

MITEK SYSTEMS INC  
Form 10QSB  
February 14, 2007

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, 2006 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*

(State or other jurisdiction of  
incorporation or organization)

87-0418827

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

*8911 Balboa Ave., Suite B, San Diego, California*

(Address of principal executive offices)

92123

(Zip Code)

Registrant's telephone number, including area  
code (858) 503-7810

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 16,751,137 shares outstanding of the registrant's Common Stock as of February 9, 2007.

Transitional Small Business Disclosure Format: Yes  No

**MITEK SYSTEMS, INC.**

**FORM 10-QSB**

**For the Quarter Ended December 31, 2006**

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ITEM 1  
FINANCIAL INFORMATIONMITEK SYSTEMS, INC  
BALANCE SHEET  
(Unaudited)

	December 31, 2006
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash and cash equivalents	\$ 2,447,663
Accounts receivable including related party of \$19,606-net of allowance of \$54,631	861,666
Inventory, prepaid expenses and other current assets	125,316
Total current assets	3,434,645
PROPERTY AND EQUIPMENT-net	72,241
OTHER ASSETS	50,777
<b>TOTAL ASSETS</b>	<b>\$ 3,557,663</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable	\$ 917,260
Accrued payroll and related taxes	266,026
Deferred revenue	521,600
Other accrued liabilities	51,346
Total current liabilities	1,756,232
Deferred rent	30,261
<b>TOTAL LIABILITIES</b>	<b>1,786,493</b>
<b>STOCKHOLDERS' EQUITY:</b>	
Preferred stock, \$0.001 par value, 1,000,000 shares authorized, none issued and outstanding	
Common stock, \$.001 par value; 40,000,000 shares authorized, 16,751,137 issued and outstanding	16,751
Additional paid-in capital	14,406,021
Accumulated deficit	(12,651,602)
Total stockholders' equity	1,771,170
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 3,557,663</b>

The accompanying notes form an integral part of these financial statements.

**MITEK SYSTEMS, INC**  
**STATEMENTS OF OPERATIONS**  
(Unaudited)

	<b>THREE MONTHS ENDED</b>	
	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>NET SALES</b>		
Software including approximately \$24,000 and \$17,000 to a related party, respectively	\$ 920,456	\$ 785,583
Professional Services, education and other including approximately \$86,000 and \$350,000 to a related party, respectively	518,376	735,079
	1,438,832	1,520,662
<b>COSTS AND EXPENSES:</b>		
Cost of sales-software	134,656	40,073
Cost of sales-professional services, education and other	22,106	369,738
Operations	21,982	21,464
Selling and marketing	255,019	398,557
Research and development	501,906	326,675
General and administrative	795,814	531,875
Total costs and expenses	1,731,483	1,688,382
<b>OPERATING LOSS</b>	<b>(292,651)</b>	<b>(167,720)</b>
<b>OTHER INCOME (EXPENSE):</b>		
Interest expense	(5,916)	(311,648)
Interest and other income	4,423	6,936
Total other income (expense) - net	(1,493)	(304,712)
<b>LOSS BEFORE INCOME TAXES</b>	<b>(294,144)</b>	<b>(472,432)</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>0</b>	<b>0</b>
<b>NET LOSS</b>	<b>\$ (294,144)</b>	<b>\$ (472,432)</b>
<b>NET LOSS PER SHARE - BASIC AND DILUTED</b>	<b>\$ (0.02)</b>	<b>\$ (0.03)</b>
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED</b>		
	16,748,974	15,018,703

The accompanying notes form an integral part of these financial statements

**MITEK SYSTEMS, INC**  
**STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>THREE MONTHS ENDED</b>	
	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (294,144)	\$ (472,432)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,288	13,339
Provision for bad debts	(15,000)	-
Gain on disposal of property and equipment	-	(2,551)
Stock-based compensation expense	44,349	-
Amortization of debt discount	-	288,085
Changes in assets and liabilities:		
Accounts receivable	231,910	(119,239)
Inventory, prepaid expenses, and other assets	74,549	40,998
Accounts payable	182,553	6,632
Accrued payroll and related taxes	(14,374)	(75,008)
Deferred revenue	(135,905)	(116,062)
Other accrued liabilities	26,790	(156,251)
Net cash provided by (used in) operating activities	112,016	(592,489)
<b>INVESTING ACTIVITIES</b>		
Purchases of property and equipment	-	(41,189)
Proceeds from sale of property and equipment	-	4,150
Net cash used in investing activities	-	(37,039)
<b>FINANCING ACTIVITIES</b>		
Proceeds from exercise of stock options	4,636	5,153
Net cash provided by financing activities	4,636	5,153
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>116,652</b>	<b>(624,375)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>2,331,011</b>	<b>2,387,204</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 2,447,663</b>	<b>\$ 1,762,829</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ -	\$ 23,563
Cash paid for income taxes	\$ -	\$ -
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES</b>		
Conversion of debt to equity	\$ -	\$ 850,000

The accompanying notes form an integral part of these 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-QSB and, therefore, do not include all information and footnote disclosures that are otherwise required by Regulation S-B and that will normally be made in the Company's Annual Report on Form 10-KSB. Refer to the Company's financial statements on Form 10-KSB for additional information. 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, 2006 are not necessarily indicative of results which may be reported for any other interim period or for the year as a whole.

**2. Recently Issued Accounting Pronouncements**

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155 (“SFAS 155”), “Accounting for Certain Hybrid Financial Instruments” which amends Statement of Financial Accounting Standards No. 133 (“SFAS 133”), “Accounting for Derivative Instruments and Hedging Activities” and Statement of Financial Accounting Standards No. 140 (“SFAS 140”), “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. SFAS 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occurring in fiscal years beginning after September 15, 2006. Earlier adoption is permitted, provided the Company has not yet issued financial statements, including for interim periods, for that fiscal year. Since the Company has no derivative instruments or hedging activities, we do not expect the adoption of SFAS 155 to have a material impact on our financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for us as of January 28, 2008. We are currently assessing the impact, if any, of SFAS 157 on our financial position, results of operation, or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 (“FIN 48”), Accounting for Uncertainty in Income Taxes, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the recognition, classification, interest and penalties, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 are effective for reporting periods beginning after December 15, 2006. The Company is currently assessing the impact of the adoption of FIN 48 and its impact on our financial position, results of operations, or cash flows.

In September 2006, the SEC released Staff Accounting Bulletin No. 108 “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 provides interpretative guidance on how public companies quantify financial statement misstatements. There have been two common approaches used to quantify such errors. Under an income statement approach, the “roll-over” method, the error is quantified as the amount by which the current year income statement is misstated. Alternatively, under a

balance sheet approach, the “iron curtain” method, the error is quantified as the cumulative amount by which the current year balance sheet is misstated. In SAB 108, the SEC established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company’s financial statements and the related financial statement disclosures. This model is commonly referred to as a “dual approach” because it requires quantification of errors under both the roll-over and iron curtain methods. SAB 108 is effective for us as of January 1, 2007. The adoption of SAB 108 is not expected to have a material impact on our financial position, results of operations, or cash flows.



### 3. Accounting for Stock-Based Compensation

#### *Stock Based Benefit Plans*

We have stock option plans for executives and key individuals who make significant contributions to Mitek. The option price to those persons owning more than 10% of the total combined voting power of the Corporation's stock shall not be less than 110% of the fair market value of the stock as determined on the date of the grant of the options.

The 1996 plan provides for the purchase of up to 2,000,000 shares of common stock through incentive and non-qualified options. Options must be granted at fair market value of our stock at the grant date and for a term of not more than ten years. Employees owning in excess of 10% of the outstanding stock are included in the plan on the same terms except that the options must be granted for a term of not more than five years. The 1996 plan maximized in February 1999 and no additional options may be granted under this plan.

The 1999 plan provides for the purchase of up to 1,000,000 shares of common stock through incentive and non-qualified options. Incentive stock options must be granted at fair market value of our stock at the grant date and for a term of not more than ten years. Non-qualified stock options may be granted at no less than 85% of fair market value of our stock at the grant date, and for a term of not more than five years. However, we have elected a three year term date on non-qualified stock option grants.

The 2000 plan provides for the purchase of up to 1,000,000 shares of common stock through incentive and non-qualified options. Incentive options must be granted at fair market value of our stock at the grant date and for a term of not more than ten years. Non-qualified stock options may be granted at no less than 85% of fair market value of our stock at the grant date, and for a term of not more than five years. However, we have elected a three year term date on non-qualified stock option grants.

The 2002 plan provides for the purchase of up to 1,000,000 shares of common stock through incentive and non-qualified options. Incentive options must be granted at fair market value of our stock at the grant date and for a term of not more than ten years. Non-qualified stock options may be granted at no less than 85% of fair market value of our stock at the grant date, and for a term of not more than five years. However, we have elected a three year term date on non-qualified stock option grants.

The 2006 plan provides for the purchase of up to 1,000,000 shares of common stock through incentive and non-qualified options. Incentive options must be granted at fair market value of our stock at the grant date and for a term of not more than ten years. Non-qualified stock options may be granted at no less than 85% of fair market value of our stock at the grant date, and for a term of not more than five years. However, we have elected a three year term date on non-qualified stock option grants.

#### **Adoption of SFAS 123 (R)**

On October 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, ("SFAS 123(R)") which establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on accounting for transactions where an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires an entity to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) for periods beginning in fiscal 2007. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied

the provisions of SAB 107 in its adoption of SFAS 123(R).

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The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of October 1, 2006, the first day of the Company's fiscal year 2007. The Company's Financial Statements as of and for the three months ended December 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statement of Operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Under the intrinsic value method, no stock-based compensation expense had been recognized in the Company's Statement of Operations, other than as related to option grants to employees and consultants below the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's Statement of Operations for the first quarter of fiscal 2007 included compensation expense for share-based payment awards granted prior to, but not yet vested as of September 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to September 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). As stock-based compensation expense recognized in the Statement of Operations for the first quarter of fiscal 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The estimated average forfeiture rates for the three months ended December 31, 2006 of approximately 2.9% for grants to all employees were based on historical forfeiture experience. The estimated expected life of option grants for the first three months of 2006 was approximately 6 years on grants to all employees. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2007, the Company accounted for forfeitures as they occurred.

SFAS 123R requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash flows. Due to the Company's loss position, there were no such tax benefits during the three months ended December 31, 2006 and December 31, 2005. Prior to the adoption of SFAS 123(R) those benefits would have been reported as operating cash flows had the Company received any tax benefits related to stock option exercises.

The fair value of stock-based awards to employees and directors is calculated using the Black-Scholes option pricing model, even though this model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from the Company's stock options. The Black-Scholes model requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The risk-free rate selected to value any particular grant is based on the U.S Treasury rate that corresponds to the expected life of the grant effective as of the date of the grant. The expected volatility is based on the historical volatility of the Company's stock price. These factors could change in the future, affecting the determination of stock-based compensation expense in future periods.

#### **Valuation and Expense Information under SFAS 123(R)**

The value of stock-based compensation is based on the single option valuation approach under SFAS 123R. Forfeitures are estimated. It is assumed no dividends will be declared. The estimated fair value of stock-based

compensation awards to employees is amortized using the straight-line method over the vesting period of the options. The fair value calculations are based on the following assumptions:

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	Three Months Ended December 31, 2006
Risk-free interest rate	2.25% - 5.07%
Expected life (years)	6
Expected volatility	90%
Expected dividends	None

The following table summarizes stock-based compensation expense related to stock options under SFAS 123(R) for the three months ended December 31, 2006 which was allocated as follows:

	Three Months Ended December 31, 2006
Research and development	\$ 11,329
Sales and marketing	9,004
General and administrative	24,016
Stock-based compensation expense related to employee stock options included in operating expenses	\$ 44,349

As a result of adopting SFAS 123(R) on October 1, 2006, the Company's net loss for the three months ended December 31, 2006 was approximately \$44,000 higher than it would have been if it had continued to account for share-based compensation under APB Opinion No. 25. The Company's net loss per common share, basic and diluted, for the three months ended December 31, 2006 was \$0.02. The Company's net loss per common share, basic and diluted, for the three months ended December 31, 2006 would have been \$0.01 if it had continued to account for share-based compensation under APB Opinion No. 25.

The following table summarizes vested and unvested options, fair value per share weighted average remaining term and aggregate intrinsic value.

	Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Term (Years)	Aggregate Intrinsic Value
December 31, 2006				
Vested	1,984,339	0.60	6.54	313,068
Unvested	586,040	0.37	8.37	180,659
Total	2,570,379	0.55	6.95	493,727

As of December 31, 2006, the company had \$175,000 of unrecognized compensation expense expected to be recognized over a weighted average period of approximately 1.5 years. During the quarter ended December 31, 2006, 5,528 options with intrinsic value of \$3,380 were exercised.

A summary of option activity under the Company's stock equity plans during the three months ended December 31, 2006 is as follows:

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	Number of Shares (in Thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)
Outstanding at September 30, 2006	2,616	\$ 1.01	
Granted	0	0	
Exercised	(6)	0.84	
Cancelled	(40)	3.20	
Outstanding at December 31, 2006	2,570	\$ 0.98	6.97

The following table summarizes significant ranges of outstanding and exercisable options as of December 31, 2006:

Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price of Exercisable Options	Number Non-Vested
\$ 0.43- - \$ 0.69	740,111	7.18	\$ 0.56	565,219	\$ 0.57	174,892
\$ 0.75- - \$ 0.92	818,222	6.75	\$ 0.80	482,296	\$ 0.83	335,926
\$ 1.06- - \$ 1.26	810,000	7.60	\$ 1.10	810,000	\$ 1.10	0
\$ 1.60- - \$ 1.68	107,000	4.51	\$ 1.60	103,389	\$ 1.60	3,611
\$ 2.13- - \$ 2.68	63,025	5.08	\$ 2.31	63,025	\$ 2.32	0
\$ 3.25- - \$12.37	32,021	3.34	\$ 6.87	32,021	\$ 6.80	0
	2,570,379	6.97	\$ 0.98	2,055,950	\$ 1.04	514,429

There were no stock options granted during the three months ended December 31, 2006. The per share weighted average fair value of options granted during the three months ended December 31, 2005 was \$0.43.

*Pro Forma Information Under SFAS 123 for Periods Prior to Fiscal 2007*

Prior to fiscal 2007, the weighted-average fair value of stock-based compensation to employees was based on the single option valuation approach. Forfeitures were recognized as they occurred and it was assumed no dividends would be declared.

Prior to fiscal 2007, we accounted 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 the three months ended December 31, 2005.

	2005
Risk free interest rates	4.43%

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Dividend yields	0%
Volatility	79%
Weighted average expected life	3 years



For purposes of pro forma disclosures, the estimated fair value of stock-based compensation awards to employees was amortized to expense over the options' vesting period. Our pro-forma information is as follows (in thousands, except for net loss per share information):

	Three months ended December 31, 2005
Net income (loss) as reported	\$ (472)
Net income (loss) pro forma	(574)
Net income (loss) per share as reported	(0.03)
Net income (loss) per share pro forma	(0.04)

#### 4. Issuance of Convertible Debt

On June 11, 2004, we secured a financing arrangement with Laurus Master Fund ("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 and has a term of three years (matures June 11, 2007).

As noted below, on June 2, 2006, Laurus converted the remaining Secured Note balance to Common Stock, leaving no principal balance due. The Secured Note was convertible into shares of our 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 Secured Note was not convertible until the sooner of (a) time the shares underlying the debt was registered with the SEC and declared effective or (b) shares were available for trading under the provisions of Rule 144. The conversion price of the Secured Note was subject to adjustment upon the occurrence of certain events, such as anti-dilution provisions, all of which were within the control of the company. A registration rights agreement was executed requiring us to register the shares of our common stock underlying the Secured Note and warrants so as to permit the public resale thereof. Liquidated damages of 2% of the Secured Note balance per month would accrue if stipulated deadlines were not met. Prior to the end of fiscal 2004, we incurred a penalty of \$208,000 to Laurus Funds for failing to register the securities underlying the Secured Notes and Warrants. 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 us to be \$73,159, using a Black-Scholes option pricing model. We incurred additional liquidated damages, payable in cash, in the amount of \$215,000 for the period January 1, 2005 to May 13, 2005. The registration became effective on May 13, 2005.

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 required the Company to register the shares underlying the warrants and which contained liquidating damages, which is not within the control of the Company by September 10, 2004, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet (\$367,887) and the change in fair value from the date of issuance to September 30, 2004 and the applicable period in 2005 has been included in other (expense) income.

In connection with the financing, Laurus was also issued warrants to purchase up to 860,000 shares of our 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 among the debt instrument and the warrants. Then we computed the beneficial conversion feature embedded in the debt instrument using the effective conversion price in accordance with EITF 98-5 and 00-27. We have 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 was being amortized over the term of the Secured Note until the note was converted to shares on June 2, 2006. Cumulative amortization of the debt discounts through June 2, 2006 was \$1,041,271. The effective annual interest rate of this Convertible Debt, after considering the total debt issue costs (discussed below), was approximately 36%.

On June 11, 2004, to secure the payment of all obligations, we entered into a Master Security Agreement which assigned and granted 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 us 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, trade styles and any other intellectual property, in each case, in which any Assignor now has 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 agreed to release its security interest on such hereafter-acquired equipment so financed by such third party financing source.

The Secured Note stipulated that it was to be repaid using cash payment along with an equity conversion option; the details of both methods for repayment are as follows: The cash repayments stipulated that beginning on December 1, 2004, or the first amortization date, we would 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 stated that each month by the fifth business day prior to each amortization date, Laurus would deliver to us 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 was not delivered by Laurus on or before the applicable notice date for such repayment date, then we would pay the monthly amount due in cash. Any portion of the monthly amount paid in cash would be paid to Laurus in an amount equal to 102% of the principal portion of the monthly amount due. If Laurus converted all or a portion of the monthly amount in shares of our common stock, the number of such shares to be issued by us would 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.

There was no conversion of debt to equity for the period ended December 31, 2006 as the debt was fully converted to equity in June 2006 which left no outstanding principal balance on the note. During the quarter ended December 31, 2005, Laurus exercised its right to convert \$850,000 of the outstanding principal balance of the note to common stock at the conversion price of \$0.70 per share, and Laurus was issued 1,214,286 shares of common stock on this conversion to equity. In the quarter ended December 31, 2005, we expensed \$288,085 of deferred financing costs associated with this debt.

## **5. Commitments and Contingencies**

*Leases* - Our office is leased under a non-cancelable operating lease. The lease costs are expensed on a straight-line basis over the lease term. In September 2005, we signed a seven year lease for a property located at 8911 Balboa Avenue, San Diego, California and moved in early December of 2005. The Lease is effective and binding on the parties as of September 19, 2005; however, the term of the Lease began on December 9, 2005, which is the date on which the Landlord achieved substantial completion of certain improvements in accordance with the terms of the Lease (the "Commencement Date"). The initial term of the Lease is seven years. The Lease will be terminable by the Company after the calendar month which is forty-eight (48) full calendar months after the Commencement Date; however, termination will require certain penalties to be paid equal to two months of base rent and all unamortized improvements and commissions. As of the date of this financial statement, the Company does not have any intent to terminate this office lease

### **Contingent Liability**

Mitek has accrued, but not yet paid, approximately \$700,000 of fees and expenses in contemplation of the merger (See Note 9). Mitek may have to recognize and pay up to \$1.2 million of additional merger related expenses as a result of the termination of the contemplated transaction. The Company has had discussions with its creditors who provided merger related services regarding these amounts owed, and at the time of such discussions, the creditors expressed a willingness to consider the Company's proposals for addressing these debts. No assurance can be made that the Company's creditors will agree to a proposal that is satisfactory to the Company

## **6. Related Party Transactions**

John H. Harland Company made an investment in Mitek in February and May 2005, as discussed in detail in the Company's annual 10K-SB filing, found at Note 8 under Stockholders' Equity. This transaction resulted in John H. Harland Company and its subsidiary, Harland Financial Services, (collectively "John Harland") being considered related parties. In connection with the sale, we granted John Harland board observation rights for as long as John Harland continues to hold at least 20% of the shares of common stock it purchased under the Securities Purchase Agreement

together with the shares of common stock issuable upon exercise of the warrants.

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In the first quarter of fiscal 2007, we realized revenue of approximately \$80,000 with John H. Harland Company ("John Harland") for maintenance covering engineering development services pursuant to an agreement dated February 22, 2005 which was subsequently amended on December 29, 2005 and March 21, 2006. In addition, we sold to Harland Financial Solutions, a subsidiary of John Harland, software licenses and related software maintenance for approximately \$30,000. In the first quarter of fiscal 2006, we realized revenue of approximately \$350,000 with John H. Harland Company for engineering development services. In addition, we sold to Harland Financial Solutions software licenses and related software maintenance for approximately \$17,000. At December 31, 2006, there was an outstanding receivable balance from Harland Financial Solutions of approximately \$20,000.

**7. Related Party Transactions** - Below is a summary of the revenues by product lines.

Revenue (000's)	Three Months Ended December 31	
	2006	2005
Recognition Toolkits	\$ 903	\$ 1,126
Document and Image Processing Solutions	12	10
Maintenance and other	524	385
Total Revenue	\$ 1,439	\$ 1,521

**8. Stockholders' Equity**

*Shares Sold For Cash*

On May 4, 2005, John H. Harland Company ("John Harland") acquired 1,071,428 shares of unregistered common stock for an aggregate purchase price of \$750,000, or \$.70 per share. As part of the acquisition of the shares on May 4, John Harland received warrants to purchase 160,714 additional shares of common stock at an exercise price of \$0.70 per share. These warrants are valid until May 4, 2012. This sale was the second sale of securities pursuant to the terms of a Securities Purchase Agreement between Mitek and John Harland dated February 22, 2005, under which, on February 22, 2005, John Harland acquired 1,071,428 shares of unregistered common stock for an aggregate purchase price of \$750,000, or \$.70 per share. As part of the acquisition of shares on February 22, John Harland received warrants to purchase 160,714 additional shares of common stock at \$0.70 per share. These warrants expire on February 22, 2012.

Under the terms of the Securities Purchase Agreement, John Harland had the right to make the second investment of \$750,000 in the event we were able to increase our authorized shares of common stock. On May 4, 2005, the Shareholders of Mitek approved an amendment to our Certificate of Incorporation which increased the authorized number of shares of common stock of Mitek from 20,000,000 to 40,000,000 and John Harland completed the second investment of \$750,000. In connection with the sale, we granted John Harland board observation rights for as long as John Harland continues to hold at least 20% of the shares of common stock it purchased under the Securities Purchase Agreement together with the shares of common stock issuable upon exercise of the warrants. As a result of these transactions, John Harland is considered a related party, as defined under Generally Accepted Accounting Principles.

**9. Subsequent Events and Liquidity**

On July 14, 2006, we announced that we had entered into an agreement to acquire substantially all of the assets and associated liabilities of Parascript LLC, a Wyoming limited liability company. Under this agreement, Parascript unit holders were to receive approximately \$80 million in cash and 52 million shares of Mitek common stock. Funding for

the transaction was to be provided by Plainfield Offshore Holdings VIII, Inc. The transaction was to be subject to approval by shareholders of Mitek and the unit holders of Parascript, as well as the authorization and registration of shares to be issued to Parascript and other customary closing conditions. For accounting purposes, this transaction was to be treated as a reverse acquisition, whereby Parascript LLC was to be treated as the acquirer of Mitek.

On January 23, 2007, Mitek notified Parascript that it was terminating the merger agreement. As previously reported, Mitek has accrued, but not yet paid, approximately \$700,000 of fees and expenses in contemplation of the merger. Mitek may have to recognize and pay up to \$1.2 million of additional merger related expenses as a result of the termination of the contemplated transaction. The Company has had discussions with its creditors who provided merger related services regarding these amounts owed, and at the time of such discussions, the creditors expressed a willingness to consider the Company's proposals for addressing these debts. No assurance can be made that the Company's creditors will agree to a proposal that is satisfactory to the Company. If the Company is required to make full payment of the various merger-related fees and expenses, it will have a material adverse effect upon our liquidity position and ability to operate.

## ITEM 2

### MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### *Management's Discussion*

In addition to historical information, this Management's Discussion and Analysis (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 us, 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 our actual financial condition, operating results and business performance may differ materially from that projected or estimated by us in forward-looking statements. We have attempted to identify certain of the factors that we currently believe may cause actual future experiences and results to differ from our 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 our products and services; (iii) intense competition, including entry of new competitors into our markets; (iv) increased or adverse federal, state and local government regulation; (v) our inability to retain our working capital or otherwise obtain additional capital on terms satisfactory to us; (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 litigation and/or administrative proceedings involving us and our employees; (xi) higher than anticipated labor costs; (xii) adverse publicity or news coverage regarding us; (xiii) inability to successfully carry out marketing and sales plans; (xiv) loss of key executives; (xv) the impact of fees and expenses related to the planned transaction with Parascript (xvi) inflationary factors; (xvii) and other specific risks that may be alluded to in this MD&A.

Our strategy for fiscal 2007 is to grow the identified markets for our new products and enhance the functionality and marketability of our 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. We also seek to expand the installed base of our Check Forgery detection Solutions by entering into reselling relationships with key resellers who will better penetrate the market and provide entrée into a larger base of community banks.

#### APPLICATION OF CRITICAL ACCOUNTING POLICIES

Mitek's financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted 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, allowance for doubtful accounts receivable, fair value of equity instruments and accounting for income taxes.

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### *Revenue Recognition*

We enter into contractual arrangements with integrators, resellers and end users that may include licensing of our 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. Our accounting policies regarding the recognition of revenue for these contractual arrangements is fully described in the Notes to the Financial Statements, filed with Form 10K-SB for the year ended September 30, 2006.

We consider many factors when applying generally accepted accounting principles to revenue recognition. These factors include, but are not limited to:

- The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
- Time period over which services are to be performed
- Creditworthiness of the customer
- The complexity of customizations to our software required by service contracts
- The sales channel through which the sale is made (direct, VAR, distributor, etc.)
- Discounts given for each element of a contract
- 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. 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 our 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 customers' 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.

### *Fair Value of Equity Instruments*

The valuation of certain items, including valuation of warrants, beneficial conversion feature related to convertible debt and compensation expense related to stock options granted, involve significant estimates 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.

### *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 we can demonstrate that we will no longer incur losses or if we are unable to generate sufficient future taxable income we could be required to maintain the valuation allowance against our deferred tax assets.

**RISK FACTORS**

This Quarterly Report on Form 10-QSB contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of issues and uncertainties such as those listed below and elsewhere in this report, which, among others, should be considered in evaluating our financial outlook.

***Risks Associated With Our Business***

**We have recently terminated our business combination agreement with Parascript and the impact of various accrued costs and expenses associated with the transaction may have a material adverse effect upon our financial resources and our ability to operate in the future.**

We expended considerable financial and other resources in connection with the proposed business combination with Parascript. We anticipated that the cash flow from the combined businesses would be used to satisfy the costs and expenses associated with the transaction. Because the transaction will not be consummated, the payment for the various substantial costs and expenses we have incurred will have a material adverse effect upon our financial condition and may have a negative impact on our ability to operate effectively, or at all, in the future.

**Because most of our revenues are from a single type of technology, our product concentration may make us especially vulnerable to market demand and competition from other technologies, which could reduce our sales and revenues and cause us to be unable to continue our business.**

We currently derive substantially all of our product revenues from licenses and sales of software products incorporating our character recognition technology. As a result, factors adversely affecting the pricing of or demand for our products and services, such as competition from other products or technologies, any decline in the demand for automated entry of hand printed characters, negative publicity or obsolescence of the software environments in which our products operate could result in lower sales or gross margins and would have a material adverse effect on our business, operating results and financial condition.

**Competition in our market may result in pricing pressures, reduced margins or the inability of our products and services to achieve market acceptance.**

We compete against numerous other companies which address the character recognition market, many of which have greater financial, technical, marketing and other resources. Other companies could choose to enter our marketplace. We may be unable to compete successfully against our current and potential competitors, which may result in price reductions, reduced margins and the inability to achieve market acceptance for our products. Moreover, from time to time, our competitors or we may announce new products or technologies that have the potential to replace our existing product offerings. There can be no assurance that the announcement of new product offerings will not cause potential customers to defer purchases of our existing products, which could adversely affect our business, operating results and financial condition.

**We must continue extensive research and development in order to remain competitive. If our products fail to gain market acceptance, our business, operating results and financial condition would be materially adversely affected by the lower sales.**

Our ability to compete effectively with our character recognition product line will depend upon our ability to meet changing market conditions and develop enhancements to our products on a timely basis in order to maintain our competitive advantage. Rapidly advancing technology and rapidly changing user preferences characterize the markets for products incorporating character recognition technology. Our continued growth will ultimately depend upon our ability to develop additional technologies and attract strategic alliances for related or separate product lines. There can

be no assurance that we will be successful in developing and marketing product enhancements and additional technologies, that we will not experience difficulties that could delay or prevent the successful development, introduction and marketing of these products, or that our new products and product enhancements will adequately meet the requirements of the marketplace, will be of acceptable quality, or will achieve market acceptance.

If our new products fail to gain market acceptance, our business, operating results and financial condition would be materially adversely affected by the lower sales. If we are unable, for technological or other reasons, to develop and introduce products in a timely manner in response to changing market conditions or customer requirements, our business, operating results and financial condition may be materially and adversely affected by lower sales.

**Our annual and quarterly results have fluctuated greatly in the past and will likely continue to do so, which may cause substantial fluctuations in our common stock price.**

Our quarterly operating results have in the past and may in the future vary significantly depending on factors including the timing of customer projects and purchase orders, new product announcements and releases by us and other companies, gain or loss of significant customers, price discounting of our products, the timing of expenditures, customer product delivery requirements, availability and cost of components or labor and economic conditions generally and in the information technology market specifically. Any unfavorable change in these or other factors could have a material adverse effect on our operating results for a particular quarter or year, which may cause downward pressure on our common stock price. We expect quarterly and annual fluctuations to continue for the foreseeable future.

**We may need to raise additional capital to fund continuing operations. If our financing efforts are not successful, we will need to explore alternatives to continue operations, which may include a merger, asset sale, joint venture, loans or further expense reductions. If these measures are not successful, we may be unable to continue our operations.**

Our efforts to reduce expenses and generate revenue may not be successful. We have funded our operations in the past by raising capital, sale of certain assets and loan from Laurus Fund. We raised \$3.0 million in gross proceeds from our June 2004 secured debt financing and a total of approximately \$2.4 million in gross proceeds ( \$1.3 million in July of 2004 and \$1.0 million in April of 2005 and a release of \$106,000 from indemnification liability withholding in the fourth quarter of fiscal 2005) from our July sale of certain assets and granting of exclusive distribution and licensing rights related to our CheckQuest® item processing and CaptureQuest® electronic document management solutions to Harland Financial Solutions, Inc. In addition we received \$1.5 million in equity investment from John H. Harland Company.

If our revenues do not increase we may expect the need to raise additional capital through equity or debt financing or through the establishment of other funding facilities in order to keep funding operations.

However, raising capital has been, and will continue to be difficult, and we may not receive sufficient funding. Any future financing that we seek may not be available in amounts or at times when needed, or, even if it is available, may not be on terms acceptable to us. Also, if we raise additional funds by selling equity or equity-based securities, the percentage ownership of our existing stockholders will be reduced and such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock.

If we are unable to obtain sufficient cash either to continue to fund operations or to locate a strategic alternative, we may be forced to seek protection from creditors under the bankruptcy laws or cease operations. Any inability to obtain additional cash as needed could have a material adverse effect on our financial position, results of operations and ability to continue in existence.

Also, see the discussion of the transaction described under Subsequent Events and the credit facilities which may exist upon the consummation of such transaction.

**Our historical order flow patterns, which we expect to continue, have caused forecasting difficulties for us. If we do not meet our forecasts or analysts' forecasts for us, the price of our common stock may decline.**

Historically, a significant portion of our sales have resulted from shipments during the last few weeks of the quarter from orders received in the last month of the applicable quarter. We do, however, base our expense levels, in significant part, on our expectations of future revenue. As a result, we expect our expense levels to be relatively fixed

in the short term. Any concentration of sales at the end of the quarter may limit our ability to plan or adjust operating expenses. Therefore, if anticipated shipments in any quarter do not occur or are delayed, expenditure levels could be disproportionately high as a percentage of sales, and our operating results for that quarter would be adversely affected. As a result, we believe that period-to-period comparisons of our results of operations are not and will not necessarily be meaningful, and you should not rely upon them as an indication of future performance. If our operating results for a quarter are below the expectations of public market analysts and investors, the price of our common stock may be materially adversely affected.

**If our products have product defects, it could damage our reputation, sales, profitability and result in other costs, any of which could adversely affect our operating results which could cause our common stock price to go down.**

Our products are extremely complex and are constantly being modified and improved, and as such they may contain undetected defects or errors when first introduced or as new versions are released. As a result, we have in the past and could in the future face loss or delay in recognition of revenues as a result of software errors or defects. In addition, our products are typically intended for use in applications that are critical to a customer's business. As a result, we believe that our customers and potential customers have a greater sensitivity to product defects than the market for software products generally.

There can be no assurance that, despite our testing, errors will not be found in new products or releases after commencement of commercial shipments, resulting in loss of revenues or delay in market acceptance, diversion of development resources, damage to our reputation, adverse litigation, or increased service and warranty costs, any of which would have a material adverse effect upon our business, operating results and financial condition.

**Our success and our ability to compete are dependent, in part, upon protection of our proprietary technology. If we are unable to protect our proprietary technology, our revenues and operating results would be materially adversely affected.**

We generally rely on trademark, trade secret, copyright and patent law to protect our intellectual property. We may also rely on creative skills of our personnel, new product developments, frequent product enhancements and reliable product maintenance as means of protecting our proprietary technologies. There can be no assurance, however, that such means will be successful in protecting our intellectual property. There can be no assurance that others will not develop technologies that are similar or superior to our technology.

The source code for our proprietary software is protected both as a trade secret and as a copyrighted work. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our products or technology without authorization, or to develop similar technology independently.

**We may have difficulty protecting our proprietary technology in countries other than the United States. If we are unable to protect our proprietary technology, our revenues and operating results would be materially adversely affected.**

We operate in a number of countries other than the United States. Effective copyright and trade secret protection may be unavailable or limited in certain countries. Moreover, there can be no assurance that the protection provided to our proprietary technology by the laws and courts of foreign nations against piracy and infringement will be substantially similar to the remedies available under United States law. Any of the foregoing considerations could result in a loss or diminution in value of our intellectual property, which could have a material adverse effect on our business, financial condition, and results of operations.

**Companies may claim that we infringe their intellectual property or proprietary rights, which could cause us to incur significant expenses or prevent us from selling our products.**

We have in the past had companies claim that certain technologies incorporated in our products infringe their patent rights. Although we have resolved the past claims and there are currently no claims of infringement pending against us, there can be no assurance that we will not receive notices in the future from parties asserting that our products infringe, or may infringe, those parties' intellectual property rights. There can be no assurance that licenses to disputed technology or intellectual property rights would be available on reasonable commercial terms, if at all.

Furthermore, we may initiate claims or litigation against parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation, either as plaintiff or defendant, could result in significant expense to us and divert the efforts of our technical and management personnel from operations, whether or not such litigation is resolved in our favor. In the event of an adverse ruling in any such litigation, we might be required to pay substantial damages, discontinue the use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to infringing technology. In the event of a successful claim against us and our failure to develop or license a substitute technology, our business, financial condition and results of operations would be materially and adversely affected.



**We depend upon our key personnel.**

Our future success depends in large part on the continued service of our key technical and management personnel. We do not have employment contracts with, or "key person" life insurance policies on, any of our employees, including Mr. James B. DeBello, our President and Chief Executive Officer, Mr. John M. Thornton, our Chairman and Mr. Tesfaye Hailemichael, our Chief Financial Officer. Loss of services of key employees could have a material adverse effect on our operations and financial condition. We are also dependent on our ability to identify, hire, train, retain and motivate high quality personnel, especially highly skilled engineers involved in the ongoing developments required to refine our technologies and to introduce future applications. The high technology industry is characterized by a high level of employee mobility and aggressive recruiting of skilled personnel.

We cannot assure you that we will be successful in attracting, assimilating and retaining additional qualified personnel in the future. If we were to lose the services of one or more of our key personnel, or if we failed to attract and retain additional qualified personnel, it could materially and adversely affect our customer relationships, competitive position and revenues.

**We do not have a current credit facility.**

As previously reported, Mitek has accrued, but not yet paid, approximately \$700,000 of fees and expenses in contemplation of the merger. Mitek may have to recognize and pay up to \$1.2 million of additional merger related expenses as a result of the termination of the contemplated transaction. The Company has had discussions with its creditors who provided merger related services regarding these amounts owed, and at the time of such discussions, the creditors expressed a willingness to consider the Company's proposals for addressing these debts. If the Company is required to make full payment of the various merger related fees and expenses, it will have a material adverse effect upon our liquidity position and ability to operate.

While we believe that our current cash on hand and cash generated from operations, to finance our operations for the next twelve months, we can make no assurance that we will not need additional financing during the next twelve months or beyond. Actual sales, expenses, market conditions or other factors which could have a material affect upon us could require us to obtain additional financing. If such financing is not available, or if available, is not available on reasonable terms, it could have a material adverse effect upon our results of operations and financial condition.

Also, see the discussion of the transaction described under Subsequent Events and the credit facilities which may exist upon the consummation of such transaction.

**The liability of our officers and directors is limited pursuant to Delaware law.**

Pursuant to our Certificate of Incorporation, and as authorized under applicable Delaware Law, our directors and officers are not liable for monetary damages for breach of fiduciary duty, except for liability (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law or (iv) for any transaction from which the director derived an improper personal benefit.

***Risks Related to Our Stock***

**A few of our stockholders have significant control over our voting stock which may make it difficult to complete some corporate transactions without their support and may prevent a change in control.**

As of December 31, 2006, John M. Thornton, who is our Chairman of the Board and his spouse, Director Sally B. Thornton, beneficially owned 2,699,959 shares of common stock or approximately 17% of our outstanding common

stock. Our directors and executive officers as a whole, own approximately 16% of our outstanding common stock, or approximately 28% including outstanding options (vested and unvested) to acquire common stock. John H. Harland Company has 2,464,284 common stock or approximately 14.7% and 321,428 warrants. Harland may acquire 321,428 common stock upon exercise of the warrants and increase its holding to approximately 16.2%. Laurus may acquire up to 1,060,000 shares upon exercise of its warrant or approximately 5% of the outstanding common stock.

The above-described significant stockholders may have considerable influence over the outcome of all matters submitted to our stockholders for approval, including the election of directors. In addition, this ownership could discourage the acquisition of our common stock by potential investors and could have an anti-takeover effect, possibly depressing the trading price of our common stock.

**Our common stock is listed on the Over-The-Counter Bulletin Board.**

Our common stock is currently listed on the Over-The-Counter Bulletin Board (the "OTCBB"). If our common stock became ineligible to be listed on the OTCBB, it would likely continue to be listed on the "pink sheets." Securities traded on the OTCBB or the "pink sheets" are subject to certain securities regulations. These regulations may limit, in certain circumstances, certain trading activities in our common stock, which could reduce the volume of trading in our common stock or the market price of our common stock. The OTC market and the "pink sheets" also typically exhibit extreme price and volume fluctuations. These broad market factors may materially adversely affect the market price of our common stock, regardless of our actual operating performance. In the past, individual companies whose securities have exhibited periods of volatility in their market price have had securities class action litigation instituted against that company. This type of litigation, if instituted, could result in substantial costs and a diversion of management's attention and resources.

**We may issue preferred stock, which could adversely affect the rights of common stock holders.**

The Board of Directors is authorized to issue up to 1,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. We have no current plans to issue shares of preferred stock. In addition, Section 203 of the Delaware General Corporation Law restricts certain business combinations with any "interested stockholder" as defined by such statute. The statute may have the effect of delaying, deferring or preventing a change in our control.

**Our common stock price has been volatile. You may not be able to sell your shares of our common stock for an amount equal to or greater than the price at which you acquire your shares of common stock.**

The market price of our common stock has been, and is likely to continue to be, highly volatile. Future announcements concerning us or our competitors, quarterly variations in operating results, announcements of technological innovations, the introduction of new products or changes in the product pricing policies of Mitek or its competitors, claims of infringement of proprietary rights or other litigation, changes in earnings estimates by analysts or other factors could cause the market price of our common stock to fluctuate substantially. In addition, the stock market has from time-to-time experienced significant price and volume fluctuations that have particularly affected the market prices for the common stocks of technology companies and that have often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. During the fiscal year ended September 30, 2006, our common stock price ranged from \$0.70 to \$1.88. During the quarter ended December 31, 2006, our common stock price ranged from \$0.92 to \$1.55.

**Future sales of our common stock may cause our stock price to decline.**

The sale of a large number of shares of our common stock in the market or the belief that such sales could occur, could cause a drop in the market price of our common stock. The shares registered in this offering will be freely tradable without restriction or further registration under the Securities Act, unless the shares are purchased by our affiliates.

**Applicable SEC Rules governing the trading of "penny stocks" limit the trading and liquidity of our common stock which may adversely affect the trading price of our common stock.**

Our common stock currently trades on the OTC Bulletin Board. Since our common stock continues to trade below \$5.00 per share, our common stock is considered a “penny stock” and is subject to SEC rules and regulations that impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure document explaining the penny stock market and the associated risks. Under these regulations, brokers who recommend penny stocks to persons other than established customers or certain accredited investors must make a special written suitability determination for the purchaser and receive the purchaser’s written agreement to a transaction prior to sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

**We do not intend to pay dividends in the foreseeable future.**

We have never declared or paid a dividend on our common stock. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends in the foreseeable future.

**ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS:**

**Comparison of Three Months Ended December 31, 2006 and 2005**

*Net Sales.* Net sales for the three month period ended December 31, 2006 were approximately \$1,439,000, compared to approximately \$1,521,000 for the same period in 2005, a decrease of approximately \$82,000, or 5%. The decrease was primarily attributable to decrease in engineering services revenue to a related party. Such decrease was partially offset by an increase in software sales during the quarter.

Revenue from John Harland Co. for engineering development services were none for the quarter ended December 31, 2006 compared with \$350,000 for the same period in fiscal 2005. The decrease in the current period is attributable to our fulfillment of the engineering services contract. However, we received \$80,000 in maintenance revenue from John Harland relating to the product licensed under the contract for engineering development services. Revenue on software licenses and related maintenance of approximately \$30,000 was sold to Harland Financial Solutions for the period ended December 31, 2006 compared to \$17,000 for the same period in 2005.

*Cost of Sales.* Cost of Sales for the three month period ended December 31, 2006 was approximately \$157,000 compared to approximately \$410,000 for the same period in 2005, a decrease of approximately \$253,000 or 62%. The dollar decrease was primarily attributable to the decrease in costs related to engineering services revenue from John Harland. Stated as a percentage of net sales, cost of sales were 11% compared to 27% for the same period in fiscal 2005. The decrease as a percentage of sales was primarily in costs related to engineering services revenue from John Harland.

*Operations.* Operations expense for the three-month period ended December 31, 2006 were approximately \$22,000, compared to \$21,000 for the same period in 2005. Stated as a percentage of net sales, operations expenses were 2% for the periods ended December 31, 2006 and 2005

*Selling and Marketing.* Selling and marketing expenses for the three month period ended December 31, 2006 were approximately \$255,000, compared to \$399,000 for the same period in 2005, a decrease of approximately \$144,000 or 36%. Stated as a percentage of net sales, selling and marketing expenses decreased to 18% for the period ended December 31, 2006, compared to 26% for the same period in 2005. The dollar decrease in expenses for the three month period is primarily attributable to reduced headcount in the current fiscal year which was offset by stock option expense of approximately \$9,000.

*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, 2006 were approximately \$502,000 compared to approximately \$327,000 for the same period in 2005, an increase of approximately \$175,000 or 54%. Stated as a percentage of net sales, research and development expenses increased to 34% for the period ended December 31, 2006 compared to 21% for the same period in 2005. The increase in expenses for the three month period ended December 31, 2006 includes approximately \$11,000 in stock option expense.

Research and Development expenses for the quarter ended December 31, 2006 did not require any reclassification to cost of goods sold, as there was no engineering services revenue in this period. In the period ended December 31, 2005, such expense was shown net of \$345,000 of costs related to contract development and therefore charged to cost of sales-professional services, education and other. Gross Research and development spending including charges to cost of sales were approximately \$502,000 and \$672,000 for the three month periods ended December 31, 2006 and 2005, respectively.

*General and Administrative.* General and administrative expenses for the three month period ended December 31, 2006 were approximately \$796,000, compared to \$532,000 for the same period in 2005, an increase of approximately \$264,000 or 50%. Stated as a percentage of net sales, general and administrative expenses increased to 55% compared to 35% for the same period in 2005. The increase in expenses for the three month period is primarily attributable to the legal and regulatory costs relating to the merger of Parascript, LLC and Mitek described in Footnote 9 of the financial statements, and includes stock option expense of approximately \$24,000.

*Interest and Other Income (Expense) - Net.* Interest and other income (expense) for the three-month period ended December 31, 2006 were approximately (\$1,000) compared to interest and other income (expense) of approximately (\$305,000) for the same period in 2005, a change of approximately \$369,000. The primary reason for the change was the elimination of interest expense relating to the debt from Laurus, which was fully converted to equity in June 2006 leaving no outstanding principal balance on the note. This transaction is more fully discussed in Note 4 to the financial statements. In the period ended December 31, 2005, interest expense totaled \$312,000, including cash interest paid to Laurus Master Fund of \$24,000. Included in interest expense during this period was amortization of the deferred loan costs related to the beneficial conversion feature of the convertible note, including additional expense recognized from accelerated conversion of debt to equity.

## LIQUIDITY AND CAPITAL

At December 31, 2006, the Company had approximately \$2,448,000 in cash and cash equivalents as compared to \$2,331,000 at September 30, 2006. Accounts receivable totaled approximately \$862,000, a decrease of approximately \$217,000 over the September 30, 2006 balance of approximately \$1,079,000. This decrease in accounts receivable was due to slightly lower sales in the first quarter and prompt collections.

We financed our cash needs during the first quarter of fiscal 2007 and for the same period in fiscal 2006 primarily from collections of accounts receivable and existing cash.

Net cash provided by operating activities during the three months ended December 31, 2006 was approximately \$112,000. The primary use of cash from operating activities was the loss during the three month period of approximately \$294,000. The primary sources of cash from operating activities was a decrease to accounts receivable of \$232,000, an increase to accounts payable of approximately \$183,000 which was offset by a decrease in deferred revenue of approximately \$136,000. The primary non-cash adjustment to operating activities was stock option expense of approximately \$44,000 and depreciation and amortization of approximately \$11,000.

Our working capital and current ratio was approximately \$1,678,000 and 1.96, respectively, at December 31, 2006, compared to \$1,905,000 and 2.12 at September 30, 2006, and total liabilities to equity ratio was 1.01 to 1 at December 31, 2006 compared to .86 to 1 at September 30, 2006.

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

We evaluate our cash requirements on a quarterly basis. Historically, we have managed our cash requirements principally from cash generated from operations and financing transactions. We believe that we will have sufficient capital to finance our operations for the next twelve months using existing cash and cash equivalents, and cash to be generated from operations, subject to the outcomes described below

As discussed in the accompanying financial statements, on July 14, 2006, we announced that we entered into an agreement to acquire substantially all of the assets and associated liabilities of Parascript LLC ("Parascript"), a Wyoming limited liability company. Funding for this transaction was to be provided by a combination of \$35 million in subordinated convertible notes and \$55 million in senior debt from Plainfield Asset Management, LLC.

On January 23, 2007, Mitek notified Parascript that it was terminating the merger agreement. As previously reported, Mitek has accrued, but not yet paid, approximately \$700,000 of fees and expenses in contemplation of the merger. Mitek may have to recognize and pay up to \$1.2 million of additional merger related expenses as a result of the termination of the contemplated transaction. The Company has had discussions with its creditors who provided merger related services regarding these amounts owed, and at the time of such discussions, the creditors expressed a willingness to consider the Company's proposals for addressing these debts. No assurance can be made that the Company's creditors will agree to a proposal that is satisfactory to the Company. If the Company is required to make full payment of the various merger related fees and expenses, it will have a material adverse effect upon our liquidity position and ability to operate.



ITEM 3

CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our 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 end of the quarter ended December 31, 2006.

There have not been any changes in our internal controls 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, 2006 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting

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-KSB for the year ended September 30, 2006, 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. Forms 8-K

None

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 13, 2007

/s/ James B. DeBello

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James B. DeBello, President and  
Chief Executive Officer

Date: February 13, 2007

/s/ Tesfaye Hailemichael

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Tesfaye Hailemichael  
Chief Financial Officer