June 28, 2012, the Borrower entered into a Second Amendment to Loan Documents (the "Second Amendment") with PNC, pursuant to which PNC has agreed to make an amendment to the PNC Loan Agreement. The modification in the Second Amendment provided for amendment of the calculation of the amount of borrowings under the secured revolving senior credit facility, specifically related to outstanding letters of credit for inventory purchases.

Prior to the refinancing with PNC on December 30, 2011, the Company had a revolving credit and floorplan with DLL. As of November 30, 2011, the DLL Credit Facility provided for aggregate borrowings of the lesser of \$32.0 million or 85% of the Borrower's eligible accounts receivable, plus 100% of unsold inventory financed by DLL and 40% of all other unsold inventory. Under the DLL Credit Facility, the interest rate for revolving credit loans was the base rate plus 3.25% and the interest rate for floorplan loans was 6.25% in excess of the base rate. The DLL Credit Facility was to expire on December 7, 2012.

On December 14, 2012, the Borrower entered into a Third Amendment to Loan Documents (the “Third Amendment”) with PNC, pursuant to which PNC has agreed to make certain amendments to the PNC Loan Agreement. The modifications provided for in the Third Amendment, among other things, (1) amend the definition of “Formula Amount” to reduce the percentage of outstanding trade letters of credit for inventory purchases used to calculate amounts available for borrowing under the Loan Agreement, (2) amend the definition of “EBITDA” to, for fiscal quarters ended on or prior to August 31, 2012, add back intangible asset impairment charges and goodwill impairment charges relating to acquisitions not to exceed \$10,000,000 in the aggregate, (3) change the point in time with respect to which the fixed charge coverage ratio covenant relating to earn out payments is calculated and (4) provide the consent of PNC and the lenders to a release of a security interest in certain receivables.

At November 30, 2012 and August 31, 2012, the Company had an outstanding balance under the revolving portion of the PNC Credit Facility of \$14.0 million and \$12.0 million, respectively. Net availability under the revolving portion of the PNC Credit Facility as of November 30, 2012 and August 30, 2012 was \$3.8 million and \$4.2 million, respectively.

As of November 30, 2012, the Company determined it was in compliance with its financial covenants under the PNC Credit Facility.

8. Subordinated Debt

On December 30, 2011, the Borrower entered into an Amended and Restated Subordinated Loan Agreement (the “Subordinated Loan Agreement”) with the Investors pursuant to which: (i) Peachtree provided an additional subordinated term loan in an original principal amount of \$3.0 million (together with the existing subordinated term loan from NewSpring in the original principal amount of \$10.0 million), (ii) NewSpring was appointed as collateral agent, (iii) the Investors waived any event of default arising from (a) the Borrower failing to meet the Total Funded Senior Debt to Pro Forma Adjusted EBITDA Ratio covenant (as set forth in the Subordinated Loan Agreement) for the trailing twelve months ending November 30, 2011 and (b) the Borrower failing to comply with the covenant in the Subordinated Loan Agreement prohibiting a Borrower name change without notice to, or the consent of, NewSpring, and (iv) the Investors agreed to make certain other amendments to the Subordinated Loan Agreement, including amending the Total Funded Senior Debt to Pro Forma Adjusted EBITDA Ratio covenant to provide that the Company and its consolidated subsidiaries shall maintain as of the last business day of the fiscal quarters ending on February 28, 2012 and May 31, 2012, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA (as such terms are defined in the Subordinated Loan Agreement) on a trailing twelve months basis for such period of not less 4.0 to 1.0 for the fiscal quarter ending on February 28, 2012 and of not less than 3.75 to 1.0 for the fiscal quarter ending on May 31, 2012. There are no scheduled principal payments on the Subordinated Credit Facility until the maturity date of August 15, 2016.

Borrowings under the Subordinated Loan Agreement will bear regular interest at a rate equal to 12.0% per annum on the outstanding principal amount. Accrued and unpaid regular interest is payable on the last business day of each fiscal quarter beginning with November 30, 2011 through August 15, 2016 at which time all unpaid principal and interest is due. Borrowings under the Subordinated Loan Agreement will bear additional interest of 2.0% per annum and this accrued and unpaid additional interest of 2.0% is, at the Company’s option, payable in cash, or added to the principal amount outstanding, on the last business day of each fiscal quarter.

On August 29, 2012, the Borrower entered into Amendment No. 2 (the "Amendment") to the Subordinated Loan Agreement with the Investors, among other things, (1) amend the definition of "Fixed Charge Coverage Ratio" to allow the Borrower to fully offset the amount of cash taxes paid by any tax refunds received, (2) amend and restate the requirements under the financial ratios and covenants in their entirety as follows: (a) require the Borrower to maintain: (i) as of the last Business Day (as defined in the Subordinated Loan Agreement) of the fiscal quarter ending August 31, 2012, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period of not greater than 4.5 to 1.0, (ii) thereafter as of the last Business Day of each fiscal quarter ending on February 28th, May 31st and August 31st of each fiscal year, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period of not greater than 3.75 to 1.0, (c) eliminate the requirement for the Borrower to test of the last Business Day of each fiscal quarter ending on November 30th of each fiscal year, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period and (d) require the Borrower to maintain, as of the last Business Day of each fiscal quarter on a trailing 12 months basis, a Fixed Charge Coverage Ratio of not less than 1.25 to 1.0.

As of November 30, 2012, the Company has determined it was in compliance with its financial covenants under the Subordinated Loan Agreement with NewSpring and Peachtree.

9. Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of accounts receivable.

The Company's revenues, by client type, consist of the following (in thousands):

| | For the Three Months Ended | | | | | |
|------------------------------|----------------------------|-------|---|-------------------|-------|---|
| | November 30, 2012 | | | November 30, 2011 | | |
| Departments of the U.S. | | | | | | |
| Government | \$ 23,315 | 40.1 | % | \$ 42,304 | 58.7 | % |
| Canadian Government Agencies | 345 | 0.6 | % | 454 | 0.6 | % |
| State and Local Governments | 594 | 1.0 | % | 1,317 | 1.8 | % |
| Commercial Companies | 19,172 | 32.9 | % | 21,074 | 29.3 | % |
| Education and Other | 14,779 | 25.4 | % | 6,881 | 9.6 | % |
| Total Revenues | \$ 58,205 | 100.0 | % | \$ 72,030 | 100.0 | % |

The Company reviews a client's credit history before extending credit. The Company does not require collateral or other security to support credit sales. The Company provides an allowance for doubtful accounts based on the credit risk of specific clients, historical experience and other identified risks. Trade receivables are carried at original invoice less an estimate made for doubtful receivables, based on review by management of all outstanding amounts on a periodic basis. Trade receivables are considered delinquent when payment is not received within standard terms of sale, and are charged-off against the allowance for doubtful accounts when management determines that recovery is unlikely and ceases its collection efforts.

The trade account receivables consist of the following (in thousands):

| | November 30, 2012 | August 31, 2012 |
|---------------------------------|----------------------|--------------------|
| Trade receivables | \$31,139 | \$24,801 |
| Allowance for doubtful accounts | (577) | (420) |
| Trade receivables, net | \$30,562 | \$24,381 |

Trade receivables include \$3.3 million and \$4.0 million of unbilled revenue as of November 30, 2012 and August 31, 2012, respectively.

Major Clients

Sales to major clients, representing at least 10% of total revenue for a period consist of the following (in thousands):

| | For the Three Months Ended | | | | | |
|-----------------------------------|----------------------------|-------|---|-------------------|-------|---|
| | November 30, 2012 | | | November 30, 2011 | | |
| School District #1 | \$ 13,014 | 22.4 | % | \$ 4,983 | 6.9 | % |
| Department of the U.S. Government | 8,561 | 14.7 | % | 21,050 | 29.2 | % |
| All Other Clients | 36,630 | 62.9 | % | 45,997 | 63.9 | % |
| Total Revenues | \$ 58,205 | 100.0 | % | \$ 72,030 | 100.0 | % |

Trade receivables due from an education client in the southeastern U.S. and one of the departments of the U.S. Government accounted for approximately 13.2% and 9.3%, respectively, of the Company's trade receivables as of November 30, 2012. The same clients accounted for approximately 15.7% and 5.6%, respectively, of the Company's trade receivable as of August 31, 2012.

10. Inventories

Inventories are stated at the lower of average cost or market. Inventories consist of finished goods purchased for resale, including computer hardware, computer software, computer peripherals and related supplies.

11. Accrued Liabilities

At November 30, 2012 and August 31, 2012, accrued liabilities consisted of the following (in thousands):

| | November 30, 2012 | August 31, 2012 |
|----------------------------------|----------------------|--------------------|
| Accrued payroll | \$5,138 | \$5,372 |
| Accrued commissions | 165 | 145 |
| Accrued state sales taxes | 95 | 95 |
| Accrued third-party service fees | 51 | 9 |
| Accrued restructuring expense | 540 | - |
| Deferred rent | 183 | 192 |
| Other accrued expenses | 3,058 | 3,248 |
| Total accrued liabilities | \$9,230 | \$9,061 |

12. Related Party Transactions

The Company leases warehouse and office space from related parties. The aggregate expense for these lease arrangements during the three months ended November 30, 2012 and 2011 was \$144,000 and \$134,000, respectively.

13. Legal Proceedings

The Company is occasionally involved in various lawsuits, claims, and administrative proceedings arising in the normal course of business. The Company believes that any liability or loss associated with such matters, individually or in the aggregate, will not have a material adverse effect on the Company's financial condition or results of operations.

14. Subsequent Events

On December 14, 2012, the Borrower entered into a Third Amendment to Loan Documents (the "Third Amendment") with PNC, pursuant to which PNC has agreed to make certain amendments to the PNC Loan Agreement. The modifications provided for in the Third Amendment, among other things, (1) amend the definition of "Formula Amount" to reduce the percentage of outstanding trade letters of credit for inventory purchases used to calculate amounts available for borrowing under the Loan Agreement, (2) amend the definition of "EBITDA" to, for fiscal quarters ended on or prior to August 31, 2012, add back intangible asset impairment charges and goodwill impairment charges relating to acquisitions not to exceed \$10,000,000 in the aggregate, (3) change the point in time with respect to which the fixed charge coverage ratio covenant relating to earn out payments is calculated and (4) provide the consent of PNC and the lenders to a release of a security interest in certain receivables.

On January 14, 2013, the Borrower entered into a Fourth Amendment to Loan Documents (the "Fourth Amendment") with PNC, pursuant to which PNC has agreed to make certain amendments to the PNC Loan Agreement. The modifications provided for in the Fourth Amendment, among other things, (1) amend the definition of "EBITDA" to include restructuring charges associated with closing the Borrower's Springfield, New Jersey facility and (2) amend the definition of "Senior Debt Payments" to include payments associated with those restructuring charges.

15. Segment Information

As Emtec has grown and expanded its service offerings through acquisitions, the Company has started to experience a substantial amount of cross-selling of services and sharing of personnel across its previous reporting units and segments. In addition, the back office functions have been consolidated under a single shared services group in the fourth quarter of fiscal 2011, to fully integrate the Company's 2011 acquisitions from an operational and financial reporting standpoint.

Further, in order to fully integrate its acquisitions from an operational and financial reporting standpoint, the Company installed a new ERP system (SAP) in June 2011. As the Company has transitioned to cross selling company-wide, the way that the Company tracks and evaluates financial information has evolved. Historically, Emtec tracked and evaluated operating results by each acquisition which was also treated as a reporting unit. With the introduction of the new ERP system and the integration of the acquisitions' operations, the Company has decided to redefine the way operating results are reviewed for purposes of performance assessment and resource allocation. Accordingly, effective June 1, 2012, the Company's reportable segments are as follows:

- Federal - provides IT consulting and procurement services the various agencies of the U.S federal government.
- Commercial, State & Local and Education ("CSLED") – provides IT consulting services to clients in the commercial, state & local and education sectors.

In addition, the Company also has a "Corporate" segment which reports costs consisting of our executive departments, employee benefit administration, accounting support, IT services, recruiting, and any other shared services, operating, and administrative expenses that are not directly attributable to the reporting segments. For purposes of performance measurement, the Company charges certain expenses directly attributable to the reporting segment and allocates costs reflected in the Corporate segment. Identifiable assets of the reporting unit exclude Corporate segment assets liabilities. Corporate segment assets consist principally of cash, prepaid expenses, non-trade accounts receivables, property and equipment, other assets, deferred taxes, other liabilities and general corporate borrowings.

The Company provides segment financial information in accordance with ASC 280, Segment Reporting. The accounting policies of our segments are the same as those described in Note 2 and there are no material intersegment transactions.

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Reporting segment data is presented in the following table (in thousands):

| | November 30, (Unaudited) 2012 | August 31, 2012 |
|--|--|--------------------|
| Assets | | |
| Federal | \$ 19,975 | \$ 14,659 |
| Commercial/SLED | 48,422 | 49,045 |
| Total assets | \$68,397 | \$63,704 |
| | November 30, (Unaudited) | |
| | 2012 | 2011 |
| Revenue | | |
| Federal | \$23,315 | \$42,304 |
| Commercial/SLED | 34,890 | 29,726 |
| Total Revenue | \$58,205 | \$72,030 |
| Operating income (loss) | | |
| Federal | \$1,465 | \$3,505 |
| Commercial/SLED | 2,798 | 932 |
| Corporate | (4,257) | (3,026) |
| Total operating profit | \$6 | \$1,411 |
| Other expense, net | 758 | 771 |
| Income (loss) before income taxes | \$(752) | \$640 |
| Depreciation and amortization | | |
| Federal | \$203 | \$274 |
| Commercial/SLED | 655 | 939 |
| Corporate | 169 | 147 |
| Total depreciation and amortization | \$1,027 | \$1,360 |
| Income tax expense (benefit) | | |
| Federal | \$369 | \$1,259 |
| Commercial/SLED | (284) | (196) |
| Corporate | (91) | (878) |
| Total income tax expense (benefit) | \$(6) | \$185 |
| Interest and other expense | | |
| Federal | \$109 | \$71 |
| Commercial/SLED | 567 | 303 |
| Corporate | 82 | 397 |
| Total interest and other expense | \$758 | \$771 |
| Purchases of property and equipment | | |
| Federal | \$6 | \$15 |
| Commercial/SLED | 18 | 26 |

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| | | |
|---|-------|-------|
| Corporate | 179 | 295 |
| Total purchases of property and equipment | \$203 | \$336 |

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.

Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Quarterly Report on Form 10-Q and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the "SEC"). In addition to historical information, this Quarterly Report on Form 10-Q contains our beliefs regarding future events and 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 those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. We undertake no obligation to publicly release any revisions to forward-looking statements after the date of this report. In evaluating those statements, you should specifically consider various factors, including the risk factors discussed in our Annual Report on Form 10-K for the year ended August 31, 2012 and other reports or documents that we file from time to time with the SEC. 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.

Overview of Emtec

Emtec, Inc., a Delaware corporation, was formed on January 17, 2001 and is an information technology ("IT") services provider. We provide consulting, application services and infrastructure services to commercial and public sector clients. The Company's client base is comprised of commercial businesses, school districts throughout the U.S. and Canada and departments of the U.S. and Canada's federal, state/provincial and local governments.

Consolidated Statements of Income for the Three Months Ended November 30, 2012 compared with the Three Months Ended November 30, 2011.

EMTEC, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)

| | Three Months Ended November 30, | | | | |
|---|------------------------------------|-----------------|-------------------|----------------|-----------|
| | 2012 | 2011 | Change | | % |
| Revenues | | | | | |
| Consulting and outsourcing | \$24,579 | \$25,614 | \$(1,035) | (4.0) |)% |
| Procurement services | 33,626 | 46,416 | (12,790) | (27.6) |)% |
| Total Revenues | 58,205 | 72,030 | (13,825) | (19.2) |)% |
| Cost of Revenues | | | | | |
| Cost of consulting and outsourcing | 18,082 | 19,479 | (1,397) | (7.2) |)% |
| Cost of procurement services | 29,628 | 40,655 | (11,027) | (27.1) |)% |
| Total Cost of Revenues | 47,710 | 60,134 | (12,424) | (20.7) |)% |
| Gross Profit | | | | | |
| Consulting and outsourcing | 6,497 | 6,135 | 362 | 5.9 |)% |
| Consulting and outsourcing % | 26.4 | % | 24.0 | % | |
| Procurement services | 3,998 | 5,761 | (1,763) | (30.6) |)% |
| Procurement services % | 11.9 | % | 12.4 | % | |
| Total Gross Profit | 10,495 | 11,896 | (1,401) | (11.8) |)% |
| Total Gross Profit % | 18.0 | % | 16.5 | % | |
| Operating expenses: | | | | | |
| Selling, general, and administrative expenses | 7,871 | 9,259 | (1,388) | (15.0) |)% |
| Retention bonuses to former owners of acquired entities | - | 146 | (146) | (100.0) |)% |
| Restructuring charges | 582 | - | 582 | 0.0 |)% |
| Non-cash operating expenses | | | | | |
| Stock-based compensation | 95 | 160 | (65) | (40.6) |)% |
| Warrant liability adjustment | 12 | (608) | 620 | (102.0) |)% |
| Earnout liability adjustment | 902 | 168 | 734 | 437 |)% |
| Depreciation and amortization | 1,027 | 1,360 | (333) | (24.5) |)% |
| Total operating expenses | \$10,489 | \$10,485 | \$4 | 0.0 | % |
| Percent of revenues | 18.0 | % | 14.6 | % | |
| Operating income | \$6 | \$1,411 | \$(1,405) | (99.6) |)% |
| Percent of revenues | 0.0 | % | 2.0 | % | |

Consolidated Results of Operations Overview

Management examines numerous measures when analyzing the results of our operations. Our objective is to grow the overall revenues, gross profit margins and continuous operating cash flows of the Company.

As we diversify our business and grow our consulting and outsourcing services revenues, and in particular our applications services revenues, we expect gross margins to increase. However, due to changes in types of services, we may occasionally see a decline in our services gross margin which may lead to a decline in our overall gross margin.

We measure our selling costs as a percentage of gross profits and sales compensation for the associates of the Company is derived from gross profit. We expect that our growth will lead to selling costs increasing, but as our revenues grow we expect our selling costs to grow less quickly than our gross profit, thereby decreasing selling costs as a percentage of total gross profits. We expect as we grow our general and administrative costs will decrease as a percentage of revenue. In the past, we have invested, from time to time, in additional selling, general and administrative costs in order to be able to grow our revenue more quickly based on market conditions. In addition, we may experience an increase in our overall selling, general and administrative costs prior to being able to rationalize some of the costs (for example after an acquisition, we may not experience overhead synergies immediately).

We currently categorize our revenues and costs of services into “Procurement Services” and “Consulting and Outsourcing.” We have made these categorizations in order to analyze our growth in IT professional services as a percentage of overall revenues. We have divided our business into two reporting segments. Our Federal segment sells our portfolio of services to the various agencies of the U.S. federal government. Our Commercial, State & Local and Education (“CSLED”) segment sells our portfolio of services to clients in the Commercial and SLED business units.

Total revenue for the quarter ended November 30, 2012 decreased by \$13.8 million or 19.2% compared to the quarter ended November 30, 2011. This decrease was primarily the result of a decrease in our revenue from our federal clients that was partially offset by an increase in revenue from our education clients.

The aggregate gross profit decreased by \$1.4 million for the quarter ended November 30, 2012 versus the same quarter in fiscal 2012. The decrease is primarily due to the reduction in revenue described above. The aggregate gross margin for the quarter ended November 30, 2012 increased to 18.0% from 16.5% in the same quarter in the prior year. This increase is primarily attributable to higher gross margins in our Consulting and Outsourcing revenues and a shift in our revenue mix from lower margin Procurement Services revenues to higher margin Consulting and Outsourcing revenues. Our Consulting and Outsourcing gross profit margin increased from 24.0% for the quarter ended November 30, 2011 to 26.4% for the quarter ended November 30, 2012 and our Consulting and Outsourcing gross profit increased by \$362,000 versus the same quarter in fiscal 2012 even though Consulting and Outsourcing service revenue declined. The decline in Consulting and Outsourcing service revenue is a result of our shift away from our lower margin staffing business and into higher margin Consulting and Outsourcing revenue which has resulted in lower utilization of our staffing consultants as they are transitioned from staffing projects to consulting projects that we manage.

We have itemized our operating expenses in order to present a more accurate picture of our ongoing costs. Our selling, general and administrative expenses include ongoing costs of our sales force and our administrative overhead. Selling, general and administrative expenses decreased by approximately \$1.4 million, or 15.0%, for the quarter ended November 30, 2012 versus the same quarter in fiscal 2012. This decrease is primarily the result of our ongoing cost cutting efforts and continued integration of our acquisitions.

As part of the consideration we give to acquire companies, we often include bonuses which may either be in the form of retention or performance incentives. Often these bonuses are awarded to the second layer of management within the acquired companies and, to a lesser extent, the former owners of the acquired companies. Since these bonuses are in lieu of purchase consideration, we separate them out in our segment comparative income statements. During the quarter ended November 30, 2012, we did not record any retention bonus expense; however in the quarter ended November 30, 2011 we recorded \$146,000 of retention bonus expense.

In the first quarter of fiscal 2013, the Company announced that it would be closing its headquarters in Springfield, New Jersey. In conjunction with the closure, the Company has restructured its back office operations and moved certain functions to other locations. The Company recorded a \$582,000 restructuring charge in its first quarter of fiscal 2013 associated with various employee costs in the restructuring, including severance. The Company expects to close the Springfield facility by the end of the second quarter or the beginning of the third quarter of fiscal 2013 and at that time will accrue an additional restructuring charge associated with rent and ongoing facility costs for the remainder of the lease. The Company is currently deciding where to relocate its official headquarters.

Stock based compensation records the expense of any stock consideration awarded to management. We believe providing management with stock-based compensation properly motivates management to increase the value of the Company's stock over time and allows us to better retain key management. It also allows the Company to increase its operating cash flows instead of paying out large cash awards for performance. Stock based compensation decreased by approximately \$65,000 for the quarter ended November 30, 2012 to \$95,000 from the same quarter in fiscal 2012.

As explained in Note 6 to our financial statements, the Company has issued various warrants. These warrants are marked-to-market each quarter. As the stock price increases and as the warrant moves closer to expiration, the Company records an expense, and as it decreases it records income related to these warrants. The warrant liability adjustment for the quarter ended November 30, 2012 was an expense of \$12,000 versus income of \$608,000 for the quarter ended November 30, 2011. This is the result of the increase in the Company's stock price during the quarter ended November 30, 2012 versus a decrease in the Company's stock price for the same quarter in fiscal 2012.

The Company recorded \$902,000 in earnout liability adjustment for the quarter ended November 30, 2012 as compared to a \$168,000 earnout liability adjustment for the quarter ended November 30, 2011. This non-cash charge represents an increase in the probability of the earn-out liability being paid for previous acquisitions by the Company based on the achievement of performance targets and the effect of the time value of money since the earn outs are closer to being paid.

Depreciation and amortization decreased by \$333,000 to \$1.0 million for the quarter ended November 30, 2012 as compared to the same quarter in fiscal 2012. This is primarily the result of the lower carrying value of the Company's customer relationship asset due to an impairment charge totaling \$4.1 million recorded during the fourth quarter of fiscal 2012.

Operating income was \$6,000 for the quarter ended November 30, 2012 as compared to \$1.4 million for the quarter ended November 30, 2011. This is the result of the decrease changes described above.

We have divided our business into three segments as of June 1, 2012:

- Federal - provides IT consulting services, outsourcing services, and procurement services to the various agencies of the U.S. federal government.
- Commercial, State & Local and Education ("CSLED") – provides IT consulting services, outsourcing services, and procurement services to clients in the commercial, state & local and education sectors.
 - Corporate- Provides operational support to the segments and generates no revenue or gross profit.

We discuss the results of each segment below.

Results of Operations - Federal

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 November 30, 2012 and 2011.

FEDERAL STATEMENTS OF OPERATIONS (In thousands)

| | Three Months Ended November 30, | | | |
|---|------------------------------------|----------------|-------------------|-----------------|
| | 2012 | 2011 | Change | % |
| Revenues | | | | |
| Consulting and outsourcing | \$2,816 | \$2,958 | \$(142) | (4.8)% |
| Procurement services | 20,499 | 39,346 | (18,847) | (47.9)% |
| Total Revenues | 23,315 | 42,304 | (18,989) | (44.9)% |
| Cost of Revenues | | | | |
| Cost of consulting and outsourcing | 2,245 | 2,170 | 75 | 3.5 % |
| Cost of procurement services | 18,055 | 34,482 | (16,427) | (47.6)% |
| Total Cost of Revenues | 20,300 | 36,652 | (16,352) | (44.6)% |
| Gross Profit | | | | |
| Consulting and outsourcing | 571 | 788 | (217) | (27.5)% |
| Consulting and outsourcing % | 20.3 % | 26.6 % | | |
| Procurement services | 2,444 | 4,864 | (2,420) | (49.8)% |
| Procurement services % | 11.9 % | 12.4 % | | |
| Total Gross Profit | 3,015 | 5,652 | (2,637) | (46.7)% |
| Total Gross Profit % | 12.9 % | 13.4 % | | |
| Operating expenses: | | | | |
| Selling, general, and administrative expenses | 1,273 | 1,911 | (638) | (33.4)% |
| Non-cash operating expenses | | | | |
| Earnout liability adjustment | 74 | (38) | 112 | (294.7)% |
| Depreciation and amortization | 203 | 274 | (71) | (25.9)% |
| Total operating expenses | \$1,550 | \$2,147 | \$(597) | (27.8)% |
| Percent of revenues | 6.6 % | 5.1 % | | |
| Operating income | \$1,465 | \$3,505 | \$(2,040) | (58.2)% |
| Percent of revenues | 6.3 % | 8.3 % | | |

Revenues - Federal

Our Federal segment's total revenue decreased by \$19.0 million for the quarter ended November 30, 2012 as compared to the same quarter in fiscal 2012. Our consulting and outsourcing revenue decreased by \$143,000, or 4.8%, to \$2.8 million for the quarter ended November 30, 2012 as compared to \$3.0 million for the quarter ended

November 30, 2011. Our procurement services revenue decreased by \$18.8 million, or 47.9%, to \$20.5 million for the quarter ended November 30, 2012 as compared to \$39.3 million for the quarter ended November 30, 2011. Historically, the Company has had a small number of large orders which accounted for 30-50% of the Federal segment's revenues during the first quarter of its fiscal year. Over time, however, the Company has been shifting its focus to longer term projects that last throughout the year, and consulting and outsourcing revenues which are delivered throughout the year. Management believes this shift and reduced demand due to the impending fiscal cliff caused a drop in the procurement revenues in the first quarter in fiscal 2013. Furthermore, procurement services revenue for the quarter ended November 30, 2011 was higher as there was a significant increase in orders after the budget and debt crisis in the federal government was resolved in 2011. Management has also reduced selling, general and administrative expenses to handle the Federal segment's less cyclical revenue base in the first quarter in fiscal 2013 compared to the same quarter in fiscal 2012.

Gross Profit - Federal

Aggregate gross profit for our Federal segment decreased \$2.6 million, or 46.7%, to \$3.0 million for the quarter ended November 30, 2012 compared to the same quarter in fiscal 2011. Procurement services gross profit decreased by \$2.4 million or 49.8% to \$2.4 million for the quarter ended November 30, 2012 as compared to \$4.8 million for the quarter ended November 30, 2011. This decrease was caused primarily from the revenue decreases described above. Aggregate gross margin decreased from 13.4% to 12.9% primarily due to pricing competition given the spending reduction by Federal clients. The 6.4 percentage point decline in the Federal segment's consulting and outsourcing gross margin is primarily related to a decline in utilization rates as some of our Federal segment's clients delayed the work on projects and other projects in our Federal segment's application services business were relocated to different client facilities and not renewed.

Operating Expenses - Federal

Selling, general and administrative expenses decreased by \$638,000 to \$1.3 million for the quarter ended November 30, 2012 as compared to \$1.9 million for the for the quarter ended November 30, 2011. This decrease was primarily the result of a planned reduction in sales personnel during fiscal 2012.

Non-cash expenses in the quarter ended November 30, 2012 include the earnout liability adjustment of \$74,000 associated with the increased likelihood of an acquisition achieving their earnout.

Operating Income – Federal

Operating income for our Federal segment decreased by \$2.0 million, or 58.2%, to \$1.5 million for the quarter ended November 30, 2012 as compared to \$3.5 million for the quarter ended November 30, 2011. This decrease is primarily related to the revenue declines described above and partially offset by a decline in selling, general and administrative expenses.

For purposes of this discussion, other expenses, including interest, are covered in our Corporate segment.

Results of Operations – CSLED

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of our Results of Operations for the quarters ended November 30, 2012 and 2011 for our CSLED segment.

Commercial, State & Local, and Education
STATEMENTS OF OPERATIONS
(In thousands)

| | Three Months Ended November 30, | | Change | % | |
|---|------------------------------------|----------------|-----------------|----------------|-----------|
| | 2012 | 2011 | | | |
| Revenues | | | | | |
| Consulting and outsourcing | \$21,763 | \$22,656 | \$(893) | (3.9) |)% |
| Procurement services | 13,127 | 7,070 | 6,057 | 85.7 |)% |
| Total Revenues | 34,890 | 29,726 | 5,164 | 17.4 |)% |
| Cost of Revenues | | | | | |
| Cost of consulting and outsourcing | 15,837 | 17,309 | (1,472) | (8.5) |)% |
| Cost of procurement services | 11,573 | 6,173 | 5,400 | 87.5 |)% |
| Total Cost of Revenues | 27,410 | 23,482 | 3,928 | 16.7 |)% |
| Gross Profit | | | | | |
| Consulting and outsourcing | 5,926 | 5,347 | 579 | 10.8 |)% |
| Consulting and outsourcing % | 27.2 % | 23.6 % | | | |
| Procurement services | 1,554 | 897 | 657 | 73.2 |)% |
| Procurement services % | 11.8 % | 12.7 % | | | |
| Total Gross Profit | 7,480 | 6,244 | 1,236 | 19.8 |)% |
| Total Gross Profit % | 21.4 % | 21.0 % | | | |
| Operating expenses: | | | | | |
| Selling, general, and administrative expenses | 3,182 | 3,991 | (809) | (20.3) |)% |
| Retention bonuses to former owners of acquired entities | - | 146 | (146) | (100.0) |)% |
| Non-cash operating expenses | | | | | |
| Stock-based compensation | 17 | 30 | (13) | (43.3) |)% |
| Earnout liability adjustment | 828 | 206 | 622 | 302 |)% |
| Depreciation and amortization | 655 | 939 | (284) | (30.2) |)% |
| Total operating expenses | \$4,682 | \$5,312 | \$(630) | (11.9) |)% |
| Percent of revenues | 13.4 % | 17.9 % | | | |
| Operating income | \$2,798 | \$932 | \$1,866 | 200.2 |)% |
| Percent of revenues | 8.0 % | 3.1 % | | | |

Comparison of quarters ended November 30, 2012 and 2011 – CSLED

Revenues – CSLED

Our CSLED segment's total revenues increased \$5.2 million, or 17.4%, to \$34.9 million for the quarter ended November 30, 2012 as compared to \$29.7 million for the quarter ended November 30, 2011. The increase in CSLED total revenue was primarily attributable to an increase in procurement services revenue partially offset by a decline in consulting and outsourcing revenue.

Consulting and outsourcing revenue decreased \$892,000, or 3.9%, to \$21.8 million for the quarter ended November 30, 2012 as compared to \$22.7 million for the quarter ended November 30, 2011. This decrease is primarily attributable to a \$2.5 million decline in our lower margin staffing revenue and was offset by a \$1.7 million increase in revenue from our Education clients and additional increases from our commercial applications outsourcing clients.

Procurement services revenue increased by \$6.1 million for the quarter ended November 30, 2012 to \$13.1 million as compared to \$7.1 million for the quarter ended November 30, 2011. A substantial portion of the procurement services revenue increase is related to our education clients resuming recurring, long-term projects which had been delayed during the quarter ended November 30, 2011.

Our CSLED segment revenues, by client type, are comprised of the following (in thousands):

| | For the Year Ended | | | | | |
|------------------------------|--------------------|-------|---|-------------------|-------|---|
| | November 30, 2012 | | | November 30, 2011 | | |
| Commercial Companies | \$19,171 | 54.9 | % | \$21,074 | 70.9 | % |
| Education and Other | 14,780 | 42.4 | % | 6,882 | 23.2 | % |
| State and Local Governments | 594 | 1.7 | % | 1,317 | 4.4 | % |
| Canadian Government Agencies | 345 | 1.0 | % | 453 | 1.5 | % |
| Total Revenues | \$34,890 | 100.0 | % | \$29,726 | 100.0 | % |

For the quarters ended November 30, 2012 and 2011, revenues from commercial clients represented approximately 54.9% and 70.9% of our total CSLED segment revenues, respectively. The decrease in revenues for the quarter ended November 30, 2012 as compared to the quarter ended November 30, 2011 is related to the \$2.5 million decline in our lower margin staffing revenue, partially offset by increases in our applications services outsourcing revenue. We have restructured our staffing business by reducing our sales efforts in this business as the return on our selling costs have continued to decrease. This restructuring has resulted in a decline in revenues but an increase in profitability in the staffing practices. We expect the decline in revenues to continue through 2013. We believe over the long-term, however, this business will contribute more to the bottom line based on the restructuring.

For the quarter ended November 30, 2012, revenues from our education business increased by \$7.9 million compared with the quarter ended November 30, 2011. The majority of this increase can be attributed to timing delays from our education clients in fiscal 2012, which have not been a problem during the first quarter of fiscal 2013.

Our State and Local government business revenues decreased by \$723,000 for the quarter ended November 30, 2012 as compared to the quarter ended November 30, 2011. This decrease is primarily due to the completion, in the fourth quarter fiscal 2012, of several infrastructure services projects in state and local governments in the U.S. Northeast.

Gross Profit - CSLED

Aggregate gross profit for our CSLED segment increased \$1.2 million, or 19.8%, to \$7.4 million for quarter ended November 30, 2012 as compared to \$6.2 million for the quarter ended November 30, 2011. Approximately one-half of this increase comes from the increased procurement services revenue and the other half of the increase comes from a shift in the mix of business away from the lower margin staffing business and into higher margin consulting and outsourcing

Operating Expenses – CSLED

Selling general and administrative expenses for the quarter ended November 30, 2012 decreased by approximately \$809,000 compared to the quarter ended November 30, 2011. This decrease is the result of our cost cutting efforts.

During the quarter ended November 30, 2012, we did not record any retention bonus expenses. In the quarter ended November 30, 2011, however, we recorded \$146,000 of these expenses.

Non-cash operating expenses for the quarter ended November 30, 2012 totaled \$1.5 million versus \$1.2 million for the quarter ended November 30, 2011. The increase over fiscal 2012 includes a \$623,000 increase in earnout liability adjustment offset in part by a \$284,000 decrease in amortization of intangible assets resulting from an impairment charge in the fourth quarter of fiscal 2012.

Operating Income – CSLED

Operating income for the CSLED segment increased \$1.9 million, or 200.3%, to \$2.8 million for the quarter ended November 30, 2012, compared to \$932,000 for the quarter ended November 30, 2011.

Results of Operations – Corporate

| | Three Months Ended November 30, | | | | |
|---|---------------------------------|----------|----------|---------|---|
| | 2012 | 2011 | Change | | % |
| Operating expenses: | | | | | |
| Selling, general, and administrative expenses | \$ 3,416 | \$ 3,357 | \$ 59 | 1.8 | % |
| Restructuring charges | 582 | - | 582 | 0.0 | % |
| Stock-based compensation | 78 | 130 | (52) | (40.0) | % |
| Warrant liability adjustment | 12 | (608) | 620 | (102.0) | % |
| Depreciation and amortization | 169 | 147 | 22 | 15.0 | % |
| Total operating expenses | \$ 4,257 | \$ 3,026 | \$ 1,231 | 40.7 | % |

Operating Expenses – Corporate

Our Corporate segment provides operational support to the Federal and CSLED segments and generates no revenue or gross profit. As we acquire new companies, we consolidate the back office functions into our Corporate shared services groups and, therefore, we will see an increase in these costs as we shift costs out of the operating segments and into Corporate. It is then our goal, once systems and processes have been harmonized, to move these costs to the environment that provides high quality service at a lower cost.

Our Corporate costs increased \$1.2 million from \$3.0 million for the quarter ended November 30, 2011 to \$4.2 million for the quarter ended November 30, 2012. Of this amount, \$647,000 is from increases in non-cash expenses. The remainder of the increase is from restructuring charges and moving various costs out of the segments and into Corporate where they can be controlled more effectively.

Recently Issued Accounting Standards

Intangibles – Goodwill and Other

In September 2011, the FASB issued ASU 2011-08, Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment. ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15,

2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The adoption of ASU 2011-08 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Offsetting Assets and Liabilities

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. ASU 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods. The adoption of ASU 2011-11 may expand existing disclosure requirements, which the Company is currently evaluating.

Liquidity and Capital Resources

The Company incurred a significant net loss in fiscal 2012 from non-cash charges and for the three months ended November 30, 2012 due to restructuring charges and non-cash charges. However, the Company generated sufficient cash from operations in 2012 to meet all of its obligations when due and paid down over \$2 million of its debt balance during the year. The Company believes it has sufficient cash flow from operations and availability under its line of credit to support all its cash needs in fiscal 2013.

The U.S. government agencies we service are historically slow in making payments of our procurement sales. This delay in payments caused the Company to experience large working capital fluctuations and increased working capital requirements during the periods of peak government deliveries. As a result, at times, we need to pay our vendors more quickly than we receive payments from the government, which leads to increases in our borrowing under our line of credit and a decline in liquidity. Management took steps to improve the liquidity by increasing our long-term borrowings over short-term borrowings. We obtained subordinated financing of \$3 million in December 2011, of which approximately \$2.5 million was used to pay down our line of credit. In addition, management is taking further steps to improve the collection process with our government clients. There can be no guarantee, however, that these efforts will be successful.

The Company believes that its existing resources together with available borrowings under its PNC Credit Facility and expected cash flow from operations will provide sufficient liquidity for at least the next 12 months.

Net cash used in operations was \$2.5 million for the three months ended November 30, 2012 as compared to net cash used in operations of \$4.5 million for the three months ended November 30, 2011. The difference between the two periods is primarily related to acquisition related payments made during the three months ended November 30, 2011.

Purchases of property and equipment for the three months ended November 30, 2012 and 2011 were \$203,000 and \$336,000, respectively. The purchases for the three months ended November 30, 2012 and 2011 related primarily to the purchase of computer equipment for internal use and furniture and fixtures. During the three months ended November 30, 2012, the Company capitalized \$91,000 in costs associated with redesigning the Company's website.

Net cash from financing activities for the three months ended November 30, 2012 and 2011 was \$2.0 million and \$3.6 million, respectively, and was primarily related to increased borrowings on our Credit Facility.

We are a net borrower; consequently, we believe our cash balance must be viewed along with the available balance on our line of credit. Cash at November 30, 2012 of \$1.1 million represented a decrease of approximately \$700,000 from cash of \$1.8 million at August 31, 2012.

Credit Facility

At November 30, 2012 and August 31, 2012, the Company had an outstanding balance under the revolving portion of the PNC Credit Facility of \$14.0 million and \$12.0 million, respectively. Net availability under the revolving portion of the PNC Credit Facility as of November 30, 2012 and August 30, 2012 was \$3.8 million and \$4.2 million, respectively.

On December 30, 2011, Emtec NJ, Emtec LLC, Emtec Federal, EGS LLC, Luceo, eBAS, Aveeva, EIS-US, KOAN-IT US, SDI, Dinero, Covelix and Emerging, (collectively the "Borrower") entered into a Revolving Credit and Security Agreement (the "PNC Loan Agreement") with PNC Bank, National Association ("PNC"), as lender and agent. The PNC Loan Agreement provides for a senior secured revolving credit facility in an amount not to exceed (i) \$30.0 million for the period from February 1 through August 31 each year during the term of the facility and (ii) \$45.0 million for the period from September 1 through January 31 each year during the term of the facility (the "PNC Credit Facility"). The PNC Credit Facility also includes a \$7.0 million sublimit for the issuance of letters of credit. The proceeds of the PNC Credit Facility were used to refinance all of the Borrower's outstanding indebtedness under its then existing senior credit facility with De Lage Landen Financial Services, Inc. ("DLL") pursuant to which DLL provided a revolving credit loan and floorplan loan (the "DLL Credit Facility"), to pay off all indebtedness of EIS-Canada under a loan agreement with De Lage Landen Financial Services Canada Inc. ("DLL Canada") pursuant to which DLL Canada provided EIS-Canada with a revolving credit line of C\$5 million, to pay related costs and expenses and for working capital and other general corporate purposes. The PNC Loan Agreement will remain in effect until December 29, 2014, unless sooner terminated by the Borrower or PNC.

Borrowings under the PNC Loan Agreement will bear regular interest at a rate equal to the Alternate Base Rate (as defined in the PNC Loan Agreement) plus 1.0% or the Eurodollar Rate (as defined in the PNC Loan Agreement) plus 3.0% on the outstanding principal amount. As of November 30, 2012, the interest rate was 4.25%.

The PNC Loan Agreement contains certain customary affirmative and negative covenants, including, among other things: (i) affirmative covenants requiring the Borrower to provide certain financial statements and schedules to PNC, maintain their legal existence, keep their collateral in good condition, and provide certain notices to PNC; and (ii) negative covenants that provide for limitations on other indebtedness, liens, amendments of organizational documents, asset sales, capital expenditures, issuance of capital stock, investments, and transactions with affiliates.

The PNC Loan Agreement also contains certain customary representations and warranties and events of default, including, among other things, failure to pay interest, principal or fees due under the PNC Loan Agreement, any material inaccuracy of any representation and warranty, any default having occurred under any Subordinated Debt (as such term is defined in the PNC Loan Agreement), and the occurrence of bankruptcy or other insolvency events. Certain of the events of default are subject to exceptions and materiality qualifiers. If an event of default shall occur and be continuing under the PNC Loan Agreement, PNC may, among other things, accelerate the repayment of the Borrower's obligations under the PNC Credit Facility.

To secure the payment of the obligations under the PNC Loan Agreement, the Borrower granted to PNC a security interest in, and a lien upon, all of its respective interests in its respective assets, including receivables, equipment, general intangibles, inventory, investment property, subsidiary stock, leasehold interests, goods, deposit accounts, letter of credit rights, commercial tort claims and insurance proceeds. All such security interests are subject to the terms of a Subordination Agreement, dated December 30, 2011 among PNC, NewSpring SBIC Mezzanine Capital II, L.P. ("NewSpring"), Peachtree II, L.P., (NewSpring and Peachtree, collectively, the "Investors") and the Borrower, as amended on March 20, 2012 (the "Subordination Agreement").

On March 20, 2012, the Borrower and EIS-Canada entered into a First Amendment and Joinder to Loan Documents with PNC, pursuant to which PNC agreed to make certain amendments to the PNC Loan Agreement and the Other Documents (as such term is defined in the PNC Loan Agreement and together with the PNC Loan Agreement, the "PNC Loan Documents"), including (1) joining EIS -Canada to the PNC Loan Documents, (2) amending the definition of EBITDA to revise certain add-backs and deductions thereto and (3) revising the covenants and representations and warranties included in the PNC Loan Agreement to include certain customary covenants and representations and warranties relating to EIS-Canada.

To secure the payment of the obligations of EIS-Canada under the PNC Loan Agreement, EIS-Canada granted to PNC a security interest in, and a lien upon, all of its interests in its assets, including accounts, securities entitlements, securities accounts, futures accounts, futures contracts and investment property, deposit accounts, instruments, documents, chattel paper, inventory, goods, equipment, fixtures, agricultural liens, as-extracted collateral, letter of credit rights and intangibles of every kind. All such security interests are subject to the terms of the Subordination Agreement.

On June 28, 2012, the Borrower entered into a Second Amendment to Loan Documents (the “Second Amendment”) with PNC, pursuant to which PNC has agreed to make an amendment to the PNC Loan Agreement. The modification in the Second Amendment provided for amendment of the calculation of the amount of borrowings under the secured revolving senior credit facility, specifically related to outstanding letters of credit for inventory purchases.

Prior to the refinancing with PNC on December 30, 2011, the Company had a revolving credit and floorplan with DLL. As of November 30, 2011, the DLL Credit Facility provided for aggregate borrowings of the lesser of \$32.0 million or 85% of the Borrower’s eligible accounts receivable, plus 100% of unsold inventory financed by DLL and 40% of all other unsold inventory. Under the DLL Credit Facility, the interest rate for revolving credit loans was the base rate plus 3.25% and the interest rate for floorplan loans was 6.25% in excess of the base rate. The DLL Credit Facility was to expire on December 7, 2012.

On December 14, 2012, the Borrower entered into a Third Amendment to Loan Documents (the “Third Amendment”) with PNC, pursuant to which PNC has agreed to make certain amendments to the PNC Loan Agreement. The modifications provided for in the Third Amendment, among other things, (1) amend the definition of “Formula Amount” to reduce the percentage of outstanding trade letters of credit for inventory purchases used to calculate amounts available for borrowing under the Loan Agreement, (2) amend the definition of “EBITDA” to, for fiscal quarters ended on or prior to August 31, 2012, add back intangible asset impairment charges and goodwill impairment charges relating to acquisitions not to exceed \$10,000,000 in the aggregate, (3) change the point in time with respect to which the fixed charge coverage ratio covenant relating to earn out payments is calculated and (4) provide the consent of PNC and the lenders to a release of a security interest in certain receivables.

On January 14, 2013, the Borrower entered into a Fourth Amendment to Loan Documents (the “Fourth Amendment”) with PNC, pursuant to which PNC has agreed to make certain amendments to the PNC Loan Agreement. The modifications provided for in the Fourth Amendment, among other things, (1) amend the definition of “EBITDA” to include restructuring charges associated with closing the Borrower’s Springfield, New Jersey facility and (2) amend the definition of “Senior Debt Payments” to include payments associated with those restructuring charges.

As of November 30, 2012, the Company determined it was in compliance with its financial covenants under the PNC Credit Facility.

Subordinated Debt

On December 30, 2011, the Borrower entered into an Amended and Restated Subordinated Loan Agreement (the “Subordinated Loan Agreement”) with the Investors pursuant to which: (i) Peachtree provided an additional subordinated term loan in an original principal amount of \$3.0 million (together with the existing subordinated term loan from NewSpring in the original principal amount of \$10.0 million), (ii) NewSpring was appointed as collateral agent, (iii) the Investors waived any event of default arising from (a) the Borrower failing to meet the Total Funded Senior Debt to Pro Forma Adjusted EBITDA Ratio covenant (as set forth in the Subordinated Loan Agreement) for the trailing twelve months ending November 30, 2011 and (b) the Borrower failing to comply with the covenant in the Subordinated Loan Agreement prohibiting a Borrower name change without notice to, or the consent of, NewSpring, and (iv) the Investors agreed to make certain other amendments to the Subordinated Loan Agreement, including amending the Total Funded Senior Debt to Pro Forma Adjusted EBITDA Ratio covenant to provide that the Company and its consolidated subsidiaries shall maintain as of the last business day of the fiscal quarters ending on February 28, 2012 and May 31, 2012, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA (as such terms are defined in the Subordinated Loan Agreement) on a trailing twelve months basis for such period of not less 4.0 to 1.0 for the fiscal quarter ending on February 28, 2012 and of not less than 3.75 to 1.0 for the fiscal quarter ending on May 31, 2012. There are no scheduled principal payments on the Subordinated Loan Agreement until the maturity date of August 15, 2016.

Borrowings under the Subordinated Loan Agreement will bear regular interest at a rate equal to 12.0% per annum on the outstanding principal amount. Accrued and unpaid regular interest is payable on the last business day of each fiscal quarter beginning with November 30, 2011 through August 15, 2016 at which time all unpaid principal and interest is due. Borrowings under the Subordinated Loan Agreement will bear additional interest of 2.0% per annum and this accrued and unpaid additional interest of 2.0% is, at the Company's option, payable in cash, or added to the principal amount outstanding, on the last business day of each fiscal quarter.

On August 29, 2012, the Borrower entered into Amendment No. 2 (the "Amendment") to the Subordinated Loan Agreement with the Investors, among other things, (1) amend the definition of "Fixed Charge Coverage Ratio" to allow the Borrower to fully offset the amount of cash taxes paid by any tax refunds received, (2) amend and restate the requirements under the financial ratios and covenants in their entirety as follows: (a) require the Borrower to maintain: (i) as of the last Business Day (as defined in the Subordinated Loan Agreement) of the fiscal quarter ending August 31, 2012, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period of not greater than 4.5 to 1.0, (ii) thereafter as of the last Business Day of each fiscal quarter ending on February 28th, May 31st and August 31st of each fiscal year, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period of not greater than 3.75 to 1.0, (c) eliminate the requirement for the Borrower to test of the last Business Day of each fiscal quarter ending on November 30th of each fiscal year, a ratio of Total Funded Senior Debt on such date to Pro Forma Adjusted EBITDA on a trailing 12 months basis for such period and (d) require the Borrower to maintain, as of the last Business Day of each fiscal quarter on a trailing 12 months basis, a Fixed Charge Coverage Ratio of not less than 1.25 to 1.0.

As of November 30, 2012, the Company has determined it was in compliance with its financial covenants under the Subordinated Loan Agreement with NewSpring and Peachtree.

Liquidity

We anticipate that our primary sources of liquidity in fiscal year 2013 will be cash generated from working capital management, operations, trade vendor credit and cash available to us under the PNC Credit Facility. Net availability under the revolving portion of the PNC Credit Facility as of November 30, 2012 and August 31, 2012 was \$3.8 million and \$4.2 million, respectively.

Our future financial performance will depend on our ability to continue to reduce and manage operating expenses as well as our ability to grow revenues. Any loss of clients, whether due to price competition or technological advances, will have an adverse effect on our revenues. Our future financial performance could be negatively affected by unforeseen factors and unplanned expenses.

We have 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.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the U.S. 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 SEC 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, business combinations,

allowance for doubtful accounts, inventory valuation reserve, the assessment of recoverability of long-lived assets, the assessment of recoverability of goodwill and intangible assets, rebates and income taxes.

Revenue Recognition

We are an IT services provider delivering consulting, staffing, application services and infrastructure solutions to commercial, education, federal, state and local government clients. Our specific practices include IT consulting, communications, data management, enterprise computing, managed services, business service management solutions, training, storage and data center planning and development and staff augmentation solutions.

It is impracticable for us to report the revenues from external clients for each of our products and services or each group of similar products and services offered. Our revenue recognition policy is as follows:

Consulting and outsourcing revenue includes time billings based upon billable hours charged to clients, fixed price short-term projects, and hardware maintenance contracts. These contracts generally are task specific and do not involve multiple deliverables. Revenues from time billings are recognized as services are delivered. Revenues from short-term fixed price projects are recognized using the proportionate performance method by determining the level of service performed based upon the amount of labor cost incurred on the project versus the total labor costs to perform the project because this is the most readily reliable measure of output. Revenues from hardware maintenance contracts are recognized ratably over the contract period.

We recognize revenue from the sales of products when risk of loss and title passes, which is upon client acceptance.

Procurement revenue represents sales of computer hardware and pre-packaged software. These arrangements often include software installations, configurations and imaging, along with delivery and set-up of hardware. We follow the criteria contained in FASB Accounting Standards Codification (“ASC”) 605-25, Revenue Recognition, Multiple-Element Arrangements, in recognizing revenue associated with these transactions. We perform software installations, configurations and imaging services at our locations prior to the delivery of the product. Some client arrangements include “set-up” services performed at client locations where our personnel perform the routine tasks of removing the equipment from boxes and setting up the equipment at client workstations by plugging in all necessary connections. This service is usually performed the same day as delivery. Revenue is recognized on the date of acceptance, except as follows:

- In some instances, the “set-up” service is performed after date of delivery. We recognize revenue for the “hardware” component at date of delivery when the amount of revenue allocable to this component is not contingent upon the completion of “set-up” services and, therefore, our client has agreed that the transaction is complete as to the “hardware” component. In instances where our client does not accept delivery until “set-up” services are completed, we defer all revenue in the transaction until client acceptance occurs.

- There are occasions when a client requests a transaction on a “bill and hold” basis. We follow the ASC 605-25 criteria and recognize revenue from these sales prior to date of physical delivery only when all the criteria of ASC 605-25 are met. We do not modify our normal billing and credit terms for these clients. The client is invoiced at the date of revenue recognition when all of the criteria have been met. At November 30, 2012 and August 31, 2012, accounts receivable related to bill and hold sales totaled \$0. Total revenues from bill and hold sales were \$1.2 million and \$0 with gross profit of \$180,000 and \$0 which was included in the results of operations for the three months ended November 30, 2012 and 2011, respectively.
- Revenue is recognized net of client returns. We have experienced minimal client returns. Since some eligible products must be returned to us within 30 days from the date of the invoice, we reduce the procurement revenue and cost of goods in each accounting period based on the actual returns that occurred in the next 30 days after the close of the accounting period.
- We recognize revenue from sale arrangements that contain both procurement revenue and services and consulting revenue in accordance with ASC 605-25 based on the relative fair value of the individual components. The relative fair value of individual components is based on historical sales of the components sold separately.
- Revenues from the sale of third party manufacturer warranties and manufacturer support service contracts where the manufacturer is responsible for fulfilling the service requirements of the client are recognized immediately on their contract sale date. Manufacturer support service contracts contain cancellation privileges that allow our clients to terminate a contract with 90 days’ written notice. In this event, the client 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 client cancellations of any significance during our most recent 3-year history and we do not expect cancellations of any significance in the future. As the Company is not obligated to perform these services, we determined it is more appropriate to recognize the net amount of the revenue and related payments as net revenue at the time of sale, pursuant to the guidelines of ASC 605-45, Revenue Recognition, Principal Agent Considerations. Revenue from the sale of warranties and support service contracts is recognized on a straight-line basis over the term of the contract, in accordance with ASC 605-20, Revenue Recognition, Services.

Business Combinations

The Company follows applicable sections of ASC 805, Business Combinations, which address accounting for business combinations using the acquisition method of accounting (previously referred to as the purchase method). Among the significant changes, this standard requires a redefining of the measurement date of a business combination, expensing direct transaction costs as incurred, capitalizing in-process research and development costs as an intangible asset and recording a liability for contingent consideration at the measurement date with subsequent re-measurements recorded as general and administrative expense. This standard also requires costs for business restructuring and exit activities related to the acquired company to be included in the post-combination financial results of operations and also provides guidance for the recognition and measurement of contingent assets and liabilities in a business combination.

The Company's business acquisitions have historically been made at prices above the fair value of the acquired net assets, resulting in goodwill, based on our expectations of synergies of combining the businesses. These synergies include elimination of redundant facilities, functions and staffing; use of our existing commercial infrastructure to expand sales of the acquired businesses' products; and use of the commercial infrastructure of the acquired businesses to cost-effectively expand procurement sales.

Significant judgment is required in estimating the fair value of intangible assets and in assigning their respective useful lives. The fair value estimates are based on available historical information and on future expectations and assumptions deemed reasonable by management, but are inherently uncertain.

The Company generally employs the income method to estimate the fair value of intangible assets, which is based on forecasts of the expected future cash flows attributable to the respective assets. Significant estimates and assumptions inherent in the valuations reflect a consideration of other marketplace participants, and include the amount and timing of future cash flows (including expected growth rates and profitability), the underlying product/service life cycles, economic barriers to entry and the discount rate applied to the cash flows. Unanticipated market or macroeconomic events and circumstances may occur, which could affect the accuracy or validity of the estimates and assumptions.

Allocation of the purchase price for acquisitions is based on estimates of the fair value of the net assets acquired and, for acquisitions completed within the past year, is subject to adjustment upon finalization of the purchase price allocation. The estimated useful lives of the individual categories of intangible assets were based on the nature of the applicable intangible asset and the expected future cash flows to be derived from the intangible asset. Amortization of intangible assets with finite lives is recognized over the shorter of the respective lives of the agreement or the period of time the assets are expected to contribute to future cash flows. We amortize our finite-lived intangible assets on patterns in which the economic benefits are expected to be realized.

Allowance For Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our clients 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 clients 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.

Inventory Valuation

Inventory is stated at the lower of average cost or market. Inventory is entirely finished goods purchased for resale and consists of computer hardware, computer software, computer peripherals and related supplies. We provide an inventory reserve for products we determine are obsolete or where salability has deteriorated based on management's review of products and sales.

Long-Lived Assets

Long-lived assets, including definite-lived intangible assets and property and equipment, are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable in accordance with ASC 360, Property, Plant and Equipment. Recoverability of long-lived assets is assessed by a comparison of the carrying amount to the estimated undiscounted future net cash flows expected to result from the use of the assets and their eventual disposition. If estimated undiscounted future net cash flows are less than the carrying amount, the asset is considered impaired and a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the asset.

Goodwill and Intangible Assets

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired companies. In accordance with ASC 350, Intangibles - Goodwill and Other, goodwill is not amortized but tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company has set an annual impairment testing date of June 1. The impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of the reporting unit and compares it to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with ASC 805, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. The Company's policy is to perform its annual impairment testing for all reporting units as of June 1. An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount.

Definite-lived intangible assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable in accordance with ASC 360, Property, Plant and Equipment. Recoverability of definite-lived intangible assets is assessed by a comparison of the carrying amount to the estimated undiscounted future net cash flows expected to result from the use of the assets and their eventual disposition. If estimated undiscounted future net cash flows are less than the carrying amount, the asset is considered impaired and a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the asset.

Rebates

Rebates received on purchased products are recorded in the accompanying consolidated statements of operations as a reduction of the cost of revenues, in accordance with ASC 605-50, Revenue Recognition, Customer Payments and Incentives.

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 our financial statements or tax returns. In estimating future tax consequences, we generally consider 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 of the deferred tax assets will not be realized.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

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Item 4. Controls and Procedures

(a) 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 defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of November 30, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures including the accumulation and communication of disclosures to the Company’s Chief Executive Officer and Chief Financial Officer were appropriate to allow timely decisions regarding required disclosure, were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving the stated goals under all potential future conditions, regardless of how remote.

(b) There has not been any change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) under the Exchange Act that occurred during the quarter ended November 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The Company is occasionally involved in various lawsuits, claims, and administrative proceedings arising in the normal course of business. The Company believes that any liability or loss associated with such matters, individually or in the aggregate, will not have a material adverse effect on the Company's financial condition or results of operations.

Item 1A. Risk Factors

Not required for smaller reporting companies.

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

Not Applicable.

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Item 3. Defaults Upon Senior Securities

Not Applicable.

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Item 4. Mine Safety Disclosures

Not Applicable.

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Item 5. Other Information

Not Applicable.

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Item 6. Exhibits

Exhibit 31.1 - Rule 13a-14(a)/15d-14(a) Certification of Dinesh R. Desai, Principal Executive Officer, of Emtec, Inc. dated January 14, 2013.

Exhibit 31.2 - Rule 13a-14(a)/15d-14(a) Certification of Gregory P. Chandler, Principal Financial Officer, of Emtec, Inc. dated January 14, 2013.

Exhibit 32.1 - Section 1350 Certificate of Dinesh R. Desai, Principal Executive Officer, of Emtec, Inc. dated January 14, 2013.

Exhibit 32.2 - Section 1350 Certificate of Gregory P. Chandler, Principal Financial Officer, of Emtec, Inc. dated January 14, 2014.

101.INS**XBRL Instance

101.SCH**XBRL Taxonomy Extension Schema

101.CAL**XBRL Taxonomy Extension Calculation

101.DEF**XBRL Taxonomy Extension Definition

101.LAB**XBRL Taxonomy Extension Labels

101.PRE**XBRL Taxonomy Extension Presentation

** information is furnished and not filed or a part of a registration statement or prospectus for purposes of XBRL 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.

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/ DINESH R. DESAI
Dinesh R. Desai
Chairman and Chief
Executive Officer
(Principal Executive Officer)

By: /s/ GREGORY P. CHANDLER
Gregory P. Chandler
Chief Financial Officer
(Principal Financial Officer)

Date: January 14, 2013