

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

MITEK SYSTEMS INC
Form 10QSB
February 14, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, DC. 20549

FORM 10-QSB

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the quarterly period ended December 31, 2004 or

Transition Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

Commission file number 0-15235

MITEK SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

87-0418827

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

14145 Danielson St, Ste B, Poway, California

92064

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (858) 513-4600

(Former name, former address and former fiscal year,
if changed since last report)

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

Yes No

There were 11,389,481 shares outstanding of the registrant's Common Stock
as of January 31, 2005.

MITEK SYSTEMS, INC.

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

FORM 10-Q

FOR THE QUARTER ENDED DECEMBER 31, 2004

INDEX

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

Page

a)	Balance Sheets As of December 31, 2004 (Unaudited) and September 30, 2004 (Audited).....	1
b)	Statements of Operations for the Three Months Ended December 31, 2004 and 2003 (Unaudited).....	2
c)	Statements of Cash Flows for the Three Months Ended December 31, 2004 and 2003 (Unaudited).....	3
d)	Notes to Financial Statements.....	4

Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	9
---------	--	---

Item 4.	Controls and Procedures.....	14
---------	------------------------------	----

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings.....	15
---------	------------------------	----

Item 6.	Exhibits and Reports on Form 8-K.....	15
---------	---------------------------------------	----

SIGNATURE.....		16
----------------	--	----

ITEM 1 FINANCIAL INFORMATION

MITEK SYSTEMS, INC
BALANCE SHEETS

	DECEMBER 31, 2004 (UNAUDITED)	SEPTEMBER 30, 2004 (AUDITED)
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash	\$ 1,365,074	\$ 2,607,170
Accounts receivable-net of allowances of \$797,473 and \$773,473 respectively	952,944	570,150
Note receivable - related party	0	133,840
Inventories - net	15,398	11,070
Prepaid expenses and other assets	238,783	180,870
	-----	-----

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

Total current assets	2,572,199	3,503,12
PROPERTY AND EQUIPMENT-net	108,699	119,11
OTHER ASSETS	20,927	
	-----	-----
TOTAL ASSETS	\$ 2,701,825	\$ 3,622,23
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 362,193	\$ 288,90
Accrued payroll and related taxes	236,056	240,00
Deferred revenue	235,582	397,72
Warrants-liability	492,541	415,90
Current portion of Convertible Debt, net of unamortized financing costs of \$347,088 and \$338,264 respectively	743,821	570,82
Other accrued liabilities	625,370	743,05
	-----	-----
Total current liabilities	2,695,563	2,656,42
LONG-TERM LIABILITIES:		
Deferred rent	10,891	13,21
Convertible Debt, net of unamortized financing costs of \$511,164 and \$606,760 respectively	1,307,018	1,484,14
	-----	-----
Total long-term liabilities	1,317,909	1,497,36
	-----	-----
TOTAL LIABILITIES	4,013,472	4,153,78
	-----	-----
STOCKHOLDERS' EQUITY (DEFICIT):		
Common stock - \$.001 par value; 20,000,000 shares authorized, 11,389,481 issued and outstanding at December 31, 2004 and September 30,2004, respectively	11,389	11,38
Additional paid-in capital	10,207,255	10,069,83
Accumulated deficit	(11,530,291)	(10,612,77
	-----	-----
Net stockholders' equity (deficit)	(1,311,647)	(531,55
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 2,701,825	\$ 3,622,23
	=====	=====

See accompanying notes to financial statements

1

MITEK SYSTEMS, INC
STATEMENTS OF OPERATIONS
UNAUDITED

THREE MONTHS ENDED
DECEMBER 31,

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

	2004	2003
SALES		
Software	\$ 818,938	\$ 671,650
Hardware	0	370,105
Professional Services, education and other	481,484	653,127
NET SALES	1,300,422	1,694,882
COSTS AND EXPENSES:		
Cost of sales-Software	81,199	115,412
Cost of sales-Hardware	0	339,977
Cost of sales-Professional Services, education and other	102,119	287,123
Operations	40,838	361,108
Selling and marketing	579,880	626,791
Research and development	370,028	509,060
General and administrative	926,815	539,304
Total costs and expenses	2,100,879	2,778,775
OPERATING LOSS	(800,457)	(1,083,893)
OTHER INCOME (EXPENSE):		
Interest expense	(133,660)	0
Change in fair value of warrant liability	(3,475)	0
Interest and other income	20,078	9,729
Total other income (expense) - net	(117,057)	9,729
LOSS BEFORE INCOME TAXES	(917,514)	(1,074,164)
PROVISION FOR INCOME TAXES	0	2,550
NET LOSS	\$ (917,514)	\$ (1,076,714)
NET LOSS PER SHARE - BASIC AND DILUTED	\$ (0.08)	\$ (0.10)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND COMMON SHARE EQUIVALENTS OUTSTANDING - BASIC AND DILUTED	11,389,481	11,264,356

See accompanying notes to financial statements

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

	DECEMBER 31,	
	2004	2003
OPERATING ACTIVITIES		
Net (loss) income	\$ (917,514)	\$ (1,076,714)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	23,077	113,044
Provision for bad debts	24,000	24,000
Change in fair value of warrant liability	3,476	0
Amortization of debt discount	86,771	0
Provision for sales returns & allowances	5,000	31,768
Fair value of stock options issued to non-employees	2,580	0
Gain on sale of equity investment	(16,159)	0
Changes in operating assets and liabilities:		
Accounts receivable	(406,791)	1,128,614
Inventories, prepaid expenses, and other assets	(62,226)	(70,092)
Other long term assets	(20,927)	0
Accounts payable	73,284	(224,118)
Accrued payroll and related taxes	(3,943)	(210,038)
Long-term payable	0	(8,552)
Deferred revenue	(162,142)	(128,622)
Other accrued liabilities	82,990	(49,284)
Net cash used in operating activities	(1,288,524)	(469,994)
INVESTING ACTIVITIES		
Purchases of property and equipment	(13,235)	(15,395)
Proceeds from sale of property and equipment	569	0
Payment (advances) on related party note receivable-net	150,000	5,841
Net cash provided by (used in) investing activities	137,334	(9,554)
FINANCING ACTIVITIES		
Repayment on convertible debt	(90,909)	0
Proceeds from exercise of stock options	0	125,523
Net cash provided by financing activities	(90,909)	125,523
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,242,099)	(354,025)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,607,173	1,819,102
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,365,074	\$ 1,465,077
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 46,888	\$ --
Cash paid for income taxes	\$ --	\$ 2,550
SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES		
Warrants issued in connection with settlement	\$ 73,159	\$ 0

See accompanying notes to financial statements

MITEK SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements of Mitek Systems, Inc. (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all information and footnote disclosures that are otherwise required by Regulation S-X and that will normally be made in the Company's Annual Report on Form 10-K. The financial statements do, however, reflect all adjustments (solely of a normal recurring nature) which are, in the opinion of management, necessary for a fair statement of the results of the interim periods presented.

Results for the three months ended December 31, 2004 and 2003 are not necessarily indicative of results which may be reported for any other interim period or for the year as a whole.

2. NEW ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No. 148 Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS 123 provided for under SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The Company has not elected to adopt the fair value accounting provisions of SFAS No. 123 and therefore the adoption of SFAS No. 148 did not have a material effect on our results of operations or financial position.

In November 2004, the FASB issued Statement No. 151, Inventory Costs--an amendment of ARB No. 43, Chapter 4. This Statement amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that ". . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . ." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Company does not believe adoption of this Statement will have a material effect on its financial statements

In December 2004, the FASB issued Statement No. 152, Accounting for Real Estate Time-Sharing Transactions--an amendment of FASB Statements No. 66 and 67. This Statement amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, Accounting for Real Estate Time-Sharing Transactions. This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a)

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. The Company does not have real estate which is subject to this Statement.

In December 2004, the FASB issued Statement No. 153 "Exchanges of Nonmonetary Assets--an amendment of APB Opinion No. 29" This Statement amends Opinion 29, Accounting for Nonmonetary Transactions, which provided based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement was issued to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The Company does not have any such assets subject to this statement.

4

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. This Interpretation also incorporates, without change, the guidance in FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, which is being superseded. The initial recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has issued no guarantees that qualify for disclosure in this interim financial statement.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 were initially to apply to variable interest entities created after January 31, 2003. The consolidation requirements were initially to apply to transactions entered into prior to February 1, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The FASB postponed implementation of FIN 46 in December 2003. The Company has no variable interest entities.

In December 2004, the FASB issued SFAS No.123 (revised 2004), "Share-Based Payment". Statement 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. The Company has evaluated the impact of the adoption of SFAS 123(R), and does not believe the impact will be significant to the Company's overall results of operations or financial position.

3. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees, and FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation.

Pro forma information regarding net loss and loss per share is required by SFAS No. 123, Accounting for Stock-based Compensation, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the dates of grant using the Black-Scholes option valuation model with the following weighted-average assumptions for December 31, 2003 and 2002.

	2004	2003
	----	----
Risk free interest rates	3.09	1.9%
Dividend yields	0%	0%
Volatility	77%	78%
Weighted average expected life	3 years	3 years

5

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information is as follows (in thousands, except for net loss per share information):

THREE MONTHS ENDED	
DECEMBER 31	

2004	2003

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

Net income (loss) as reported	\$ (917)	\$ (1,077)
Net income (loss) pro forma	(1,009)	(1,237)
Net income (loss) per share as reported	(.09)	(.10)
Net income (loss) per share pro forma	(.09)	(.11)

4. CONVERTIBLE DEBT

On June 11, 2004, the Company secured a financing arrangement with Laurus. The financing consists of a \$3 million Secured Note that bears interest at the rate of prime (as published in the Wall Street Journal), plus one percent (6% as of December 2, 2004) and has a term of three years (June 11, 2007). The Secured Note is convertible into shares of the Company's common stock at an initial fixed price of \$0.70 per share, a premium to the 10-day average closing share price as of June 11, 2004. The conversion price of the Secured Note is subject to adjustment upon the occurrence of certain events. The effective annual interest rate of this Convertible Debt, after considering the total debt issue costs (discussed below), is approximately 17.6%

In connection with the financing, Laurus was also issued warrants to purchase up to 860,000 shares of the Company's common stock. The warrants are exercisable as follows: 230,000 shares at \$0.79 per share; 230,000 shares at \$0.85 per share and the balance at \$0.92 per share. The gross proceeds of the convertible debt were allocated to the debt instrument and the warrants on a relative fair value basis. Then the Company computed the beneficial conversion feature embedded in the debt instrument using the effective conversion price in accordance with EITF 98-5 and 00-27. The Company recorded a debt discount of (i) \$367,887 for the valuation of the 860,000 warrants issued with the note (computed using a Black-Scholes model with an interest rate of 2.53%, volatility of 81%, zero dividends and expected term of three years); (ii) \$522,384 for a beneficial conversion feature inherent in the Secured Note and (iii) \$151,000 for debt issue costs paid to affiliates of the lender, for a total discount of \$1,041,271. The \$1,041,271 is being amortized over the term of the Secured Note. On October 4, 2004 the Company filed the registration statement with the Securities and Exchange Commission and the registration statement remains pending as of the date of this report. Amortization of the debt discounts through September 30, 2004 was \$96,247.

To secure the payment of all obligations, the Company entered into a Master Security Agreement which assigns and grants to Laurus a continuing security interest in all of the following property now owned or at any time upon execution of the agreement, acquired by the Company or subsidiaries, or in which any assignor now have or at any time in the future may acquire any right, title or interest: all cash, cash equivalents, accounts, deposit accounts, inventory, equipment, goods, documents, instruments (including, without limitation, promissory notes), contract rights, general tangibles, chattel paper, supporting obligations, investment property, letter-of-credit rights, trademarks, trademark applications, patents, patent applications, copyrights, copyright applications, tradestyles and any other intellectual property, in each case, in which any Assignor now have or may acquire any right, title or interest, all proceeds and products thereof (including, without limitation, proceeds of insurance) and all additions, accessions and substitutions. In the event any Assignor wishes to finance an acquisition in the ordinary course of business of any hereafter-acquired equipment and have obtained a commitment from a financing source to finance such equipment from an unrelated third party, Laurus agrees to release its security interest on such hereafter-acquired equipment so financed by such third party financing source.

The Secured Notes stipulates that the Secured Note is to be repaid using cash payment along with an equity conversion option; the details of both methods

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

for repayment are as follows: The cash repayments stipulate that beginning on December 1, 2004, or the first amortization date, the Company shall make monthly payments to Laurus on each repayment date until the maturity date, each in the amount of \$90,909, together with any accrued and unpaid interest to date. The conversion repayment states that each month by the fifth business day prior to each amortization date, Laurus shall deliver to the Company a written notice converting the monthly amount payable on the next repayment date in either cash or shares of common stock, or a combination of both. If a repayment notice is not delivered by Laurus on or before the applicable notice date for such repayment date, then the Company pays the monthly amount due in cash. Any portion of the monthly amount paid in cash shall be paid to Laurus in an amount equal to 102% of the principal portion of the monthly amount due. If Laurus converts all or a portion of the monthly amount in shares of the Company's common stock, the number of such shares to be issued by the Company will be the number determined by dividing the portion of the monthly amount to be paid in shares of common stock, by the applicable fixed conversion price, which is presently \$0.70 per share.

A registration rights agreement was executed requiring the Company to register the shares of its common stock underlying the Secured Note and warrants so as to permit the public resale thereof (See Note 9). Liquidated damages of 2% of the Secured Note balance per month accrue if stipulated deadlines are not met. The registration statement was filed with the Securities and Exchange Commission on October 4, 2004.

The following table reflects the Convertible Debt at December 31, 2004:

Convertible Debt	\$ 2,909,091
Deferred financing costs	(858,252)

	2,050,839
Less: Current Portion, net of unamortized financing costs	(743,821)

	\$ 1,307,018
	=====

The debt has the following principal amounts due over the remaining life as follows:

Year ended 9/30/05	\$ 818,182
Year ended 9/30/06	1,090,909
Year ended 9/30/07	\$ 1,000,000

7

5. WARRANT LIABILITY

In conjunction with raising capital through the issuance of convertible debt, the Company has issued various warrants that have registration rights for the underlying shares. As the contracts must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet (\$492,541) and the change in fair value from the date of issuance to September 30, 2004 has been included in other (expense) income.

Prior to the end of fiscal 2004, the Company incurred a penalty to Laurus Funds for failing to register the securities underlying the Debt

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

Instrument described in Note 7. The amount of the penalty was \$208,000. This amount was shown as interest expense in the Financial Statements for the year ended September 30, 2004. On October 4, 2004, the Company settled this penalty with Laurus Master Fund, LLC by agreeing to issue an additional warrant for the purchase of 200,000 shares at a price of \$0.70 per share. The value of this additional warrant was calculated by the Company to be \$73,159, using a Black-Scholes option pricing model.

For the quarter ended December 31, 2004 the change in fair value of the warrants issued with registration rights for the underlying shares increased by approximately \$3,476 to \$492,541 at December 31, 2004 and is recognized in other expense.

6. NOTE RECEIVABLE FROM MITEK SYSTEMS, LTD.

During the Quarter, the Company was approached by the Principal Shareholder of Mitek Systems, Ltd, who offered to repurchase the Company's interest. In exchange for a cash payment of \$150,000 and the cancellation of the stock options granted the principal, the Company agreed to exchange the shares held and the note outstanding, including accrued and unpaid interest. Mitek Systems, Ltd also agreed to cease using the Company's trade name and entered into a reseller agreement on terms similar to other resellers unrelated to the Company.

7. PRODUCT REVENUES - Below is a summary of the revenues by product lines.

	THREE MONTHS ENDED DECEMBER 31	
REVENUE	2004	2003
	-----	-----
(000'S)		
Recognition Toolkits	\$ 911	\$ 452
Check Image Solutions	0	688
Document and Image Processing Solutions	64	240
Maintenance and other	325	315
	-----	-----
Total Revenue	\$1,300	\$1,695
	=====	=====

8

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion

In addition to historical information, this Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A") contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. As contained herein, the words "expects," "anticipates," "believes," "intends," "will," and similar types of expressions identify forward-looking statements, which are based on information that is currently available to the Company, speak only as of the date hereof, and are subject to certain risks and uncertainties. To the extent that the MD&A contains forward-looking statements regarding the financial condition, operating results, business prospects or any other aspect of the Company, please be advised that the Company's actual financial condition, operating results and business

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

performance may differ materially from that projected or estimated by the Company in forward-looking statements. The Company has attempted to identify certain of the factors that it currently believes may cause actual future experiences and results to differ from the Company's current expectations. The difference may be caused by a variety of factors, including, but not limited, to the following: (i) adverse economic conditions; (ii) decreases in demand for Company products and services; (iii) intense competition, including entry of new competitors into the Company's markets; (iv) increased or adverse federal, state and local government regulation; (v) the Company's inability to retain or renew its working capital credit line or otherwise obtain additional capital on terms satisfactory to the Company; (vi) increased or unexpected expenses; (vii) lower revenues and net income than forecast; (viii) price increases for supplies; (ix) inability to raise prices; (x) the risk of additional litigation and/or administrative proceedings involving the Company and its employees; (xi) higher than anticipated labor costs; (xii) adverse publicity or news coverage regarding the Company; (xiii) inability to successfully carry out marketing and sales plans, including the Company's strategic realignment; (xiv) loss of key executives; (xv) changes in interest rates; (xvi) inflationary factors; (xvii) and other specific risks that may be alluded to in this MD&A.

The Company's strategy for fiscal 2005 is to grow the identified markets for its new products and enhance the functionality and marketability of the Company's image based recognition and forgery detection technologies. In particular, Mitek is determined to expand the installed base of its Recognition Toolkits and leverage existing technology by devising recognition-based applications to detect potential fraud and loss at financial institutions. The Company also seeks to expand the installed base of its Check Forgery detection Solutions by entering into reselling relationships with key resellers who will better penetrate the market and provide entree into a larger base of community banks.

Management presumes that users of these interim financial statements and information have read or have access to the discussion and analysis for the preceding fiscal year. See also Item 3, "Quantitative and Qualitative Disclosures about Market Risk."

CRITICAL ACCOUNTING POLICIES

Mitek's financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates by management are affected by management's application of accounting policies are subjective and may differ from actual results. Critical accounting policies for Mitek include revenue recognition, impairment of accounts and notes receivable, loss contingencies, fair value of equity instruments and accounting for income taxes.

Revenue Recognition

The Company enters into contractual arrangements with end users that may include licensing of the Company's software products, product support and maintenance services, consulting services, resale of third-party hardware, or various combinations thereof, including the sale of such products or services separately. The Company's accounting policies regarding the recognition of revenue for these contractual arrangements is fully described in Notes to the Financial Statements on Form 10K previously filed.

The Company considers many factors when applying accounting principles

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

- o The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
- o Availability of products to be delivered
- o Time period over which services are to be performed
- o Creditworthiness of the customer
- o The complexity of customizations to the Company's software required by service contracts
- o The sales channel through which the sale is made (direct, VAR, distributor, etc.)
- o Discounts given for each element of a contract
- o Any commitments made as to installation or implementation "go live" dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse affect on the Company's future revenues and operating results.

Accounts Receivable.

We evaluate the creditworthiness of our customers prior to order fulfillment and we perform ongoing credit evaluations of our customers to adjust credit limits based on payment history and our assessment of the customer's current creditworthiness. We constantly monitor collections from our customers and maintain a provision for estimated credit losses that is based on historical experience and on specific customer collection issues. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Since our revenue recognition policy requires customers to be deemed creditworthy, our accounts receivable are based on customers whose payment is reasonably assured. Our accounts receivable are derived from sales to a wide variety of customers. We do not believe a change in liquidity of any one customer or our inability to collect from any one customer would have a material adverse impact on our financial position.

Loss Contingencies

The financial statements presented include accruals for a loss contingency, relating to the litigation with BSM. While the Company believes it has meritorious defenses against such claims, the ultimate resolution to the matter, which is expected to occur within one year could result in a loss in excess of the amount accrued.

Fair Value of Equity Instruments

The valuation of certain items, including valuation of warrants,

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

beneficial conversion feature related to convertible debt and compensation expense related to stock options granted, involve significant estimations with underlying assumptions judgmentally determined. The valuation of warrants and stock options are based upon a Black Scholes valuation model, which involve estimates of stock volatility, expected life of the instruments and other assumptions. As the Company's stock is thinly traded, the estimates, which are based partly on historical pricing of the Company's stock, may not represent fair value, but the Company believes it is presently the best form of estimating objective fair value.

Deferred Income Taxes.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We maintain a valuation allowance against the deferred tax asset due to uncertainty regarding the future realization based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. Until such time as the Company can demonstrate that it will no longer incur losses or if the Company is unable to generate sufficient future taxable income we could be required to maintain the valuation allowance against our deferred tax assets.

10

ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS:

Comparison of Three Months Ended December 31, 2004 and 2003

Net Sales. Net sales for the three month period ended December 31, 2004 were \$1,300,000, compared to \$1,695,000 for the same period in 2003, a decrease of \$395,000, or 23%. The decrease was primarily attributable to the elimination of revenue from the Check Image Solutions business, which accounted for \$688,000 in fiscal 2004. This 100% decline in revenue was offset by a 105% increase in revenue associated with our recognition toolkits, the result of license renewals signed in the first quarter of 2004. Sales in the Document and Image Processing Solutions also declined, by 71%. This is primarily due to the absence of a dedicated sales force for this product line. Sales of Maintenance declined by 5%, reflecting the reduction of the installed base of maintenance customers, due to the elimination of the Check Image Solution business, offset by continued increase in the installed base of recognition toolkit customers purchasing product support.

Cost of Sales. Cost of Sales for the three month period ended December 31, 2004 was \$183,000, compared to \$743,000 for the same period in 2003, a decrease of \$560,000 or 75%. Stated as a percentage of net sales, cost of sales decreased to 14% for the three month period ended December 31, 2004 compared to 44% for the same period in 2003. The dollar decrease, and the decrease as a percentage of sales, in cost of sales is almost entirely due to the elimination of hardware installations related to the Company's CheckQuest product line, which was sold to Harland Financial Solutions last year, during the three months, as compared to the same period in 2004.

Operations. Operations expenses include costs associated with shipping and receiving, quality assurance, customer support, installation and training. As installation, training, maintenance and customer support revenues are recognized, an appropriate amount of these costs are charged to cost of sales, with unabsorbed costs remaining in operations expense. Gross Operations expense for the three-month period ended December 31, 2004 were \$41,000, compared to \$510,000 for the same period in 2003. Net Operations expenses for the three-month period ended December 31, 2004 were \$41,000, compared to \$361,000

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

for the same period in 2003, a decrease of \$320,000 or 89%. As a percentage of net sales, operations expenses decreased to 3% for the three-month period ended December 31, 2004, compared to 21% for the same period in 2003. The dollar decrease in gross expenses is almost entirely due to the elimination of hardware installations related to the Company's CheckQuest product line, which was sold to Harland Financial Solutions last year. The dollar decrease in net expense, and the decrease in expense as a percentage of net sales attributable to the reduced spending discussed above.

Selling and Marketing. Selling and marketing expenses for the three month period ended December 31, 2004 were \$580,000, compared to \$627,000 for the same period in 2003, a decrease of \$47,000 or 7%. Stated as a percentage of net sales, selling and marketing expenses increased to 45% for the three month period ended December 31, 2004, compared to 37% for the same period in 2003. The dollar decrease in expenses is primarily attributable to reduced commissions resulting from lower sales. The increase in expenses as a percentage of net sales is primarily attributable to lower revenues.

Research and Development. Research and development expenses are incurred to maintain existing products, develop new products or new product features, and development of custom projects. Research and development expenses for the three month period ended December 31, 2004 were \$370,000 compared to \$509,000 for the same period in 2003, a decrease of \$139,000 or 27%. Stated as a percentage of net sales, research and development expenses decreased to 28% for the three month period ended December 31, 2004, compared to 30% for the same period in 2003. The decrease in expenses for the three-month period is primarily the result of the elimination of four full time engineers associated with the CheckQuest business, which was sold to Harland Financial Solutions last year. The decrease in expenses as a percentage of net sales is primarily attributable to reduced costs, as discussed above.

General and Administrative. General and administrative expenses for the three month period ended December 31, 2004 were \$927,000, compared to \$539,000 for the same period in 2003, an increase of \$388,000 or 72%. As a percentage of net sales, general and administrative expenses increased to 71% in 2004, from 32% in 2003. The dollar increase in expenses for the three month period is attributable to increased legal costs primarily relating to patent work and litigation with BSM, and increased audit fees, due to the restatement of prior reported quarters. The increase in expenses as a percentage of net sales is primarily attributable to the increased spending discussed above.

Interest and Other Income (Expense) - Net. Interest and other income (expense) for the three-month period ended December 31, 2004 was (\$117,000), compared to interest and other income (expense) of \$10,000 for the same period in 2003, a change of \$124,000. The primary reason for the change is the cash interest paid to Laurus Master Fund during the quarter of \$47,000, as well as amortization of the deferred loan costs related to the warrants issued and the beneficial conversion feature of the convertible note.

LIQUIDITY AND CAPITAL

At December 31, 2004 the Company had \$1,365,000 in cash as compared to \$2,607,000 at September 30, 2004. Accounts receivable totaled \$953,000, an increase of \$383,000 over the September 30, 2004, balance of \$570,000. This increase was primarily a result of increased sales activity during the first fiscal quarter.

The Company has financed its cash needs during the first quarter of fiscal 2005 primarily from collection of accounts receivable. During fiscal

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

2004, the Company financed its cash needs primarily from financing and investing activities.

Net cash used in operating activities during the three months ended December 31, 2004 was (\$1,289,000). The primary use of cash from operating activities was the loss during the quarter of \$918,000, an increase in accounts receivable of \$407,000, a decrease to the deferred revenue accounts of \$162,000. The primary source of cash from operating activities was depreciation and amortization of \$110,000 and increased deferred loan fees related to issuance of warrants of \$73,000. The Company used part of the cash provided from operating activities to finance the acquisition of equipment used in its business.

During the quarter ended December 31, 2004, the Company also received cash of approximately \$150,000 from financing activities in the form of proceeds from the repayment of the note receivable from Mitek Systems, Ltd. as discussed in Note 6 of the accompanying financial statements.

The Company's working capital and current ratio were (\$123,000) and .95, respectively, at December 31, 2004, and \$847,000 and 1.32, respectively, at September 30, 2004. At December 31, 2004, total liabilities to equity ratio was (3.13) to 1 compared to (7.81) to 1 at September 30, 2004. As of December 31, 2004, total liabilities were \$185,000 less than on September 30, 2004.

There are no significant capital expenditures planned for the foreseeable future.

The Company evaluates its cash requirements on a quarterly basis. Historically, the Company has managed its cash requirements principally from cash generated from operations. Although the Company's strategy for fiscal 2004 is to grow the identified markets for its new products and enhance the functionality and marketability of the Company's character recognition technology, it has not yet observed a significant change in liquidity or future cash requirements as a result of this strategy. Cash requirements over the next twelve months are principally to fund operations, including spending on research and development. The Company believes that it will have sufficient liquidity to finance its operations for the next twelve months using existing cash, cash generated from operations, and borrowings under the Company's line of credit, as discussed above.

NEW ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No. 148 Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS 123 provided for under SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The Company has not elected to adopt the fair value accounting provisions of SFAS No. 123 and therefore the adoption of SFAS No. 148 did not have a material effect on our results of operations or financial position.

In November 2004, the FASB issued Statement No. 151, Inventory Costs--an amendment of ARB No. 43, Chapter 4. This Statement amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that ". . .

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . ." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Company does not believe adoption of this Statement will have a material effect on its financial statements

12

In December 2004, the FASB issued Statement No. 152, Accounting for Real Estate Time-Sharing Transactions--an amendment of FASB Statements No. 66 and 67. This Statement amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, Accounting for Real Estate Time-Sharing Transactions. This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. The Company does not have real estate which is subject to this Statement.

In December 2004, the FASB issued Statement No. 153 "Exchanges of Nonmonetary Assets--an amendment of APB Opinion No. 29" This Statement amends Opinion 29, Accounting for Nonmonetary Transactions, which provided based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement was issued to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The Company does not have any such assets subject to this statement.

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. This Interpretation also incorporates, without change, the guidance in FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, which is being superseded. The initial recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has issued no guarantees that qualify for disclosure in this interim financial statement.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 were initially to apply to variable interest entities created after January 31, 2003. The consolidation requirements were initially to apply to transactions entered into prior to February 1, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The FASB postponed implementation of FIN 46 in December 2003. The Company has no variable interest entities.

In December 2004, the FASB issued SFAS No.123 (revised 2004), "Share-Based Payment". Statement 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. The Company has evaluated the impact of the adoption of SFAS 123(R), and does not believe the impact will be significant to the Company's overall results of operations or financial position.

13

ITEM 4 CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective as of the quarter ended December 31, 2004 to timely alert them to material information relating to the Company required to be included in the Company's Exchange Act filings. Except as discussed in the following paragraph, there have been no changes in the Company's internal control over financial reporting subsequent to the quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

In connection with the audit of the Company's financial statements for the year ended September 30, 2004, the Company identified that they had incorrectly accounted for (i) the beneficial conversion feature of the convertible promissory note issued to Laurus in the third quarter of fiscal 2004 and (ii) the categorization and recording of the warrants that were issued to Laurus in connection with the convertible promissory note issued to Laurus in the third quarter of fiscal 2004. We have determined that the incorrect accounting resulted from a significant deficiency in our internal controls over application of existing accounting principles to new transactions and financial reporting.

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

Management has enhanced its internal controls and now believes that the significant deficiency has been remediated.

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d - 15(f) under the Exchange Act) during the fiscal quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As noted above, we identified certain deficiencies in our internal controls, for which, we have now enhanced the internal controls. We now believe that the significant deficiency has been remedied.

14

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no additional material legal proceedings pending against the Company not previously reported by the Company in Item 3 of its Form 10-K for the year ended September 30, 2004, which Item 3 is incorporated herein by reference.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits:

The following exhibits are filed herewith:

EXHIBIT NUMBER	EXHIBIT TITLE
31.1	Certification of Periodic Report by the Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Periodic Report by the Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Periodic Report by the Chief Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002
32.2	Certification of Periodic Report by the Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002

b. The following is a list of Current Reports on Form 8-K filed by the Company during the fiscal quarter ended December 31, 2004:

- o Form 8-K filed with the Securities and Exchange Commission on October 6, 2004, under Item 4 and Item 9 announced that Mitek Systems, Inc. had dismissed Deloitte & Touche LLP as Mitek's independent auditor and engaged Stonefield Josephson, Inc. as Mitek's independent auditor.

15

Edgar Filing: MITEK SYSTEMS INC - Form 10QSB

SIGNATURES

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

MITEK SYSTEMS, INC.

Date: February 12, 2005

/s/ James B. DeBello

James B. DeBello, President and
Chief Executive Officer

Date: February 12, 2005

/s/ John M. Thornton

John M. Thornton, Chairman and
Chief Financial Officer