Emtec®

Business & Technology Empowered

2013 Financial Report

Emtec, Inc. and Subsidiaries

Financial Report
August 31, 2013

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McGladrey LLP

McGladrey

Independent Auditor's Report

To the Board of Directors
Emtec, Inc.
Radnor, Pennsylvania

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Emtec, Inc. and its subsidiaries which comprise the consolidated balance sheets as of August 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, cash flows, and stockholders' equity (deficit) for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Emtec, Inc. and its subsidiaries as of August 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

McGladrey LLP

Blue Bell, Pennsylvania
April 15, 2014

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EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands)

	August 31, 2013	August 31, 2012
Assets		
Current Assets		
Cash	$ 1,415	$ 1,769
Receivables:		
Trade, net of allowance for doubtful accounts	17,674	24,381
Other	526	1,356
Inventories, net	570	2,346
Prepaid expenses and other	1,832	2,623
Deferred tax asset – current	1,097	1,032
Total current assets	23,114	33,507
Property and equipment, net	2,806	3,538
Investment in unconsolidated variable interest entity	3,982	-
Intangible assets, net	7,067	10,457
Goodwill	11,812	13,307
Deferred tax asset-long term	699	743
Other assets	1,488	1,771
Total assets	$ 50,968	$ 63,323
Liabilities, Put Options and Stockholders' Equity (Deficit)		
Current Liabilities		
Line of credit	$ 10,597	$ 12,004
Current portion of capital lease obligations	89	85
Accounts payable	7,987	16,314
Income taxes payable	342	144
Accrued liabilities	8,265	9,062
Due to former stockholders of acquired companies	1,254	-
Current portion earn-out liabilities	500	2,251
Current portion of put option liability in connection with acquisition	-	700
Deferred revenue	1,196	1,229
Total current liabilities	30,230	41,789
Deferred tax liability	806	589
Earn-out liabilities, net of current portion	1,233	2,570
Warrant liabilities	1,774	2,414
Put option and restricted stock liability in connection with acquisition of Dinero	335	229
Put option liability in connection with acquisition, net of current portion	700	-
Capital lease obligations, net of current portion	-	189
Subordinated debt, net of original issue discount	14,668	12,555
Accrued liabilities	163	163
Total liabilities	49,909	60,498
Commitments and contingencies (Note 17)		
Put options in connection with acquisitions	1,428	1,428
Stockholders' Equity (Deficit)		
Common stock $0.01 par value; 30,000,000 shares authorized; 18,214,437 and 17,616,437 shares issued and 16,935,296 and 17,616,437 shares outstanding at August 31, 2013 and August 31, 2012, respectively	183	177
Additional paid-in capital	16,957	16,915
Accumulated deficit	(15,262)	(15,516)
Accumulated other comprehensive loss, foreign currency translation adjustments, net of tax	(513)	(179)
	1,365	1,397
Less: treasury stock, at cost, 1,279,141 and -0- shares at August 31, 2013 and August 31, 2012	(1,734)	-
Total stockholders' equity (deficit)	(369)	1,397
Total liabilities, put options and stockholders' equity (deficit)	$ 50,968	$ 63,323

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

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands)

	For The Years Ended August 31, 2013	2012
Revenues		
Consulting and outsourcing	$ 90,796	$ 103,438
Procurement services	85,857	121,135
Total Revenues	176,653	224,573
Cost of Revenues		
Cost of consulting and outsourcing	69,783	80,132
Cost of procurement services	75,609	106,420
Total Cost of Revenues	145,392	186,552
Gross Profit		
Consulting and outsourcing	21,013	23,306
Procurement services	10,248	14,715
Total Gross Profit	31,261	38,021
Operating expenses:		
Selling, general, and administrative expenses	30,328	33,351
Stock-based compensation	780	420
Warrant liability adjustment	(640)	890
Earnout liability adjustment	(1,790)	557
Impairment of intangible assets	931	4,132
Impairment of goodwill	1,495	5,295
Deconsolidation transaction	(7,776)	-
Depreciation and amortization	4,018	5,304
Total operating expenses	27,346	49,949
Operating income (loss)	3,915	(11,928)
Other expense (income):		
Interest income – other	(23)	(102)
Interest expense	3,223	3,298
Other	(92)	(117)
Income (loss) before income tax expense (benefit)	807	(15,007)
Income tax expense (benefit)	553	(2,584)
Net income (loss)	$ 254	$ (12,423)

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

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

	Years Ended August 31, 2013	Years Ended August 31, 2012
Net income (loss)	$ 254	$ (12,423)
Foreign currency translation adjustment, net of taxes	(334)	(416)
Total comprehensive loss	$ (80)	$ (12,839)

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

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

	For The Years Ended August 31, 2013	2012
Cash Flows From Operating Activities		
Net income (loss)	$ 254	$ (12,423)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities		
Depreciation and amortization	4,018	5,304
Amortization of original issue discount associated with subordinated debt	113	107
Deferred income tax benefit (expense)	195	(2,955)
Stock-based compensation	780	420
Impairment of identifiable intangible assets	931	4,132
Impairment of goodwill	1,495	5,295
Earnout liability adjustment	(1,790)	557
Warrant liability adjustment	(640)	890
Deconsolidation transaction, non-cash	(7,776)	-
Changes In Operating Assets and Liabilities, Net of Impact of Deconsolidation Transaction		
Receivables	6,618	7,682
Inventories	106	(1,007)
Prepaid expenses and other assets	1,160	(246)
Accounts payable	(4,828)	(1,533)
Customer deposits	-	(34)
Income taxes payable	197	(166)
Accrued liabilities	(265)	(3,772)
Earn-out liabilities	(1,298)	-
Due to former stockholders of acquired companies	1,254	-
Deferred revenue	1,631	(503)
Net Cash Provided by Operating Activities	**2,155**	**1,748**
Cash Flows From Investing Activities		
Purchases of property and equipment	(907)	(786)
Acquisitions related contingent earnout payment	-	(500)
Net Cash Used In Investing Activities	**(907)**	**(1,286)**
Cash Flows From Financing Activities		
Net decrease in line of credit	(1,407)	(5,218)
Repayments under capital lease	(185)	(160)
Proceeds from issuance of long term subordinated debt and warrants	2,000	3,000
Purchase of treasury stock	(1,734)	-
Net Cash Used In Financing Activities	**(1,326)**	**(2,378)**
Effect of exchange rates on cash	(276)	(354)
Net decrease in Cash	**(354)**	**(2,270)**
Beginning Cash	1,769	4,039
Ending Cash	**$ 1,415**	**$ 1,769**
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Income taxes	$ 173	$ 89
Interest	$ 2,413	$ 2,937

Supplemental Disclosures of Non Cash Investing and Financing Activities

In August 2012, the Company reclassified $700 associated with the SDI put option from mezzanine equity to a current liability.
In August 2013, the $700 associated with the SDI put option was reclassified as a non-current liability - See Note 2.
In April 2013, as part of a reverse stock split, the Company repurchased 1,279,141 shares of it common stock - see Note 2.
In August 2013, the Company contributed its wholly-owned subsidiary, Emtec Federal, with Spectrum Systems, LLC. The transaction was accounted for as a deconsolidation - see Note 2.
In March 2012, the Company entered into a capital lease with a value of $64.

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

EMTEC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED AUGUST 31, 2013 AND 2012
(In thousands, except share data)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock, at Cost	Total Stockholders' Equity (Deficit)
	Shares	Amount					
Balance at August 31, 2011	17,619,813	$ 177	$ 16,589	$ (3,093)	$ 237	$ -	$ 13,910
Stock-based compensation	70,000	1	288	-	-	-	289
Employee stock forfeitures	(73,376)	(1)	-	-	-	-	(1)
Conversion of SDI put options	-	-	38	-	-	-	38
Cumulative translation adjustment	-	-	-	-	(416)	-	(416)
Net loss	-	-	-	(12,423)	-	-	(12,423)
Balance at August 31, 2012	17,616,437	177	16,915	(15,516)	(179)	-	1,397
Stock-based compensation	598,000	6	667	-	-	-	673
Effect of 20,000 for 1 reverse stock-split	(18,215,348)	-	-	-	-	-	-
Redemption of fractional shareholders	-	-	-	-	-	(1,734)	(1,734)
Effect of 1 for 20,000 stock-split	18,215,348	-	-	-	-	-	-
Write-off of Emtec Federal's additional paid-in capital in connection with Deconsolidation Transaction	-	-	(625)	-	-	-	(625)
Cumulative translation adjustment	-	-	-	-	(334)	-	(334)
Net income	-	-	-	254	-	-	254
Balance at August 31, 2013	18,214,437	$ 183	$ 16,957	$ (15,262)	$ (513)	$ (1,734)	$ (369)

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

1. Organization

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.

2. Summary of Significant Accounting Policies

Principles of Consolidation

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

Reverse Stock Split

On April 30, 2013, the Company's Board of Directors (the "Board") approved a reverse stock split of the Company's authorized, issued and outstanding stock at an exchange rate ratio of 20,000 to 1 whereby each 20,000 shares of common stock held immediately prior to the reverse stock split were exchanged for one share of the same class of common stock. In lieu of the issuance of any fractional shares on account of the reverse stock split, stockholders who held fewer than 20,000 shares of common stock immediately prior to the effective time of the reverse stock split (the "Fractional Stockholders") received from the Company $1.05 in cash for each share of common stock. At the effective time of the reverse stock split, the Fractional Stockholders ceased to be stockholders of the Company. A special committee of the Board also recommended, and the Board approved, a forward stock split (together with the reverse stock split, the "Transaction") of the authorized, issued and outstanding common stock at an exchange rate of 1 for 20,000 whereby each share of authorized, issued and outstanding common stock held immediately following the reverse stock split and the redemption of fractional shares was exchanged for 20,000 shares of the same class of common stock. The purpose of the transaction was to reduce public company costs through a reduction of the number of Emtec stockholders in order for the Company to deregister its common stock with the Securities and Exchange Commission and suspend its reporting requirements as a public company.

Deconsolidation of Emtec Federal, Inc.

On August 26, 2013, the Company entered into a series of transactions (collectively referred to as the "Deconsolidation Transaction") in connection with the contribution of Emtec's wholly-owned subsidiary, Emtec Federal, Inc. ("Emtec Federal") with Spectrum Systems Holding, Inc. to form a new company, Spectrum Systems, LLC ("Spectrum"). After the transaction, the operations of the combined entities will operate as Spectrum. In exchange for the contribution of Emtec Federal, the Company received the following equity in Spectrum, representing a 34% ownership interest:

- 34,000 Class A Common Units (non-voting) of Spectrum which represents 34% of the total Class A and B Common Units of Spectrum, and
- 5,100 Class B Preferred Units (non-voting) of Spectrum with a preferred return of $5.1 million and includes a preferred yield of 8% per annum on the unpaid preferred return.

Below is a capitalization table that summarizes the ownership in Spectrum as of August 31, 2013:

Member	(Non-voting) Number of Class A Common Units	(Voting) Number of Class B Common Units	Number of Class A Preferred Units	Number of Class B Preferred Units	Preferred Return (in thousands)
Spectrum Systems Holdings, Inc.	-	35,900	-	3,600	$ 3,600
Emtec, Inc.	34,000	-	-	5,100	5,100
Outside Investors	12,000	3,600	400	800	800
Incentive Units (not allocated)	9,500	-	-	-	n/a
Warrant	5,000	-	-	-	n/a
Totals	60,500	39,500	400	9,500	$ 9,500

As more fully described in Note 4, our investment in Spectrum (a variable interest entity) is accounted for under the equity method, as our ownership does not constitute a controlling financial interest. As we do not have a controlling financial interest in Spectrum, Emtec Federal was deconsolidated effective August 26, 2013.

As part of the Deconsolidation Transaction and upon certain conditions being met, Emtec Federal is obligated to transfer a contract and certain employees to Qbase Holdings, LLC ("Qbase") for 200,000 common units of Qbase representing a less than 1% ownership interest. Accordingly, our investment in Qbase is accounted for under the cost method.

The following table summarizes the consideration received, the consideration transferred and the resulting gain on deconsolidation that was recorded within the Deconsolidation transaction caption of our fiscal 2013 consolidated statement of operations (in thousands):

$'000	
Consideration received (at fair value):	
Interest in Spectrum	$ 3,982
Interest in Qbase	96
Total consideration received	4,078
Net liabilities of Federal assumed by Spectrum (at book value)	3,698
Gain on deconsolidation	**$ 7,776**

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 generally accepted accounting principles in the United States of America ("GAAP").

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, valuation of receivables, impairment of goodwill and other intangible and long-lived assets and income taxes. 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 prospectively reflects changes in estimates as deemed appropriate. Actual results could differ materially from those estimates.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and accounts receivable.

The Company has not experienced any losses related to its cash balances and believes credit risk to minimal.

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

	For the Year Ended					
		Aug 31, 2013			Aug 31, 2012	
Commercial Companies	$	72,939	41.3%	$	83,360	37.1%
Departments of the U.S. Government		50,529	28.6%		87,996	39.2%
Education and other		50,180	28.4%		45,959	20.5%
State and Local Governments		2,011	1.1%		5,218	2.3%
Canadian Government Agencies		994	0.6%		2,040	0.9%
Total Revenues	$	176,653	100.0%	$	224,573	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.

Major Clients

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

	For the Year Ended					
		Aug 31, 2013			Aug 31, 2012	
School District #1	$	36,721	20.8%	$	29,288	13.0%
Department of the U.S. Government		21,063	11.9%		37,392	16.7%
All Other Clients		118,868	67.3%		157,893	70.3%
Total Revenues	$	176,652	100.0%	$	224,573	100.0%

Trade receivables due from School District #1 and the department of the U.S. government accounted for approximately 13.9% and 1.0%, respectively, of the Company's trade receivables as of August 31, 2013. The same clients accounted for approximately 15.7% and 5.6%, respectively of the Company's trade receivable as of August 31, 2012.

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 9) approximated its fair value due to its variable interest rate. In addition, the carrying value of the subordinated debt (Note 10) 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.

Fair Value on a Recurring Basis: The following table summarizes the financial liabilities measured at fair value on a recurring basis as of August 31, 2013 and 2012 (in thousands):

	Level	August 31, 2013	August 31, 2012
Warrant liabilities	2	$ 1,774	$ 2,414
Put option in connection with acquisition of SDI	2	$ 700	$ 700
Earn-out liabilities	3	$ 1,733	$ 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.

As of August 31, 2012, the Company believed that it was more likely than not that the former shareholders of SDI would 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 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 August 31, 2012. In March 2013, the Company entered into an agreement with the former shareholders of SDI to modify certain provisions of the stock purchase agreement, including the date on which former shareholders of SDI could elect to put their restricted stock to the Company. Under the original stock purchase agreement, the one-time put election would occur on the third anniversary of the acquisition date, June 4, 2013. In March 2013, former shareholders of SDI owning 82% of the restricted common stock agreed to defer the one-time put date until June 4, 2015. In September 2013, the former shareholder of SDI owing the remaining restricted stock agreed to defer the one-put date until June 4, 2015. Accordingly, as of August 31, 2013, the Company will classify the restricted stock in the amount of $700,000 as a long-term liability.

The following table summarizes the changes in earn out liabilities for the year ended August 31, 2013 and 2012 (in thousands):

	Earnout Liabilities
Balance at September 1, 2011	$ 4,764
Valuation adjustments	557
Additions	-
Payments	(500)
Balance at August 31, 2012	4,821
Valuation adjustments	(1,790)
Additions	-
Reclass to Due to Former Shareholders	(1,298)
Balance at August 31, 2013	$ 1,733

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 a discount rate of 20.4% and probabilities, ranging from 0% to 100%, associated with the achievement of the earn out targets in future years.

An increase (decrease) in the discount rate, in isolation, may result in a lower (higher) fair value measurement, and an increase (decrease) in any of the probabilities, in isolation, may result in a higher (lower) fair value measurement.

Fair Value on a Nonrecurring Basis: Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments were not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet by caption and by level within the fair value hierarchy (as described above) as of August 31, 2013 and 2012 (in thousands).

	Carrying Value at August 31, 2013				Year Ended August 31, 2013
	Total	Level 1	Level 2	Level 3	Impairment
Goodwill	$ 11,812	$ -	$ -	$ 11,812	$ 1,495
Identifiable intangible assets, net	$ 7,067	$ -	$ -	$ 7,067	$ 931

	Carrying Value at August 31, 2012				Year Ended August 31, 2012
	Total	Level 1	Level 2	Level 3	Impairment
Goodwill	$ 13,307	$ -	$ -	$ 13,307	$ 5,295
Identifiable intangible assets, net	$ 10,457	$ -	$ -	$ 10,457	$ 4,132

See Note 18 for additional discussion regarding the determination of fair value and table summarizing changes in goodwill and identifiable intangible assets.

In connection with the Deconsolidation Transaction, Emtec received a 34% investment interest in Spectrum (see Note 4). Furthermore, as part of this transaction, Emtec received 200,000 shares of Qbase Holdings, LLC ("Qbase") as consideration for transferring a contract to Qbase. As the transaction date of August 26, 2013 is proximal to August 31, 2013, the carrying values of the investments in Spectrum and the Qbase stock approximates their fair values.

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 provide 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.

Revenue Recognition

The Company recognizes revenue from procurement sales when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred; seller's price to buyer is fixed or determinable; and collectability is probable. Generally, shipping terms are FOB destination; as such, revenue is recorded upon the delivery of the product to the customer.

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 ASC 605, *Revenue Recognition*, 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 and, as such, we recognize revenue for these services at the time of product delivery. 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 these cases, we allocate consideration between the "hardware" and the "set-up" services as described below. 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 FASB ASC 605 criteria and recognize revenue from these sales prior to date of physical delivery only when all the criteria of FASB ASC 605 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. Bill and hold transactions were not material for the years ended August 31, 2013 and 2012.

- Revenue is recognized net of expected returns. We estimate returns based on a variety of factors, including historical return rates. Client returns have not been material for any period presented.

The Company recognizes revenue from sale arrangements that contain both procurement revenue and services and consulting revenue in accordance with FASB ASC 605-25. The estimate selling price assigned to each unit is representative of each unit's value, and 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. Furthermore, the related cost of the third party manufacturer warranties and manufacturer support service contracts is included in cost of revenues in the same period as the contract sales date.

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.

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 FASB ASC 605-50*, Revenue Recognition, Customer Payments and Incentives*. At August 31, 2013 and 2012, approximately $92,000 and $420,000, respectively, of rebates receivable were recorded in "Receivable-other" in the accompanying consolidated balance sheets.

Inventories

Inventories are stated at the lower of average cost or market. Inventories consist principally of goods which have valid purchase orders from our clients and are awaiting delivery, including computer hardware, computer software, computer peripherals and related supplies. We no longer purchase finished goods and hold them for resale.

Property and Equipment

Property and equipment are recorded at cost with the exception of property and equipment from acquisitions which are recorded at fair value on the date of an acquisition. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the assets, which generally are two to five years. Maintenance and repair costs are charged to expense as incurred. The cost and accumulated depreciation relating to property and equipment retired or otherwise disposed of are eliminated from the accounts, and any resulting gains or losses are credited or charged to income.

Prior to fiscal year 2012, the Company entered into a capital lease for computer equipment and related software with a value of $468,000. In March 2012, the Company entered into a capital lease for computer equipment with a value of $64,000. The assets associated with the capital lease are being amortized on a straight-line basis over the estimated useful life of five years with the amortization being included in depreciation expense. Accumulated amortization related to the capital lease assets was approximately $210,000 and $127,000 as August 31, 2013 and 2012, respectively.

Goodwill and Intangible Assets

Goodwill

In accordance with ASC Topic 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 Topic 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.

Identifiable Intangible 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 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 name owned by acquired entities. The amount ascribed to trade name is being amortized on a straight-line basis over 5 years.

Amortization expense related to intangible assets was $2.4 million and $3.8 million for the years ended August 31, 2013 and 2012, respectively. We currently expect future amortization to be as follows (in thousands):

Years ending August 31,		
2014	$	1,919
2015		1,713
2016		1,438
2017		517
2018		509
Thereafter		971

Financing Costs

Financing costs incurred are amortized over the life of the associated financing arrangements. Amortization expense totaled approximately $455,000 and $323,000 for the years ended August 31, 2013 and 2012, respectively.

Advertising

Advertising costs are expensed as incurred. Advertising expense was $628,000 and $478,000 for the years ended August 31, 2013 and 2012, respectively. Advertising expense is included in selling, general and administrative expenses in the consolidated statements of operations. We receive marketing development funds from various manufacturers, which are also included as a reduction in selling, general and administrative expense.

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 2010 and prior.

Reconciliation of liabilities for unrecognized tax benefits, recorded in current and long-term accrued liabilities, for the years ended August 31, 2013 and 2012 (in thousands) are as follows:

	For the Years Ended August 31,	
	2013	2012
Balance, beginning	$ 197	$ 197
Unrecognized tax positions of prior periods:		
Increase	-	-
Decrease	-	-
Unrecognized tax positions of current year:		
Increase	-	-
Decrease	-	-
Decrease in Unrecognized tax benefits due to settlements	-	-
Decrease in Unrecognized tax benefits due to lapse of statute of limitations	-	-
Balance, ending	$ 197	$ 197

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 (loss).

Stock-Based Employee Compensation

The Company has a stock-based employee compensation plan which is more fully described in Note 13 – Stock-Based Compensation. The Company follows ASC 718 – 10 to account for stock options. ASC 718 - 10 requires that the Company record compensation expense equal to the fair value of all equity-based compensation over the vesting period of each award. The Company uses the Black-Scholes option pricing model to estimate the fair value of stock-based awards.

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 that the fair value of a reporting unit is less than its carrying amount. 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.

Comprehensive Income

In February 2013, FASB issued ASU 2013-02, *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 becomes effective prospectively for fiscal years beginning after December 31, 2013, and interim and annual periods thereafter. The adoption of ASU 2013-02 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Income Taxes

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 was issued to clarify the financial presentation of unrecognized tax benefits in the instances described. ASU 2013-11 is effective for reporting periods beginning after December 15, 2013. The effect of adopting ASU 2013-11 is not expected to have a material effect on the Company's financial statements.

3. Liquidity

The Company generated operating income in fiscal 2013 of $4.0 million as compared to an operating loss of $12.0 million for fiscal 2012. The Company generated sufficient cash from operations in 2013 to meet all its obligations, but borrowed $2.0 million to fund the repurchase of the Company's common stock associated with the reverse stock split. In 2012, the Company also generated sufficient cash flow from operations to meet all its obligations and paid down over $2.0 million of its debt. However, the Company has a net working capital deficit at each of August 31, 2013 and 2012 and is dependent on its line of credit to finance its working capital needs. We managed our liquidity during 2013 through a restructuring/downsizing of our procurement operations that culminated with the contribution of our Federal procurement business to Spectrum in exchange for an equity interest in Spectrum. Furthermore, the Company sold its staffing business in January 2014 and anticipates additional cost savings in overhead costs.

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

4. Investment in Unconsolidated Variable Interest Entity

As also discussed in Note 1, on August 26, 2013, we joined with Spectrum Holdings, Inc. to form Spectrum Systems, LLC ("Spectrum"), a company that provides IT procurement services to various agencies of the U.S. Federal government. We contributed our Federal procurement business in exchange for a 34% ownership interest in Spectrum and the right to appoint two of its five board members. Spectrum meets the definition of a variable interest entity. We do not hold a majority of the voting rights in Spectrum nor do we, through other arrangements, have the power to make decisions that significantly impact the economic performance of Spectrum. Accordingly, we are not the primary beneficiary of Spectrum and our investment in Spectrum is accounted for under the equity method. Our maximum risk of loss related to this arrangement is limited to our investment in Spectrum.

In accordance with the applicable accounting guidance, our investment was recognized at fair value based on the total enterprise value of Spectrum of approximately $9.1 million. This amount exceeded the book value of the underlying equity in the net assets of Spectrum by approximately $12.6 million which was attributed to goodwill and identifiable intangible assets.

The following table presents the combined information of the financial position (unaudited) for Spectrum Systems, LLC accounted for using the equity method as of August 31, 2013 (in thousands):

Current assets	$	9,911
Property, plant and equipment, net		55
Goodwill and identifable intangibles assets, net		12,577
Total assets	$	22,543
Current liabilities	$	9,860
Long-term debt		3,500
Other liabilities		74
Total liabilities		13,434
Equity		9,109
Total liabilities and equity	$	22,543

The results of operations for Spectrum Systems, LLC were immaterial for the period August 26, 2013 to August 31, 2013 and are not being presented.

5. 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 would be closed and certain functions handled by this facility will be distributed to other facilities within the Company. The costs associated with the Restructuring Plan include severance for terminated employees, real estate exit costs and related costs related to closing the Springfield facility.

The initial Restructuring Plan ("Initial Plan") provision, established in November 2012, only included the severance costs associated with terminated employees. After vacating the Springfield facility, the Company increased the Restructuring Plan provision to include real estate exit and related costs.

In August 2013, the Company established an additional restructuring accrual for severance and related costs in connection with the Deconsolidation Transaction for employees whose positions were being terminated. The Company also established a provision for real estate exit and related costs associated with vacating the Springfield facility in August 2013 as described earlier.

The following table summarizes the Restructuring Plan provision, activity and ending balances included in "Other accrued expenses" in the consolidated balance sheet for the year ended August 31, 2013 by cost type (in thousands):

	August 31, 2012 Balance	**Additions**	**Cash Payments**	**August 31, 2013 Balance**
Employee severance and related costs (Initial Plan)	$ -	$ 582	$ (544)	$ 38
Employee severance and related costs (Deconsolidation Transaction)	$ -	1,046	(25)	1,021
Real estate exit and related costs - Springfield Facility	-	204	-	204
Total	$ -	$ 1,832	$ (569)	$ 1,263

6. Trade Receivables and Allowance for Doubtful Accounts

At August 31, 2013 and 2012, trade receivables consisted of the following (in thousands):

	August 31, 2013	August 31, 2012
Trade receivables	$ 18,025	$ 24,801
Allowance for doubtful accounts	(351)	(420)
Trade receivables, net	$ 17,674	$ 24,381

Trade receivables include $2.2 million and $4.0 million of unbilled revenue as of August 31, 2013 and 2012, respectively.

An analysis of the allowance for doubtful accounts for years ended August 31 is as follows (in thousands):

	2013	**2012**
Balance, beginning of year	$ 421	$ 486
Provision for doubtful accounts	348	295
Charge-offs	(418)	(361)
Recoveries	-	-
Balance, end of year	$ 351	$ 420

7. Inventories

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

8. Property and Equipment

At August 31, 2013 and 2012, property and equipment consisted of the following (in thousands):

	August 31, 2013	August 31, 2012	Estimated Life Years
Leasehold improvements	$ 1,009	$ 1,011	2 to 5
Computer equipment	3,760	3,760	3 to 5
Furniture and fixtures	364	479	3 to 5
Automobiles	133	133	3 to 5
Software	4,530	4,103	5
	9,796	9,486	
Less accumulated depreciation	(6,990)	(5,948)	
Property and Equipment, Net	$ 2,806	$ 3,538	

Depreciation expense was $1.6 million and $1.5 million for the years ended August 31, 2013 and 2012, respectively.

9. 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 $5.0 million (Canadian), 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 August 31, 2013, 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. 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.

On December 14, 2012, the Borrower entered into a Third Amendment to Loan Documents (the “Third Amendment”) with PNC. 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. The modifications provided for in the Fourth Amendment, among other things, (1) amend the definition of “EBITDA” for the fiscal quarter ended on November 30, 2012 to add back severance expense incurred during such fiscal quarter associated with a restructuring charge related to the closure of the Company’s Springfield, New Jersey location in an aggregate amount not to exceed $585,000 and to add back for the fiscal quarters ending on February 28, 2013 or May 31, 2013, if included in such period, additional restructuring charges incurred during such quarter or quarters associated with and related to the closure of Borrower’s Springfield, New Jersey location closing in an aggregate amount not to exceed $375,000, including lease termination charges, and (2) amend the definition of “Senior Debt Payments” to include severance expense payments and lease termination payments relating to the closure of the Company’s’ Springfield, New Jersey location (if such payments are associated with the restructuring charges as described above).

On April 15, 2013, the Borrower and Wave6 LLC (“Wave6”) entered into a Fifth Amendment and Joinder to Loan Documents (the “Fifth Amendment”) with PNC, pursuant to which PNC agreed to make certain amendments to the PNC Loan Agreement, including (1) joining Wave6 to the PNC Loan Documents, and (2) revising the covenants and representations and warranties included in the PNC Loan Agreement to include certain customary covenants and representations and warranties relating to Wave6.

To secure the payment of the obligations of Wave6 under the PNC Loan Agreement, Wave6 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 July 10, 2013, the Borrower entered into a Sixth Amendment to Loan Documents (the “Sixth Amendment”) with PNC. The modifications provided for in the Fourth Amendment, among other things, (1) provide the consent of PNC for the consummation of the Certification of Incorporation Transactions by the Borrower, (2) provide the consent of PNC for the incurrence of an additional $2,000,000 of subordinated debt under the Subordinated Agreement by the Borrower, (3) provide the consent of PNC that the Fixed Charge Coverage Ratio covenant shall not be tested for the fiscal quarter ending

May 31, 2013, (4) amend the definition of “Maximum Revolving Advance Amount” to mean for the period February 1, 2013 through August 31, 2013, an amount not to exceed $25,000,000 and for the period September 1, 2013 through January 31, 2014, an amount not to exceed $30,000,000, (5) amend the definition of “NewSpring Subordinated Debt” to an original principal amount of $11,000,000, (6) amend the definition of “Peachtree Subordinated Debt” to an original principal amount of $4,000,000, (7) amend by adding the definitions of “Certificate of Incorporation Transaction Costs”, Certificate of Incorporation Transactions”, “Excess Proceeds”, and “Federal Spinoff” (8) amend and restate the Fixed Charge Coverage Ratio financial covenant to 1.05 to 1.0 for the quarter ending November 30, 2013 and 1.20 to 1.0 for the quarter ending February 28, 2014 and thereafter, (9) amend and restate the minimum EBITDA financial covenant for the quarter ending May 31, 2013 of not less than $250,000 and for the quarter ending August 31, 2013 of not less than $800,000, and (10) added a provision that the Federal Spinoff will consummated by the Borrower no later than August 31, 2013.

On August 26, 2013, the Borrower entered into a Seventh Amendment to Loan Documents (the “Seventh Amendment”) with PNC. The modifications provided for in the Seventh Amendment include, among other things, the consent of PNC to a series of transactions related to the formation of Spectrum Systems, LLC.

Prior to the refinancing with PNC on December 30, 2011, the Company had a revolving credit and floorplan with DLL. As of the date of the refinancing with PNC, 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.

At August 31, 2013 and 2012, the Company had an outstanding balance under the revolving portion of the PNC Credit Facility of $10.6 million and $12.0 million, respectively. Net availability under the revolving portion of the PNC Credit Facility as of August 30, 2013 and 2012 was $1.7 million and $4.2 million, respectively.

The Company determined that it was not in compliance with the minimum EBITDA covenant under the Sixth Amendment to Loan Documents with PNC for the fiscal quarter ended August 31, 2013. However, the Company was granted a waiver for the event of default related to this covenant as part of the Eighth Amendment and Waiver to the Loan Documents with PNC (the “Eighth Amendment”). In addition to granting that waiver, PNC agreed to make certain modifications to the Loan Documents. The modifications provided for in the Eighth Amendment include, among other things, (i) a waiver for the event of default related to the calculation of the Fixed Charge Coverage Ratio covenant for the period ending November 30, 2013, and a waiver from compliance with the Fixed Charge Coverage Ratio covenant for the period ending February 28, 2014, (ii) PNC’s agreement to amend the Loan Documents’ definitions of EBITDA, Senior Debt Payments, Applicable Margin, Availability Block and Subordinated Debt Payments (iii) PNC’s agreement to amend and restate the Fixed Charge Coverage Ratio covenant to provide that the Company and its consolidated subsidiaries shall maintain for the two fiscal quarters ending May 31, 2014, the three fiscal quarters ending August 31, 2014 and thereafter, each fiscal quarter on a rolling four quarter basis, a Fixed Charge Coverage Ratio of not less than 1.05 to 1.00 (iv) PNC’s agreement to amend and restate Minimum EBITDA to provide that the Company and its consolidated subsidiaries shall maintain for the month ending February 28, 2014, EBITDA of not less than $270,000; for the two months ending March 2014, EBITDA of not less than $616,000; and for the three months ending April 30, 2014, EBITDA of not less than $1,060,000, and (v) beginning with the fiscal quarter ending August 31, 2014, the establishment of a Total Funded Debt to EBITDA covenant.

10. Subordinated Debt

On August 15, 2011, the Company, and its direct and indirect domestic subsidiaries Emtec, Inc., a New Jersey corporation, Emtec Viasub LLC, a Delaware limited liability company, Emtec Federal, Inc., a New Jersey corporation, Emtec Global Services LLC, a Delaware limited liability company (“Emtec Global Services”), Luceo, Inc., an Illinois corporation, eBusiness Application Solutions, Inc., a New Jersey corporation, Aveeva, Inc., a Delaware corporation, Secure Data, Inc., a Delaware corporation, Emtec Infrastructure Services Corporation, a Delaware corporation, KOAN-IT (US) Corp., a Delaware corporation, Covelix, Inc., a Delaware corporation (“Covelix”), Dinero Solutions, LLC, a Georgia limited liability company, and Gnuco, LLC (d/b/a Emerging Solutions LLC), a Delaware limited liability company (“Emerging Solutions”) (collectively, the “Borrowers”), entered into a Subordinated Loan Agreement (the “Subordinated Loan Agreement”) with NewSpring SBIC Mezzanine Capital II, L.P., a Delaware limited partnership (“NewSpring”). The Subordinated Loan Agreement provides for a subordinated term loan in an original principal amount of $10.0 million (the “Subordinated Credit Facility”). The proceeds of the Subordinated Credit Facility were used to pay a portion of the purchase price for the Acquisition, to pay down a portion of the amount outstanding under the DLL Credit Documents and to pay related costs and expenses. The Subordinated Credit Facility’s scheduled maturity date is August 15, 2016.

On December 30, 2011, the Borrowers entered into an Amended and Restated Subordinated Loan Agreement (the “Subordinated Loan Agreement”) with the NewSpring and Peachtree II, LP (“Peachtree), and collectively referred to as the “Investors”, pursuant to which: (i) Peachtree provided an additional subordinated term loan in an original principal amount of $3.0 million, (ii) NewSpring was appointed as collateral agent, (iii) the Investors waived any event of default arising from (a) the Borrowers 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 Borrowers 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.

On August 29, 2012, the Borrowers entered into Amendment No. 2 (the “Amendment No. 2”) to the Subordinated Loan Agreement with the Investors, pursuant to which the Investors have agreed to make certain modifications to the-Subordinated Loan Agreement.

On July 10, 2013, the Borrowers entered into Amendment No. 3 (the “Amendment No. 3”) to the Subordinated Loan Agreement with the Investors, pursuant to which the Investors have agreed to make certain modifications to the Subordinated Loan Agreement. The modifications provided for in the Amendment No. 3, include among other things, (i) the Investors have agreed to provide an additional $2,000,000 (the “Senior Senior Subordinated Loan”) to the Borrowers, (ii) amended to require the Borrowers to have EBITDA of not less than $800,000 for the fiscal quarter ending August 31, 2013, and (iii) the Investors have agreed to provide Borrowers with a waiver for an event of default for failing to meet financial covenants for the fiscal quarter ended May 31, 2013 and the fiscal quarter ending August 31, 2013.

On August 26, 2013, the Borrowers entered into Amendment No. 4 (“Amendment No. 4”) to the Subordinated Loan Agreement with the Investors, pursuant to which the Investors agreed to make certain modifications to the-Subordinated Loan Agreement. The modifications provided for in Amendment No. 4 include, among other things, the consent of the Investors to a series of transactions related to the formation of Spectrum Systems, LLC.

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. Borrowings under the Subordinated Loan Agreement, with the exception of the Senior Senior Subordinated Loan will bear additional interest of 2.0% per annum and this accrued and unpaid additional interest of 2.0% is, at the Borrowers’ option, payable in cash, or added to the principal amount outstanding, on the last business day of each fiscal quarter. The Senior Senior Subordinated Loan will bear additional interest of 4.0% per annum and this accrued and unpaid additional interest of 4.0% is, at the Borrowers’ option, payable in cash, or added to the principal amount outstanding, on the last business day of each fiscal quarter.

The Company determined that it was not in compliance with the minimum EBITDA covenant under Amendment No. 3 of the Subordinated Loan Agreement with NewSpring and Peachtree for the fiscal quarter ended August 31, 2013. However, the Company was granted a waiver for the event of default related to compliance with this covenant as part of Amendment No. 5 to and Waiver Under the Subordinated Loan Agreement (“Amendment No. 5”). In addition to granting that waiver, the Investors have agreed to make certain modifications to the Subordinated Loan Agreement. The modifications provided for in Amendment No. 5 include, among other things, (i) a waiver of the event of default related to the calculation of the Fixed Charge Coverage Ratio covenant for the period ending November 30, 2013 and the Total Funded Senior Debt to EBITDA Ratio covenant for the period ending February 28, 2014, (ii) a waiver from compliance with the Fixed Charge Coverage Ratio covenant for the period ending February 28, 2014 and the Total Funded Senior Debt to EBITDA Ratio covenant for the period ending November 30, 2013, (iii) the Investors’ agreement to amend the Loan Agreement’s definitions of EBITDA, Senior Debt Payments and Subordinated Debt Payments, (iv) the Investors’ agreement to amend and restate the Total Funded Debt to EBITDA Ratio covenant to provide that the Company and its consolidated subsidiaries shall maintain for the two fiscal quarters ending August 31, 2014 and the three fiscal quarters ending November 30, 2014, a ratio of Total Funded Debt to EBITDA of not more than 5.00 to 1.00 and commencing with the fiscal quarter ending February 28, 2015 and thereafter on a rolling four quarter basis, a ratio of Total Funded Debt to EBITDA of not more than 3.50 to 1.00, (v) the Investors’ agreement to amend and restate the Fixed Charge Coverage Ratio covenant to provide that the Company and its consolidated subsidiaries shall maintain for the two fiscal quarters ending May 31, 2014 and the three fiscal quarters ending August 31, 2014, and thereafter each fiscal quarter on a rolling four quarter basis, a Fixed Charge Coverage Ratio of not less than 1.05 to 1.00, and (vi) the Investors' agreement to amend and restate Senior Loan Agreement Minimum EBITDA to provide that the Company and its consolidated subsidiaries shall maintain for the month ending February 28, 2014, EBITDA of not less than $270,000; for the two months ending March 2014, EBITDA of not less than $616,000; and for the three months ending April 30, 2014, EBITDA of not less than $1,060,000.

11. Accrued Liabilities

At August 31, 2013 and 2012, accrued liabilities consisted of the following (in thousands):

	August 31, 2013	**August 31, 2012**
Accrued payroll	$ 4,224	$ 5,372
Accrued commissions	136	145
Accrued state sales taxes	47	95
Accrued third-party service fees	-	9
Accrued restructuring expense	1,263	-
Deferred rent	-	192
Other accrued expenses	2,595	3,249
Total accrued liabilities	$ 8,265	$ 9,062

12. Income Taxes

Income tax expense (benefit) for the years ended August 31, 2013 and 2012 consisted of the following (in thousands):

	Year Ended August 31, 2013	Year Ended August 31, 2012
Income (Loss) Before Income Tax Expense:		
Domestic- U.S. operations	$ 1,157	$ (13,059)
Foreign operations	(350)	(1,948)
Total	$ 807	$ (15,007)
Income Tax Expense (Benefit):		
Current expense:		
Federal	$ 73	$ 243
State & other	115	44
Domestic-U.S.	188	287
Foreign	170	24
Total Current Expense	358	311
Deferred expense (benefit):		
Federal	470	(2,826)
State & other	(183)	(96)
Domestic-U.S.	287	(2,922)
Foreign	(92)	27
Total Deferred Expense (Benefit)	195	(2,895)
Income Tax Expense (Benefit)	$ 553	$ (2,584)

A reconciliation of the Federal statutory provision to the provision for financial reporting purposes for the years ended August 31, 2013 and 2012 is as follows (in thousands):

	Year Ended August 31, 2013	Year Ended August 31, 2012
Statutory federal tax provision	$ 275	$ (5,102)
State income taxes, net of federal	(119)	25
Foreign income taxes, net of federal	(53)	(67)
FIN 48 accrual/(settlements)- net	13	13
Stock compensation tax benefit shortfall	15	46
Prior year expense (overaccrual)/underaccrual	(3)	96
Expense (net)- Warrant liability valuations	(218)	303
Expense (net)- Earn-out liability valuations	(334)	213
Goodwill impairment charges	518	1,309
Valuation allowances	356	393
Other permanent differences	103	187
Provision for income taxes	$ 553	$ (2,584)

The tax effects of temporary differences that give rise to significant portions net of deferred tax assets and deferred tax liabilities at August 31, 2013 and 2012 are as follows (in thousands):

	2013	2012
Deferred tax assets:		
Trade receivables	$ 162	$ 159
Inventories	79	139
Accrued liabilities	747	564
Deferred Revenue	96	109
Customer Relationships /other intangibles	885	169
Stock Option/Restricted Stock Plan	440	304
Loss Carryforwards & other	2,778	1,310
	5,187	2,754
Less: Valuation Allowances	(749)	(393)
Total Deferred Tax Assets	4,438	2,361
Deferred tax liabilities:		
Property and equipment	(428)	(734)
Foreign Subsidiary Earnings	(253)	(385)
Investment in Joint Venture	(2,640)	-
Goodwill	(127)	(56)
Total Deferred Tax Liabilities	(3,448)	(1,175)
Net Deferred Tax Assets	$ 990	$ 1,186

At August 31, 2013 and 2012, the net deferred tax asset (liability) is reflected as follows (in thousands):

Deferred tax asset-current	$ 1,097	$ 1,032
Deferred tax asset- long term	699	743
Deferred tax liablility	(806)	(589)
Net deferred tax asset	$ 990	$ 1,186

For the year ended August 31, 2013, we incurred a consolidated Federal tax net operating loss of approximately $3.4 million and recorded a deferred tax asset and corresponding income tax benefit of $1.15 million. This Federal net operating loss will expire, if not used by August 2033 fiscal year.

At August 31, 2013, we hold state tax net operating loss carryforwards, on a consolidated unitary basis, approximating $8.2 million, expiring in varying amounts after our August 2027 fiscal year. The primary jurisdictions for our consolidated state income tax returns are California and Illinois. At August 31, 2013, deferred tax assets attributable to these state tax loss carryforwards amounted to $47,000 for California and $66,000 for Illinois.

Our subsidiary, Emtec-NJ, holds state tax net operating loss carryforwards, on a separate company basis, approximating $8.6 million. These tax loss carryforwards expire in varying amounts after our August 2031 fiscal year. At August 31, 2013, deferred tax assets attributable to these state tax loss carryforwards amounted to $567,000.

Our Canadian subsidiary, KOAN-IT, held Canadian tax net operating loss carryforwards of approximately $2 million as of August 31, 2013. We recorded a deferred tax asset of $694,000 and an offsetting valuation allowance in the same amount, with a net result of zero tax benefits recognized.

We also recorded a valuation allowance of $55,000 at August 31, 2013 for other state net operating loss carryforwards to reduce deferred tax assets to net amounts that were more likely than not to be realized.

13. 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 4 to 5 years.

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 year ended August 31, 2013 and 2012 is as follows:

For the Year Ended August 31, 2013	Shares	Weighted Average Exercise Price		Weighted Average Remaining Term	Aggregate Intrinsic Value *	
Options Outstanding - September 1, 2012	466,833	$	1.17			
Options Granted	121,250	$	1.31			
Options Exercised	-		-			
Options Forfeited or Expired	(64,000)	$	1.31			
Options Outstanding - August 31, 2013	524,083	$	1.18	5.04 years	$	65,792
Options Exercisable - August 31, 2013	422,873	$	1.07	4.79 years	$	65,792

* Represents the total pre-tax intrinsic value based on the Company's average closing stock prices for the year ended August 31, 2013.

For the Year Ended August 31, 2012	Shares	Weighted Average Exercise Price		Weighted Average Remaining Term	Aggregate Intrinsic Value *	
Options Outstanding - September 1, 2011	416,333	$	1.12			
Options Granted	115,000	$	1.31			
Options Exercised	-		-			
Options Forfeited or Expired	(64,500)	$	1.13			
Options Outstanding - August 31, 2012	466,833	$	1.17	4.68 years	$	26,100
Options Exercisable - August 31, 2012	382,558	$	1.05	4.17 years	$	26,100

* Represents the total pre-tax intrinsic value based on the Company's average closing stock prices for the year ended August 31, 2012.

There were 121,250 and 115,000 stock options issued during the years ended August 31, 2013 and 2012, respectively. The following assumptions were used to value stock options issued during each of years ended August 31, 2013 and 2012.

	2013	2012
Weighted-Average Fair Value	$ 0.54	$ 0.54
Assumptions		
Expected Volatility	117.2% - 120.7%	114.5% - 122%
Expected Term	5 years	5 years
Expected Forfeiture Rate	10.9%	0%
Dividend Yield	0%	0%
Risk-Free Interest Rate	0.67% - 1.35%	0.94% - 1.07%

Non-vested Stock (Restricted Stock)

The following tables summarize the Company's restricted stock activity during the years ended August 31, 2013 and 2012:

For the Year Ended August 31, 2013	Shares		Weighted Average Grant Date Fair Value		Fair Value
Nonvested - September 1, 2012	729,999	$	0.63		
Granted	598,000	$	1.05		
Vested	(381,667)	$	0.64	$	462,828(a)
Forfeited	-		-		
Nonvested - August 31, 2013	946,332	$	0.88	$	1,054,025(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 year ended August 31, 2013 which would have been received by holders of restricted stock shares had all such holders sold their underlying shares on that date.

For the Year Ended August 31, 2012	Shares		Weighted Average Grant Date Fair Value		Fair Value
Nonvested - September 1, 2011	1,222,369	$	0.71		
Granted	70,000	$	0.33		
Vested	(488,994)	$	0.77	$	406,012(a)
Forfeited	(73,376)	$	0.87		
Nonvested - August 31, 2012	729,999	$	0.63	$	575,170(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 year ended August 31, 2012 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 $673,000 and $289,000 during the fiscal years ended August 31, 2013 and 2012, respectively. As of August 31, 2013, the Company had $281,000 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 21, 2012, the Company developed the terms surrounding certain stock appreciation rights to be granted to management. Mr. Gregory P. Chandler, the Company's Chief Financial Officer, was granted on May 12, 2012 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"). On February 4, 2013, Mr. Dinesh Desai, the Company's Chief Executive Officer, was granted a stock appreciation right award under the 2006 Plan covering 1,315,084 shares of Common Stock, with a per share base price of $1.75 (the "Desai Award"). Collectively the Chandler Award, Misra Award, and Desai Award are called "the Awards," and Mr. Chandler, Mr. Misra, and Mr. Desai are each individually referred to as an "Awardee".

The purpose of the Company's stock appreciation right 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 such increase in value. 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 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 all of the entire Awards (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 all of the entire Awards, 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 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 August 31, 2013 and 2012, the Company has not recorded compensation expense associated with either Award during the years ended August 31, 2013 and 2012. However, if the Company determines that a liquidity event is probable, compensation expense associated with Awards will be recorded at that time.

14. Warrants

DARR Westwood LLC

On August 2, 2010, the Company entered into a letter agreement (the "Letter Agreement") with DARR Westwood LLC ("DARR"), pursuant to which, among other things, (a) DARR agreed (i) to certain transfer restrictions on shares of Common Stock owned by DARR, which are described below, and (ii) to transfer to the Company for cancellation the existing warrant owned by DARR to purchase 8% of the outstanding Common Stock on a fully diluted basis, and (b) the Company issued to DARR 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. DARR's sole member is Dinesh R. Desai, the Company's Chairman, Chief Executive Officer and President.

Under the terms of the Letter Agreement, DARR 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 DARR's rights under the Warrant or (b) any shares of Common Stock currently or in the future owned by DARR. 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 DARR 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 DARR 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, *Derivates and Hedging*, the Company recorded a liability on August 2, 2010 of $916,000. At August 31, 2013 and August 31, 2012, the net liability recorded on the balance sheet was $615,000 and $1.1 million, respectively. The Company recorded (income) expense on its consolidated results of operations of ($453,000) and $334,000 for the years ended August 31, 2013 and 2012, respectively, as a result of adjusting the warrant liability to fair value. As a result of the Company's stock being thinly traded, 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 Credit Facility with NewSpring, which is described in more detail in Note 10 – 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 August 31, 2013 and 2012, the NewSpring Warrant would be exercisable into 903,606 shares of Common Stock. The exercise price for the Common Stock is $0.01 per share, which may be paid through a cashless exercise. On December 30, 2011, in connection with the entry into the PNC Credit Facility with PNC and Peachtree becoming a lender under the Subordinated Credit Facility, 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.

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 August 31, 2013 and 2012, the liability recorded on the Company's balance sheet was $890,000 and $1.0 million, respectively. The Company recorded (income) expense on its consolidated statements of operations of ($144,000) and $318,000 for the years ended August 31, 2013 and 2012, respectively, as a result of adjusting the warrant liability to fair value. Because the Company's stock is thinly traded, 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 Amended and Restated Subordinated Credit Facility, 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 August 31, 2013 and 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 (as defined) 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 August 31, 2013 and 2012, the liability recorded on the Company's balance sheet was $268,000 and $311,000, respectively. The Company recorded (income) expense on its consolidated statements of operations of ($43,000) and $238,000 for the years ended August 31, 2013 and 2012, respectively, as a result of adjusting the warrant liability to fair value. Because the Company's stock is thinly traded, there may continue to be adjustments associated with determining the fair value of the liability related to the Peachtree Warrant in future periods.

15. Retirement Plan

The Company maintains Associates' 401(k) Investment Plans (the "Plans"), which are savings and investment plans intended to be qualified under Section 401 of the IRS. The Plans cover the majority of the associates of the Company. The Company makes contributions to certain plans based on a participant's contribution. The Company's 401(k) match expense totaled $375,000 and $435,000 for the years ended August 31, 2013 and 2012, respectively. The expense is included in cost of sales and selling, general and administrative expenses in the consolidated statements of operations.

16. Related Party Transactions

The Company leases warehouse and office space from related parties which includes shareholders, officers and employees. The aggregate expense for these lease arrangements for the years ended August 31, 2013 and 2012 was $510,000 and $559,000, respectively.

17. Commitments and Contingencies

The Company leases its operating facilities, certain sales offices and transportation equipment under non-cancelable operating lease agreements that expire on various dates through August 31, 2020. Rent expense was $2.0 million and $2.3 million for the years ending August 31, 2013 and 2012, respectively, and is recorded in selling, general and administrative expenses on the consolidated statements of operations.

The following are our contractual obligations associated with lease commitments. We lease warehouse and office facilities, vehicles and certain office equipment under non-cancelable operating leases. Future minimum lease payments, including amounts due to related parties, under such leases are as follows (in thousands):

Years ending August 31,	Related parties	Others	Total
2014	$ 376	$ 1,274	$ 1,650
2015	105	941	1,046
2016	-	1,002	1,002
2017	-	901	901
2018	-	550	550
Thereafter	-	524	524
Total	$ 481	5,192	5,673

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.

On March 16, 2005, the Company sold its 5.49% working interest in the Roosevelt Hot Springs geothermal unit to Energy Minerals, Inc. ("buyer"). As part of the transaction, the buyer assumed the remaining liability under the geothermal steam purchase agreement with Pacificorp (d/b/a Utah Power & Light Company). Under the 30-year agreement executed in 1993, a $1.0 million prepayment was received by the Company from Pacificorp. The agreement gives Pacificorp the right to recover a pro-rata portion of their original $1.0 million pre-payment should the geothermal unit fail to produce steam at levels specified under the agreement. The Company recorded the pre-payment as deferred revenue and was amortizing the amount as earned revenue over the 30-year term of the steam purchase agreement. Energy Minerals, Inc. has been assigned rights to the steam purchase agreement with Pacificorp and assumed the remaining $672,000 deferred revenue liability as of March 16, 2005. However, should the geothermal unit fail to produce steam at levels specified under the agreement during the remaining 30-year term of the agreement, PacifiCorp could potentially make a claim against the Company as a former owner, if the current ownership of the geothermal unit failed to satisfy Pacificorp's claims. The Company believes that the probability of this occurrence is remote due to the production and operating history of the geothermal unit.

18. Goodwill and Identifiable Intangible Assets

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 for the years ended August 31, 2013 and 2012 are as follows (in thousands):

	2013	2012
Balance, beginning of year	$ 13,307	$ 18,609
Impairment charge	(1,495)	(5,295)
Translation and other adjustments	-	(7)
Balance, end of year	$ 11,812	$ 13,307

In accordance with ASC Topic 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 which is referred to as a reporting unit (also known as a component) in accordance with the guidance of ASC Topic 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.

In connection with the annual goodwill impairment testing at June 1, 2013, the Company determined the fair value of the reporting units using an equally weighted combination of the income and market valuation approaches. However, for the annual goodwill impairment testing at June 1, 2012, the Company determined the fair value of the reporting units utilizing the income approach.

Under the income approach, the Company determined fair value based on the estimated future cash flows of each reporting unit, discounted to present value using risk-adjusted discount rates, which reflect the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn. The Company used discounts rates ranging between 12.9% and 20.4% at June 1, 2013 and 15.3% to 17.8% at June 1, 2012, for its reporting units. Cash flow projections are derived from budgeted amounts and operating forecasts (typically a five-year model) plus an estimate of later period cash flows, all of which are developed by the Company. Subsequent period cash flows are developed for each reporting unit using growth rates that the Company believes are reasonably likely to occur along with a terminal value derived from the reporting unit's earnings before interest, taxes, depreciation and amortization ("EBITDA"). The Company used long-term growth rates ranging between -5.0% and 3.0% at June 1, 2013 and 4.0% at June 1, 2012, for its reporting units.

Under the market company approach, the Company determined the estimated fair value of its reporting units by comparison to prices paid for similar companies. The search for guideline companies began with examination of reporting public companies, which were in similar businesses to the Company's reporting units. From this list, we identified companies that were similar to each reporting unit's business characteristics with regard to product offerings, services performed, growth rates, profitability and size in terms of assets held and volume of sales. This approach to value is based on the premise that prices paid for the stock of one company can provide an indication of what a willing buyer would pay for the stock of another company sharing similar characteristics. More specifically, this approach involves establishing relationships between the price for shares of similar public companies and certain benchmarks such as revenues, earnings, earnings before interest and taxes ("EBIT") and EBITDA, net income or book value. In valuing of the Company's reporting units, the Company utilized the multiples of market value of capital ("MVC") divided by EBITDA (MVC/EBITDA), for the last twelve months, projected 2013 and projected 2014, of the selected guideline companies. These multiples were applied to each reporting unit's projected EBITDA for the year ending August 31, 2014 in order to derive a fair value under the market approach.

Determining the fair value of a reporting unit requires judgment and the use of significant estimates and assumptions. Such estimates and assumptions include revenue growth rates, operating margins, discount rates, weighted average costs of capital and views on future market conditions, among others. We believe that the estimates and assumptions used in our impairment assessments are reasonable and based on available market information, but variations in any of the assumptions could result in materially different calculations of fair value and determinations of whether or not an impairment is indicated. As part of this analysis, the Company engaged an external valuation firm to review and validate the Company's impairment analysis to value its goodwill. Management has reviewed the reports prepared by the external valuation firm for each reporting unit and agrees with the conclusions therein.

June 1, 2013 Testing

As of June 1, 2013, the Company performed its impairment goodwill impairment test and determined that the respective book values of the Company's SLED and Commercial reporting units did not exceed their fair values and, therefore, no impairment existed. However, it was determined that the Federal Applications reporting unit had an impairment of $1.5 million as of June 1, 2013. The goodwill associated with the Company's Federal Infrastructure reporting unit was written-off as of June 1, 2012.

June 1, 2012 Testing

As of June 1, 2012, the Company performed its impairment goodwill impairment test and determined that the respective book values of the Company's Federal Applications and SLED reporting units did not exceed their fair values and therefore no impairment existed. However, the Company determined that its Federal Infrastructure and Commercial reporting units had impairments of $521,000 and $4.8 million, respectively, as of June 1, 2012.

Identifiable Intangible Assets

The changes in the carrying amount of identifiable intangible assets for the years ended August 31, 2013 and 2012 are as follows (in thousands):

	August 31, 2012					August 31, 2013	
	Balance	Accumulated Amortization	Additions	Amortization	Impairment, Translation, and Other Adjustments*	Balance	Accumulated Amortization
Customer relationships	$ 17,451	$ 9,791	$ -	$ 1,568	$ (929)	$ 16,522	$ 11,359
Noncompete agreements	2,421	830	-	470	(6)	2,415	1,300
Software technology	12	6	-	2	-	13	8
Trademarks	1,546	458	-	27	(12)	1,533	485
Tradenames	203	91	-	303	(73)	130	394
Total other intangible assets	$ 21,633	11,176	$ -	$ 2,370	$ (1,020)	$ 20,613	$ 13,546

* Primarily represents impairment in the amount of $938,000 for the Federal Applications asset group in connection with goodwill impairment testing, effective June 1, 2013.

	August 31, 2011					August 31, 2012	
	Gross Balance	Accumulated Amortization	Additions	Amortization	Impairment, Translation, and Other Adjustments*	Balance	Accumulated Amortization
Customer relationships	$ 21,601	$ 6,890	$ -	$ 2,901	$ (4,150)	$ 17,451	$ 9,791
Noncompete agreements	2,421	347	-	483	-	2,421	830
Software technology	15	4	-	2	(2)	13	6
Trademarks	1,548	142	-	316	(3)	1,545	458
Tradenames	203	-	-	91	-	203	91
Total other intangible assets	$ 25,788	$ 7,383	$ -	$ 3,793	$ (4,155)	$ 21,633	$ 11,176

* Primarily represents impairment in the amounts of $102,000 and $4.1 million for the Federal Infrastructure and the Commercial asset groups, respectively, in connection with goodwill impairment testing, effective June 1, 2012.

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 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. In connection with the step two analyses for goodwill under ASC 350, it was determined that customer relationships and tradenames for Federal Applications asset group had an impairment of $938,000, as of June 1, 2013. Furthermore, in connection with the step two analyses for goodwill under ASC 350, it was determined that customer relationships for Federal Infrastructure and Commercial reporting units had impairments of $102,000 and $4.0 million, respectively, as of June 1, 2012.

19. Subsequent Events

On January 17, 2014, the Company sold its staffing business to an unrelated, third party. The sale was structured as an asset purchase whereby Emtec transferred certain assets, liabilities, contracts and employee relationships to the buyer for $2.7 million cash at closing.

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EMTEC INC.
Corporate Directory

Board of Directors	Dinesh R. Desai, *Chairman* Gregory P. Chandler Sunil Misra
Corporate Management	Dinesh R. Desai *Chairman, Chief Executive Officer and President* Sunil Misra *President & COO* Gregory P. Chandler *Chief Financial Officer* Sam Bhatt *Vice President of Finance and Secretary*
Additional Information for Shareholders	**Corporate Headquarters** 100 Matsonford Road, Suite 420 2 Radnor Corporate Center Radnor, PA 19087 (973) 376-4242 www.emtecinc.com

Emtec

100 Matsonford Road, Suite 420
2 Radnor Corporate Center
Radnor, PA 19087

www.emtecinc.com