MITEK SYSTEMS INC
Form 10-Q
August 16, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2010

or

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

For the transition period from _________ to ___________.

Commission File Number 0-15235

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

Delaware	87-0418827
(State of Incorporation)	(I.R.S. Employer Identification No.)
8911 Balboa Ave., Suite B San Diego, California	92123
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number: (858) 503-7810

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act Check one):

Large Accelerated Filer o	Accelerated Filer o
Non-Accelerated Filer o	

Smaller Reporting
Company x

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

There were 17,418,337 shares outstanding of the registrant's common stock as of August 12, 2010.

MITEK SYSTEMS, INC.

FORM 10-Q

For the quarterly period ended June 30, 2010

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Special Note About Forward-Looking Statements

We make forward-looking statements in this report, particularly in Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in the documents that are incorporated by reference into this report, if any. These forward-looking statements relate to Mitek's outlook or expectations for earnings, revenues, expenses, asset quality or other future financial or business performance, strategies or expectations, or the impact of legal, regulatory or supervisory matters on Mitek's business, results of operations or financial condition. Specifically, forward looking statements used in this report may include statements relating to future business prospects, revenue, income and financial condition of Mitek.

Forward-looking statements can be identified by the use of words such as "estimate," "may," "plan," "project," "forecast," "intend," "expect," "anticipate," "believe," "seek," "target" or similar expressions. These statements reflect Mitek's judgment based on currently available information at June 30, 2010 and involve a number of risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

In addition to those factors discussed under the heading "Risk Factors" in Part II, Item 1A of this report, and in Mitek's other public filings with the Securities and Exchange Commission, important factors could cause actual results to differ materially from our expectations. These factors include, but are not limited to:

- adverse economic conditions;
- general decreases in demand for Mitek products and services;
- intense competition (including entry of new competitors), including among competitors with substantially greater resources than Mitek;
- loss of key customers or contracts;
- increased or adverse federal, state and local government regulation;
- inadequate capital;
- unexpected costs;
- lower revenues and net income than forecast;
- the risk of litigation and administrative proceedings;
- the possible fluctuation and volatility of operating results and financial condition;
- adverse publicity and news coverage;
- inability to carry out marketing and sales plans; and
- loss of key employees and executives.

You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date hereof, or in the case of a document incorporated by reference, as of the date of that document. Except as required by law, we undertake no obligation to publicly update or release any revisions to these forward-looking statements to reflect any events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

The above list is not intended to be exhaustive and there may be other factors that would preclude us from realizing the predictions made in the forward-looking statement. We operate in a continually changing business environment and new factors emerge from time to time. We cannot predict such factors or assess the impact, if any, of such factors on their respective financial positions or results of operations.

In this report, unless the context indicates otherwise, the terms "Mitek," "Company," "we," "us," and "our" refer to Mitek Systems, Inc., a Delaware corporation.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MITEK SYSTEMS, INC
BALANCE SHEETS

	June 30, 2010 (Unaudited)	September 30, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,495,428	$ 674,115
Accounts receivable including related party of $1,485 and $10,003, respectively, net of allowance of $6,003 and $24,268, respectively	554,403	360,817
Deferred maintenance fees	99,353	60,683
Inventory, prepaid expenses and other current assets	90,715	49,910
Total current assets	2,239,899	1,145,525
PROPERTY AND EQUIPMENT-net	39,559	60,367
SOFTWARE DEVELOPMENT COSTS-net	262,885	365,753
OTHER LONG-TERM ASSETS	49,538	29,465
TOTAL ASSETS	$ 2,591,881	$ 1,601,110
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 335,254	$ 356,305
Accrued payroll and related taxes	230,109	206,197
Deferred revenue	809,097	700,714
Deferred rent, current	9,193	118,732
Other accrued liabilities	40,647	44,023
Total current liabilities	1,424,300	1,425,971
LONG-TERM LIABILITIES:		
Convertible debt	587,339	-
Deferred rent, non-current	42,350	49,374
Total long-term liabilities	629,689	49,374
TOTAL LIABILITIES	2,053,989	1,475,345
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.001 par value, 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock, $0.001 par value, 40,000,000 shares authorized, 17,226,137 and 16,751,137 issued and outstanding, respectively	17,226	16,751
Additional paid-in capital	16,195,188	14,920,999
Accumulated deficit	(15,674,522)	(14,811,985)

Total stockholders' equity		537,892		125,765
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	2,591,881	$	1,601,110

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

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MITEK SYSTEMS, INC
STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
SALES:				
Software	$ 370,464	$ 418,778	$ 2,076,220	$ 1,346,869
Maintenance and professional services	452,026	495,960	1,422,246	1,467,600
Total sales	822,490	914,738	3,498,466	2,814,469
COSTS AND EXPENSES:				
Cost of sales-software	139,713	117,473	562,090	338,273
Cost of sales-maintenance and professional services	63,531	70,268	176,433	180,104
Operations	-	-	-	29,840
Selling and marketing	224,772	133,340	620,611	684,397
Research and development	491,619	409,903	1,505,443	1,413,588
General and administrative	458,184	268,737	1,289,969	1,160,843
Total costs and expenses	1,377,819	999,721	4,154,546	3,807,045
OPERATING LOSS	(555,329)	(84,983)	(656,080)	(992,576)
OTHER (EXPENSE) INCOME:				
Interest and other expense	(91,782)	(1,337)	(205,337)	(3,770)
Interest income	547	643	1,218	4,442
Total other (expense) income - net	(91,235)	(694)	(204,119)	672
LOSS BEFORE INCOME TAXES	(646,564)	(85,677)	(860,199)	(991,904)
PROVISION FOR INCOME TAXES	-	-	(2,338)	(1,800)
NET LOSS	$ (646,564)	$ (85,677)	$ (862,537)	$ (993,704)
NET LOSS PER SHARE - BASIC AND DILUTED	$ (0.04)	$ (0.01)	$ (0.05)	$ (0.06)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND COMMON SHARE EQUIVALENTS OUTSTANDING - BASIC AND DILUTED	16,867,236	16,751,137	16,791,705	16,751,137

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

MITEK SYSTEMS, INC
STATEMENTS OF CASH FLOWS
(Unaudited)

	For the nine months ended June 30, 2010	2009
OPERATING ACTIVITIES		
Net loss	$ (862,537)	$ (993,704)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	291,229	92,037
Accretion of discount on convertible debt	202,425	-
Depreciation and amortization	130,408	40,017
Amortization of capitalized debt issuance costs	25,091	-
Provision for bad debts	(18,265)	(23,609)
Loss on disposal of property and equipment	-	1,767
Changes in assets and liabilities:		
Accounts receivable	(175,321)	297,695
Deferred maintenance fees	(38,670)	-
Inventory, prepaid expenses, and other current assets	4,358	(14,454)
Accounts payable	(21,051)	(55,929)
Accrued payroll and related taxes	23,912	(123,446)
Deferred revenue	108,383	5,062
Deferred rent	(116,563)	(3,982)
Other accrued liabilities	(3,376)	88,196
Net cash used in operating activities	(449,977)	(690,350)
INVESTING ACTIVITIES		
Purchases of property and equipment	(6,733)	(9,050)
Investment in software development costs	-	(63,735)
Proceeds from sale of property and equipment	-	70
Net cash used in investing activities	(6,733)	(72,715)
FINANCING ACTIVITIES		
Proceeds from the issuance of convertible debt-net	922,223	-
Proceeds from the issuance of common stock	345,000	-
Proceeds from exercise of stock options	10,800	-
Net cash cash provided by financing activities	1,278,023	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	821,313	(763,065)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	674,115	1,300,281
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,495,428	$ 537,216
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 2,353	$ 2,003
Cash paid for income taxes	$ 2,338	$ 1,800
NON-CASH FINANCING AND INVESTING ACTIVITIES		
Debt discount on convertible note due to warrants	$ 226,068	$ -

Beneficial conversion feature related to convertible debt issued	$ 401,568	$ -

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

MITEK SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited financial statements as of June 30, 2010 of Mitek Systems, Inc. (the "Company") have been prepared in accordance with the instructions to Form 10-Q and Article 8 of Regulation S-X and accordingly, they do not include all information and footnote disclosures required by accounting principles generally accepted in the United States of America. Refer to the Company's financial statements on Form 10-K for the year ended September 30, 2009 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 and nine months ended June 30, 2010 are not necessarily indicative of results which may be reported for any other interim period or for the year as a whole.

Going Concern

The Company incurred net losses of approximately $647,000 and $863,000 for the three and nine months ended June 30, 2010, respectively, compared to net losses of approximately $86,000 and $994,000 for the three and nine months ended June 30, 2009. As of June 30, 2010, the Company has incurred an accumulated deficit of approximately $15,700,000. Net cash used in operating activities decreased from approximately $690,000 in the third quarter of fiscal 2009 to approximately $450,000 in the third quarter of fiscal 2010. Net cash used in investing activities was approximately $7,000 in the nine months ended June 30, 2010, compared to approximately $73,000 in the nine months ended June 30, 2009. The Company's cash balance was approximately $1,495,000 as of June 30, 2010.

In January 2009, the Company implemented a plan to decrease its operating expenses by reducing its workforce in light of the economic contraction of the financial services market into which the Company primarily sells its products. The staff reduction included general and administrative, sales and marketing and technical staff. The Company has diligently maintained key resources to adequately pursue new sales opportunities and support its operations. The Company's management does not believe that such reductions have impaired the Company's ability to develop its ImageNet Mobile Deposit application and other mobile capture products, or to provide technical support to its current and prospective customers.

In December 2009, the Company raised approximately $922,000, net of transaction costs and expenses, from the private placement of debentures and warrants. This private placement is discussed in greater detail in Note 4 to the financial statements included in this report.

In June 2010, the Company sold 460,000 shares of common stock at $0.75 per share to accredited investors in a private placement, resulting in net proceeds of $345,000.

With the proceeds raised from the issuance of the convertible debentures in December 2009 and the sale of common stock in June 2010 together with improved year-over-year performance, the Company has been able to selectively retain additional staff to pursue its growth plan.

Based on its current operating plan, the Company's existing working capital may not be sufficient to meet the cash requirements to fund its planned operating expenses, capital expenditures, and working capital requirements for the next twelve months without additional sources of cash and/or the deferral, reduction or elimination of significant planned expenditures. The Company may need to raise significant additional funds to continue its

operations. Although the Company had negative cash flows from operations during the nine months ended June 30, 2010, the Company did have a significant increase in cash over September 30, 2009. In the absence of positive cash flows from operations the Company may be dependent on its ability to secure additional funding through the issuance of debt or equity instruments. If adequate funds are not available, the Company may be forced to significantly curtail its operations or to obtain funds through entering into additional collaborative agreements or other arrangements that may be on unfavorable terms, if attainable at all.

These factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. This basis of accounting contemplates the recovery of the Company's assets and the satisfaction of liabilities in the normal course of business. In addition, these financial statements do not include any adjustments to the specific amounts and classifications of assets and liabilities, which might be necessary should the Company be unable to continue as a going concern. The Company is taking expense reduction measures to conserve cash.

Earnings per share

The computation of basic and diluted earnings per share is as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
Net loss	$ (646,564)	$ (85,677)	$ (862,537)	$ (993,704)
Weighted-average common shares and share equivalents outstanding - basic and diluted	16,867,236	16,751,137	16,791,705	16,751,137
Earnings per share:				
Basic and diluted	$ (0.04)	$ (0.01)	$ (0.05)	$ (0.06)

2. Recently Issued Accounting Pronouncements

During June 2008, the Financial Accounting Standards Board ("FASB") issued an update to Accounting Standards Codification ("ASC") Topic 815, Derivatives and Hedging, ("ASC 815"), which is effective for fiscal years beginning after December 15, 2008. ASC 815 addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under ASC 815 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). The Company has determined that ASC 815 did not materially affect its financial statements during the nine months ended June 30, 2010.

In October 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-13, Revenue Recognition: Multiple-Deliverable Revenue Arrangements ("ASU 2009-13"), which amends ASC Topic 605, Revenue Recognition. ASU 2009-13 revises the current accounting treatment to specifically address how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This guidance is applicable to revenue arrangements entered into or materially modified during the first fiscal year that begins after June 15, 2010. The guidance may be applied either prospectively from the beginning of the fiscal year for new or materially modified arrangements or retrospectively. The Company does not anticipate the adoption of this guidance will have a material impact on the financial statements.

In October 2009, the FASB issued ASU No. 2009-14, Certain Revenue Arrangements That Include Software Elements ("ASU 2009-14"), which amends ASC Topic 985, Software. ASU 2009-14 amends the ASC to change the accounting model for revenue arrangements that include both tangible products and software elements, such that tangible products containing both software and non-software components that function together to deliver the tangible product's essential functionality are no longer within the scope of software revenue guidance. The changes to the ASC as a result of this update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company does not anticipate the adoption of this guidance will have a material impact on the financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (“ASU 2010-06”), which amends ASC Topic 820, Fair Value Measurements and Disclosures, adding new requirements for disclosures for Levels 1 and 2, separate disclosures of purchases, sales, issuances, and settlements relating to Level 3 measurements and clarification of existing fair value disclosures. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to provide Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010; although, early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2010-06 on its financial statements.

In February 2010, the FASB issued ASU No. 2010-09, Subsequent Events – Amendments to Certain Recognition and Disclosure Requirements (“ASU 2010-09”) that amends ASC Subtopic 855-10, Subsequent Events – Overall. ASU 2010-09 requires an SEC filer to evaluate subsequent events through the date that the financial statements are issued but removed the requirement to disclose this date in the notes to the entity’s financial statements. The amendments are effective upon issuance of the final update and accordingly, the Company has adopted the provisions of ASU 2010-09. The Company has determined that adoption of ASU 2010-09 did not materially affect its financial statements.

In April 2010, the FASB issued ASU No. 2010-17, Milestone Method of Revenue Recognition ("ASU 2010-17") to (i) limit the scope of this ASU to research or development arrangements and (ii) require that guidance in this ASU be met for an entity to apply the milestone method (record the milestone payment in its entirety in the period received). However, the FASB clarified that, even if the requirements in ASU 2010-17 are met, entities would not be precluded from making an accounting policy election to apply another appropriate accounting policy that results in the deferral of some portion of the arrangement consideration. ASU 2010-17 will apply to milestones in both single-deliverable and multiple-deliverable arrangements involving research or development transactions. ASU 2010-17 will be effective for fiscal years (and interim periods within those fiscal years) beginning on or after June 15, 2010; although, early adoption is permitted. Entities can apply this guidance prospectively to milestones achieved after adoption; however, retrospective application to all prior periods is also permitted. The Company is currently evaluating the impact, if any, that adoption of ASU 2010-17 will have on its financial statements.

3. Capitalized Software Development Costs

The Company has developed Mobile Capture software, a software solution that captures and reads data from mobile devices using proprietary technology. The Company has completed all of the planning, designing, coding, and testing activities necessary to establish technological feasibility of the product and has determined that the product can be produced to meet its design specifications including functions, features, and technical performance requirements.

Costs of internally developed software are expensed until the technological feasibility of the software product has been established. Thereafter, software development costs, to the extent that management expects such costs to be recoverable against future revenues, are capitalized until the product's general availability to customers in accordance with FASB ASC Topic 985-20, Costs of Software to Be Sold, Leased, or Marketed ("ASC 985-20").

The Company evaluates its capitalized software development costs at each balance sheet date to determine if the unamortized balance related to any given product exceeds the estimated net realizable value of that product. Any such excess is written off through accelerated amortization in the quarter it is identified. Determining net realizable value, as defined by ASC 985-20, requires making estimates and judgments in quantifying the appropriate amount to write off, if any. Actual amounts realized from the software products could differ from those estimates. Also, any future changes to the Company's product portfolio could result in significant increases to its cost of license revenue as a result of the write-off of capitalized software development costs. The Company completed its first production general release of ImageNet Mobile DepositTM on October 31, 2008, and entered into an agreement with a major financial institution on November 4, 2008 to conduct a performance evaluation of the product. In accordance with ASC 985-20, the Company ceased capitalizing software development costs related to this product on the date that it completed its first production general release.

In June 2009, the Company began to recognize revenue from the sale of ImageNet Mobile DepositTM, at which time it started amortizing the capitalized software development costs associated with the product in accordance with ASC 985-20. Under ASC 985-20, the annual amortization shall be the greater of the amount computed using (a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on. The Company determined it was appropriate to amortize the related capitalized software development costs over the remaining economic life of the product, estimated to be three years. The Company recorded amortization of software development costs of approximately $34,000 and $103,000 in the three and nine months ended June 30, 2010, respectively, compared to approximately $11,000 in the three and nine months ended June 30, 2009.

4. Convertible Debt

On December 10, 2009, the Company entered into a securities purchase agreement with accredited investors pursuant to which the Company agreed to issue in exchange for aggregate consideration of approximately $1,000,000 the following securities: (i) 5% senior secured convertible debentures in the principal amount of approximately $1,000,000, and (ii) warrants to purchase an aggregate of 337,501 shares of the Company's common stock with an exercise price of $0.91 per share. Each investor received a warrant to purchase that number of shares of the Company's common stock that equals 25% of the quotient obtained by dividing such investor's aggregate subscription amount by $0.75. The transaction resulted in proceeds to the Company of approximately $922,000, net of transaction costs and expenses.

Interest is payable in cash or stock at the rate of 5% per annum on each conversion date (as to the principal amount being converted), on each early redemption date (as to the principal amount being redeemed) and on the maturity date. The principal amount of the debentures, if not paid earlier, is due and payable on December 10, 2011. The Company has the right to redeem all or a portion of the debentures before maturity by payment in cash of the outstanding principal amount plus accrued and unpaid interest being redeemed. The Company agreed to honor any notices of conversion that it receives from the holder before the date the Company pays off the debentures. The debentures are convertible into shares of the Company's common stock at any time at the discretion of the holder at a conversion price per share of $0.75, subject to adjustment for stock splits, stock dividends and the like. The Company has the right to force conversion of the debentures if (i) the closing price of its common stock exceeds 200% of the then effective conversion price for 20 trading days out of a consecutive 30 trading day period or (ii) the average daily trading volume for its common stock exceeds 100,000 shares per trading day for 20 trading days out of a consecutive 30 trading day period and the closing price of its common stock exceeds 100% of the then effective conversion price for 20 trading days out of a consecutive 30 trading day period. The debentures impose certain covenants on the Company including restrictions against paying cash dividends or distributions on shares of its outstanding common stock. The debentures are secured by all of the Company's assets under the terms of a security agreement it entered into with the investors dated December 10, 2009.

In evaluating the accounting for the convertible note, the Company considered whether the conversion option related to the convertible note required bifurcation and separate accounting as a liability at fair value. Because the conversion option entitles the holder to convert to a fixed number of shares at a fixed price, the Company believes it is not required to bifurcate the conversion option and the related debt host. Similarly, the warrant contract entitles the holder to convert to a fixed number of shares at a fixed price and is therefore recorded in stockholders' equity.

Of the gross proceeds, approximately $786,000 was allocated to the debentures and approximately $226,000 to the warrants. The value of the warrants was estimated using a Black-Scholes option valuation model. The amount allocated to the warrants was recorded as a discount on the debentures and is being amortized to interest expense over the term of the debentures. In addition, based on the conversion price of $0.75 and relative value of the debentures, a beneficial conversion feature of approximately $402,000 was recorded as an additional discount on the debentures and is being amortized to interest expense in the accompanying statements of operations over the term of the debentures.

The fair value of the vested warrants was estimated on the grant date using the Black-Scholes option valuation model with the following assumptions:

Risk-free interest rate	2.19%
Expected term (in years)	5.00
Stock price volatility	2.07
Expected dividend yield	0%

The following represents the principal amount of the liability component, the unamortized discount, and the net carrying amount of the debentures at June 30, 2010:

Principal, including accrued interest of $28,751	$ 1,041,301
Unamortized discount	(453,962)
Net carrying amount	$ 587,339

5. Income Taxes

At September 30, 2009, the Company had net deferred tax assets of approximately $7,240,000. The deferred tax assets are primarily comprised of federal and state net operating loss carryforwards (approximately 79% of the net deferred tax assets at October 1, 2009). Such carryforwards began to expire in 2008 and will continue to expire through 2023. Under the Tax Reform Act of 1986, the amount of and the benefit from net operating losses that can be carried forward may be limited in certain circumstances. The Company carries a deferred tax valuation allowance equal to 100% of total net deferred assets. In recording this allowance, management has considered a number of factors, but chiefly, the Company's recent history of sustained operating losses. Management has concluded that a valuation allowance is required for 100% of the total deferred tax assets as it is more likely than not that the deferred tax assets will not be realized.

The Company has not determined the amount of the annual limitation on operating loss carryforwards that can be utilized in a taxable year. Any operating loss carryforwards that will expire prior to utilization as a result of such limitations will be removed from deferred tax assets with a corresponding reduction of the valuation allowance. Based on the 100% valuation allowance on the deferred tax assets, the Company does not anticipate that future changes in the Company's unrecognized tax benefits will impact its effective tax rate.

The Company's policy is to classify interest and penalties related to income tax matters as income tax expense. The Company had no accrual for interest or penalties as of September 30, 2009 or June 30, 2010, and has not recognized interest and/or penalties in the statements of operations for the three and nine month periods ended June 30, 2010.

6. Stockholders' Equity

On June 11, 2010, the Company sold 460,000 shares of common stock at $0.75 per share to accredited investors in a private placement, resulting in net proceeds of $345,000.

Warrants

Historically, the Company has granted warrants to purchase its common stock to service providers and investors. As of September 30, 2009, the Company had warrants to purchase 1,381,428 shares of its common stock outstanding with exercise prices ranging from $0.70 to $0.92 per share, subject to adjustment per the terms of the agreements. These warrants expire from June 2011 to May 2012.

Included in the warrants discussed above, are warrants to purchase, in the aggregate, 321,428 shares of the Company’s common stock at an exercise price of $0.70 per share, subject to adjustment per the terms of the agreement the Company granted to John H. Harland Company, a related party. These warrants expire from February 2012 to May 2012.

In connection with the issuance of the convertible debentures in December 2009, the Company issued warrants to purchase an aggregate of 337,501 shares of the Company’s common stock with an exercise price of $0.91 per share as discussed in greater detail in Note 4 to the financial statements included in this report.

The following table summarizes warrant activity in the nine months ended June 30, 2010:

	Number of warrants	Weighted-average exercise price	
Oustanding and exercisable at September 30, 2009	1,381,428	$	0.80
Issued	337,501	$	0.91
Exercised for cash	-		-
Expired	-		-
Oustanding and exercisable at June 30, 2010	1,718,929	$	0.82

There were no exercises of warrants during the nine months ended June 30, 2010 and 2009. Subsequent to the end of the quarter, on July 27, 2010, a warrant holder exercised a warrant to purchase 200,000 shares of the Company’s common stock at $0.70 per share. The warrant, which was granted on October 4, 2004, was exercised under the cashless exercise method, resulting in the issuance of 83,333 shares of common stock to the warrant holder and the cancellation of the remaining 116,667 shares in consideration of the issue. On August 11, 2010, the warrant holder exercised a second warrant to purchase 230,000 shares of the Company's common stock at $0.79 per share. This warrant, which was granted on June 11, 2004, was also exercised under the cashless exercise method, resulting in the issuance of 108,867 shares of common stock to the warrant holder and the cancellation of the remaining 121,133 shares in consideration of the issue.

Stock-based Compensation

The Company adopted the fair value recognition provisions of the FASB ASC Topic 718, Compensation-Stock Compensation (“ASC 718”).

The fair value of stock-based awards to employees and directors is calculated using the Black-Scholes option pricing model. 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.

The value of stock-based compensation is based on the single option valuation approach under ASC 718. 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 estimated expected remaining contractual life of stock option grants at June 30, 2010 was approximately 1.5 years on grants to directors and 6.7 years on grants to employees.

The fair value calculations for stock-based compensation awards to employees for the nine month periods ended June 30, 2010 and 2009 were based on the following assumptions:

	2010	2009
Risk-free interst rate	0.35% - 2.58%	0.44% - 2.29%
Expected life (in years)	5.26	5.31
Expected volatility	217%	192%
Expected dividends	None	None

ASC 718 requires the cash flows resulting from the tax benefits ensuing 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 valuation allowance from losses in the previous years, there was no such tax benefits during the three and nine months ended June 30, 2010. Prior to the adoption of ASC 718 those benefits would have been reported as operating cash flows had the Company received any tax benefits related to stock option exercises.

There were 70,000 stock options granted during the three months ended June 30, 2010.

The following table summarizes stock-based compensation expense related to stock options under ASC 718 for the three and nine months ended June 30, 2010 and 2009, which was allocated as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Research and development	$ 31,785	$ 7,807	$ 65,475	$ 25,376
Sales and marketing	10,199	2,350	19,772	11,074
General and administrative	32,561	13,130	205,982	55,587
Stock-based compensation expense related to employee stock options included in operating expenses	$ 74,545	$ 23,287	$ 291,229	$ 92,037

The following table summarizes vested and unvested options, fair value per share weighted average remaining term and aggregate intrinsic value at June 30, 2010:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value
Vested	3,138,593	0.39	4.96	$ 974,043
Unvested	1,268,407	0.52	9.16	400,952
Total	4,407,000	0.42	6.17	$ 1,374,995

As of June 30, 2010, the Company had $631,944 of unrecognized compensation expense expected to be recognized over the weighted average remaining vesting life of approximately 2.2 years.

A summary of option activity under the Company's stock equity plans during the nine months ended June 30, 2010 is as follows:

	Number of Shares	Weighted Average Exercise Price Per Share		Weighted Average Remaining Contractual Term (in Years)
Oustanding, September 30, 2009	3,533,000	$	0.56	6.10
Granted:				
Board of Directors	150,000	$	0.79	2.66
Executive Officers	250,000	$	0.79	9.66
Employees	595,500	$	0.79	9.41
Exercised	(15,000)	$	0.72	-
Cancelled	(106,500)	$	1.15	-
Oustanding, June 30, 2010	4,407,000	$	0.60	6.17

The following table summarizes significant ranges of outstanding and exercisable options as of June 30, 2010:

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price		Number of Exercisable Options	Weighted Average Exercise Price of Exercisable Options		Number of Unvested Options
$0.07 - $0.69	2,300,500	6.10	$	0.29	1,795,318	$	0.32	505,182
$0.70 - $0.92	1,341,500	7.70	$	0.79	578,275	$	0.80	763,225
$1.06 - $1.68	725,000	3.82	$	1.11	725,000	$	1.11	-
$2.13 - $2.68	38,500	1.65	$	2.28	38,500	$	2.28	-
$3.25 to $12.37	1,500	0.09	$	6.13	1,500	$	6.13	-
	4,407,000	6.17	$	0.60	3,138,593	$	0.62	1,268,407

On June 10, 2009, the Company's 1999 Stock Option Plan expired in accordance with the terms of the plan, and since that date no further options could be granted under the plan. Options granted under the plan that were outstanding at such date remain in effect until such options are exercised, forfeited or expire in accordance with the plan. As of June 30, 2010, options to purchase 678,250 shares of the Company's common stock were outstanding under the plan.

7. Product Revenue and Sales Concentrations

Product Revenues

During the three and nine months ended June 30, 2010 and 2009, the Company's revenues were derived primarily from its Character Recognition Product line.

Below is a summary of revenues:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Revenue				
Software licenses	$ 370,464	$ 418,778	$ 2,076,220	$ 1,346,869
Maintenance and professional services	452,026	495,960	1,422,246	1,467,600
Total Revenue	$ 822,490	$ 914,738	$ 3,498,466	$ 2,814,469

Sales Concentration

The Company sells its products primarily to original equipment manufacturers, system integrators and resellers who ultimately sell to depository institutions. For the three and nine months ended June 30, 2010 and 2009, the Company had the following sales concentrations:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Customers to which sales were in excess of 10% of total sales:				
Number of customers	1	2	3	1
Aggregate percentage of sales	17.0%	30.5%	40.2%	14.8%

Below is a summary of sales to customers to which sales were in excess of 10% of total sales and the corresponding accounts receivable balances for the three and nine months ended June 30, 2010 and 2009:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Sales	140,075	279,000	1,404,803	418,000
Accounts receivable balance	21,439	177,000	201,731	100

8. Related Parties

John H. Harland Company ("JHH Co.") made investments in the Company in February and May 2005. JHH Co. acquired a total of 2,142,856 shares of unregistered common stock for an aggregate purchase price of $1,500,000 or $0.70 per share. As part of the acquisition of shares, JHH Co. received warrants to purchase 321,428 additional shares of common stock at $0.70 per share. This transaction resulted in JHH Co. and its subsidiary, Harland Financial Solutions (collectively "John Harland"), being considered related parties of the Company due to the amount of the Company's common stock beneficially owned by John Harland. John Harland is not involved in the management decisions of the Company and does not participate in any board meetings, unless invited.

The Company recognized revenues from John Harland of approximately $14,000 and $15,000 for the three months ended June 30, 2010 and 2009, respectively, for professional services, including software maintenance. Revenue recognized from John Harland for professional services was approximately $45,000 and $46,000 in the nine months ended June 30, 2010 and 2009, respectively. There was an outstanding accounts receivable balance due from John Harland of approximately $1,000 at both June 30, 2010 and at June 30, 2009.

9. Commitments and Contingencies

The Company’s principal executive office, as well as its research and development facility, is located in an office building in San Diego, California that the Company leases under a non-cancelable operating lease. The lease costs are expensed on a straight-line basis over the lease term. The lease on this facility commenced in December 2005 and expires in December 2012. On February 1, 2009, the lease was amended to allow the Company to defer the payment of 50% of the basic rent due for the months of February through September 2009. The Company began repaying the deferred rent with interest at an annual rate of 6% in equal monthly installments on October 1, 2009. The Company paid the final installment on March 1, 2010. In addition, in connection with the February 2009 amendment, the Company waived its right to exercise an early termination option. On September 13, 2009, the lease was amended to reduce the amount of office space subject to the lease by approximately 1,722 square feet to approximately 14,205 square feet, which reduced the Company’s basic rent proportionately starting in December 2009.

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

Special Note Regarding Forward-Looking Statements

To the extent that this management's discussion and analysis of financial condition and results of operations 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 those 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. Please see "Special Note About Forward–Looking Statements" at the beginning of this report. Please consider our forward-looking statements in light of those risks as you read this report.

Business

Our business develops and markets intelligent character recognition and document capture products and services deployed primarily in the financial services markets. Our technology is currently used to process checks by banks and is used in other markets for specialized applications.

During the past fiscal year, we have leveraged our technology and industry customer relationships to enter the rapidly growing market for smartphone mobile business applications. Branded "Oomph" for Office on My Phone, our new mobile applications use our proprietary technology to capture and read data from photos of documents taken using camera-equipped smartphones.

We have developed and deployed a software application that allows users to remotely deposit a check using their smartphone camera. Additionally, we have developed and deployed a receipt archival application and a mobile document faxing application using our proprietary technology.

Application of Critical Accounting Policies

Our financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP. 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. Our critical accounting policies include revenue recognition, allowance for accounts receivable, fair value of equity instruments and accounting for income taxes.

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 accompanying Notes to the Financial Statements included in this report.

We consider many factors when applying GAAP 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; and
- 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 effect on our future revenues and operating results.

Accounts Receivable

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.

Fair Value of Equity Instruments

The valuation of certain items, including valuation of warrants, beneficial conversion feature related to debentures 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.

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.

Capitalized Software Development Costs

Research and development costs are charged to expense as incurred. However, the costs incurred for the development of computer software that will be sold, leased, or otherwise marketed are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated future revenues and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when product sales commence. Amortization is provided on a product-by-product basis on either the straight-line method over periods not exceeding three years or the sales ratio method. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product are expensed immediately.

Analysis of Financial Condition and Results of Operations

Comparison of the Three Months Ended June 30, 2010 and 2009

Sales

Sales were approximately $822,000 and $915,000 for three months ended June 30, 2010 and 2009, respectively, a decrease of approximately $93,000, or 10%. Sales of software licenses decreased by approximately $49,000 or 12% to approximately $370,000 in the three months ended June 30, 2010 from approximately $419,000 in the three months ended June 30, 2009. The decrease in net sales primarily relates to reduced sales of our core products due to the continued decline of manual check processing in the back office of financial institutions. Sales of maintenance and professional services decreased by approximately $44,000 or 9% to $452,000 in the current fiscal quarter, compared

to approximately $496,000 in the same period last year, primarily due to the timing of the renewals of maintenance contracts.

We recognized no revenue from Harland Financial Solutions, a subsidiary of John H. Harland Company (collectively “John Harland”), from the sale of software licenses in the three months ended June 30, 2010 and 2009. Revenue from John Harland from the sale of maintenance and professional services was approximately $14,000 in the three months ended June 30, 2010, compared to approximately $15,000 in the three months ended June 30, 2009. John Harland is a related party as discussed in greater detail in Note 8 to our financial statements included in this report.

Cost of Sales

Cost of sales was approximately $203,000 in the three months ended June 30, 2010, compared to approximately $188,000 in the three months ended June 30, 2009, an increase of approximately $15,000 or 8%, primarily due to an increase in sales of products containing third-party software. The increase in cost of sales resulted in lower margins in the current three-month period. Stated as a percentage of sales, cost of sales was 25% for the three months ended June 30, 2010, compared to 21% for the three months ended June 30, 2009.

Operations Expenses

Operations expenses include payroll, employee benefits, and other personnel-related costs associated with purchasing, shipping and receiving. Due to the workforce reduction implemented in January 2009, we eliminated our operations department. Other costs previously included in this department have been reallocated to the other departments. As a result, there were no operations expenses for the three months ended June 30, 2010 and 2009.

Selling and Marketing Expenses

Selling and marketing expenses include payroll, employee benefits, and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, trade shows, seminars, and other programs. In the three months ended June 30, 2010 and 2009, selling and marketing expenses were approximately $225,000 and $133,000, respectively, an increase of approximately $92,000 or 69%. The increase in the current three-month period primarily relates to increased direct operating expenses, such as outside services, travel reimbursements costs and stock-based compensation expense, increased public relations and other product promotion costs and increased personnel costs due to increased headcount. Stated as a percentage of sales, selling and marketing expenses for the three months ended June 30, 2010 were 27%, compared to 15% in the three months ended June 30, 2009.

Research and Development Expenses

Research and development expenses include payroll, employee benefits, consultant expenses and other headcount-related costs associated with product development. These costs are incurred to maintain and enhance existing products. We retain what we believe to be sufficient staff to sustain our existing product lines, including development of new, more feature-rich versions of our existing product, as we determine the marketplace demands. We also employ research personnel, whose efforts are instrumental in ensuring product paths from current technologies to anticipated future generations of products within our area of business.

Research and development expenses for the three months ended June 30, 2010 were approximately $492,000, compared to approximately $410,000 for the three months ended June 30, 2009, an increase of approximately $82,000 or 20%. The increase in the current three-month period primarily relates to increased direct operating expenses, such as travel reimbursements and stock-based compensation expense, and increased personnel costs due to increased headcount. Stated as a percentage of sales, research and development expenses were 60% and 45% in the three months ended June 30, 2010 and 2009, respectively.

General and Administrative Expenses

General and administrative expenses include payroll, employee benefits, and other personnel-related costs associated with the finance, facilities, and legal, accounting and other administrative fees. General and administrative expenses were approximately $458,000 in the three months ended June 30, 2010 compared to approximately $269,000 in the three months ended June 30, 2009, an increase of approximately $189,000 or 70%. The increase in the current three month period primarily relates to increased personnel costs due to payment of a one-time management performance bonus and salary increases and increased direct operating expenses, such as legal fees, travel reimbursements and

stock-based compensation expense. Stated as a percentage of sales, general and administrative expenses were 56% for the three months ended June 30, 2010, compared to 29% for the three months ended June 30, 2009.

Other (Expense) Income

Interest and other expense increased by approximately $91,000 for the three months ended June 30, 2010 to approximately $92,000, compared to approximately $1,000 for the same period last fiscal year. The increase in the current period primarily relates to accretion of the discount on the debentures issued in December 2009 and accrued interest on the principal amount of the debentures. Interest income was approximately $1,000 for the three months ended June 30, 2010 and 2009.

Comparison of the Nine Months Ended June 30, 2010 and 2009

Sales

Sales in the nine months ended June 30, 2010 were approximately $3,498,000, compared to approximately $2,814,000 in the nine months ended June 30, 2009, an increase of approximately $684,000 or 24%. Sales of software licenses increased by approximately $729,000 or 54% to approximately $2,076,000 in the nine months ended June 30, 2010 from approximately $1,347,000 in the nine months ended June 30, 2009. The increase in software license sales primarily relates to the one-time sale of a $524,000 license of one of our core products to an existing key customer in the second quarter of fiscal 2010 and increased sales of ImageNet Mobile DepositTM software licenses. Sales of maintenance and professional services were approximately $1,422,000 and $1,468,000 in the nine months ended June 30, 2010 and 2009, respectively, a decrease of approximately $46,000 or 3%, due to the timing of the renewals of maintenance contracts

We recognized no revenue from John Harland from the sale of software licenses in the nine months ended June 30, 2010 and 2009. Revenue from John Harland from the sale of maintenance and professional services was approximately $45,000 and $46,000 in the nine months ended June 30, 2010 and 2009, respectively.

Cost of Sales

Cost of sales was approximately $739,000 in the nine months ended June 30, 2010, compared to approximately $518,000 in the nine months ended June 30, 2009, an increase of approximately $221,000 or 43%, primarily the result of the increase in sales and the decreased margin on significant sales of our core product in the current nine month period. Stated as a percentage of sales, cost of sales was 21% for the nine months ended June 30, 2010, compared to 18% for the nine months ended June 30, 2009.

Operations Expenses

As a result of the workforce reduction in January 2009 and the elimination of the operations department, there were no operations expenses for the nine months ended June 30, 2010 compared to approximately $30,000 for the nine months ended June 30, 2009, which included payroll, employee benefits, and other personnel-related costs associated with purchasing, shipping and receiving. Stated as a percentage of sales, operations expenses were 0% and 1% in the nine months ended June 30, 2010 and 2009, respectively.

Selling and Marketing Expenses

Selling and marketing expenses decreased by approximately $63,000 or 9% to $621,000 in the nine months ended June 30, 2010, down from approximately $684,000 in the same period last year. The decrease in the current nine month period primarily relates to a decrease in personnel costs due to the workforce reduction implemented in January 2009, partially offset by increases in direct operating expenses, such as outside services, travel reimbursements and stock-based compensation expense, and increased public relations and other product promotion costs. Stated as a percentage of sales, selling and marketing expenses for the nine months ended June 30, 2010 were 18%, compared to 24% in the nine months ended June 30, 2009.

Research and Development Expenses

Research and development expenses for the nine months ended June 30, 2010 were approximately $1,505,000, compared to approximately $1,414,000 for the nine months ended June 30, 2009, an increase of approximately $91,000 or 6%. The increase in the current nine month period primarily relates to increases in outside services, travel reimbursements, stock-based compensation expense and other direct operating expenses, partially offset by decreases

in personnel costs due to the workforce reduction implemented in January 2009. Stated as a percentage of sales, research and development expenses were 43% and 50% in the nine months ended June 30, 2010 and 2009, respectively.

General and Administrative Expenses

General and administrative expenses were approximately $1,290,000 in the nine months ended June 30, 2010 compared to approximately $1,161,000 in the nine months ended June 30, 2009, an increase of approximately $129,000 or 11%. The increase in the current nine month period primarily relates to increased personnel costs due to payment of a one-time management performance bonus and salary increases and increases in other direct operating expenses, such as stock-based compensation expense and travel reimbursements, partially offset by decreases in accounting fees and other outside services. Stated as a percentage of sales, general and administrative expenses were 37% for the nine months ended June 30, 2010, compared to 41% for the nine months ended June 30, 2009.

Other (Expense) Income

Interest and other expense increased by approximately $201,000 for the nine months ended June 30, 2010 to approximately $205,000, compared to approximately $4,000 for the same period last fiscal year. The increase in the current period primarily relates to accretion of the discount on the debentures issued in December 2009 and accrued interest on the principal amount of the debentures. Interest income was approximately $1,000 and $4,000 for the nine months ended June 30, 2010 and 2009, respectively.

Liquidity and Capital Resources

At June 30, 2010, we had approximately $1,495,000 in cash and cash equivalents compared to approximately $674,000 on September 30, 2009, an increase of approximately $821,000, or 122%, primarily related to proceeds of approximately $922,000 from the issuance of the debentures in December 2009. See Note 4 to our financial statements included in this report. In addition, in June 2010, we sold 460,000 shares of common stock at $0.75 per share to accredited investors in a private placement, resulting in net proceeds of $345,000. The balance of accounts receivable was approximately $554,000 and $361,000 at June 30, 2010 and 2009, respectively, an increase of approximately $193,000 or 54%, inclusive of a decrease of approximately $18,000 in the allowance for bad debts. The increase in accounts receivable was primarily due to increased sales and the timing of customer billings and the receipt of payments.

Deferred revenue, which consists of maintenance and support service fees that are deferred and recognized as income over the contract period on a straight-line basis, was approximately $809,000 and $701,000 at June 30, 2010 and September 30, 2009, respectively. We believe that as the installed base of our products grows and as customers purchase additional complementary products, the maintenance and support service fees that are deferred, as well as those recognized as income over the contract term, will increase.

In addition to the proceeds we raised from the issuance of the convertible debentures in December 2009 and the sale of common stock in June 2010, we financed our cash needs during the nine months ended June 30, 2010 from collections of accounts receivable and existing cash and cash equivalents. Prior to the December 2009 financing, we financed our cash needs from the collection of accounts receivable and existing cash and cash equivalents.

Net cash used in operating activities during the nine months ended June 30, 2010 was approximately $450,000, compared to approximately $690,000 during the nine months ended June 30, 2009, a decrease of approximately $240,000 or 35%. The primary uses of cash from operating activities during the nine months ended June 30, 2010 included the net loss of approximately $863,000, an increase in accounts receivable of approximately $193,000, an increase in deferred maintenance fees of approximately $39,000 and a decrease in deferred rent of approximately $117,000 and other accrued liabilities of approximately $3,000, partially offset by an increase in deferred revenue of approximately $108,000. Net cash used in operating activities in the current nine-month period also included non-cash stock-based compensation of approximately $291,000, accretion of the discount on the debentures of approximately $202,000, amortization of software development costs of approximately $103,000, depreciation and amortization of fixed assets of approximately $27,000 and amortization of debt issuance costs of approximately $25,000.

Net cash used in investing activities was approximately $7,000 during the nine months ended June 30, 2010, compared to approximately $73,000 during the nine months ended June 30, 2009. The decrease in cash used in investing activities in the current period is primarily due to a decrease of approximately $64,000 in software development costs related to our Mobile Deposit software application, which costs we ceased capitalizing when we completed our first production general release in November 2008, and a reduction of approximately $2,000 in purchases of property and equipment. We do not have any significant capital expenditures planned for the foreseeable future.

Cash generated from financing activities during the nine months ended June 30, 2010, included: (i) the sale in December 2009 of 5% senior secured convertible debentures in the principal amount of approximately $1,000,000 and warrants to purchase an aggregate of 337,501 shares of our common stock with an exercise price of $0.91 per share, and (ii) the sale in June 2010 of 460,000 shares of our common stock at $0.75 per share, in each case in private placements with accredited investors. The debentures are convertible into shares of our common stock at any time at the discretion of the holder at a conversion price per share of $0.75, subject to adjustment for stock splits, stock dividends and the like. The December 2009 transaction resulted in proceeds to us of approximately $922,000, net of transaction costs and expenses, and the June 2010 transaction resulted in net proceeds of $345,000.

We had working capital of approximately $816,000 and a 1.57 current ratio at June 30, 2010, compared to negative working capital of approximately $280,000 and a 0.80 current ratio at September 30, 2009. At June 30, 2010, our total liability to equity ratio was 3.82 to 1 compared to 11.73 to 1 on September 30, 2009. Although our working capital has increased in the current period as a result of the financings completed in December 2009 and June 2010, we continue to experience a significant decline in working capital in the long term. We do not currently have any credit facilities in place, or any arrangement that we can draw upon for additional capital.

In January 2009, we implemented a plan to decrease our operating expenses by reducing our workforce in light of the economic contraction of the financial services market into which we primarily sell our products. The staff reduction included general and administrative, sales and marketing and technical staff. We have diligently maintained key resources to adequately pursue new sales opportunities and support our operations.

Based on our current operating plan, our existing working capital may not be sufficient to fund our planned operating expenses, capital expenditures, and working capital requirements for the next twelve months without additional sources of cash and/or the deferral, reduction or elimination of significant planned expenditures. A shortfall from projected sales levels could have a material adverse effect on our ability to continue operations at current levels. If this were to occur, we would be forced to liquidate certain assets where possible, and/or to suspend or curtail certain of our operations. Any of these actions could harm our business, results of operations and future prospects. To guard against this risk, we intend to seek debt, equity or equity-based financing, as we did in December 2009 and June 2010. We can give no assurance that we will be able to obtain additional financing on favorable terms or at all. If we raise additional funds by selling additional shares of our capital stock, or securities convertible into shares of our capital stock, the ownership interest of our existing shareholders may be diluted. The amount of dilution could be increased by the issuance of warrants or securities with other dilutive characteristics, such as anti-dilution clauses or price resets. If we need additional funding for operations and we are unable to raise it, we may be forced to liquidate assets and/or curtail or cease operations or to obtain funds through entering into additional collaborative agreements or other arrangements that may be on unfavorable terms. These factors raise substantial doubt about our ability to continue as a going concern.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Disclosure not required as a result of the Company's status as a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this report, 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 Rules 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2010, our disclosure controls and procedures were designed and functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to management including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

Changes in Internal Controls over Financial Reporting

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 quarter ended June 30, 2010 that have materially

affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not aware of any legal proceedings or claims that we believe may have, individually or in the aggregate, a material adverse effect on our business, financial condition, operating results, cash flow or liquidity.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in "Part I. Item 1—Description of Business—Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results and future prospects. As of the date of this report, other than the risk factors set forth below, we do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

We have a history of losses and we may not achieve profitability in the future.

Our operations resulted in a net loss of approximately $647,000 in the three months ended June 30, 2010. We incurred a loss of approximately $863,000 in the nine months ended June 30, 2010. In addition, as a public company, we incur significant legal, accounting, and other expenses related to being a public company. As a result of these expenditures, we will have to generate and sustain increased revenue to achieve and maintain future profitability. We may not achieve sufficient revenue to achieve or maintain profitability. We have incurred and may continue to incur significant losses in the future for a number of reasons, including due to the other risks described in this report, and we may encounter unforeseen expenses, difficulties, complications, delays, and other unknown factors. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses for the foreseeable future.

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 our product pricing policies or those of our 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, 2009, the closing price of our common stock ranged from $0.05 to $1.01. During the first nine months of fiscal 2010, the closing price our common stock price ranged from $0.56 to $1.04.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In June 2010, we sold an aggregate of 460,000 shares of common stock at $0.75 per share to accredited investors in a private placement.

In July 2010, we issued an aggregate of 83,333 shares of common stock upon the cashless exercise of a warrant.

In August 2010, we issued an aggregate of 108,867 shares of common stock upon the cashless exercise of a warrant.

None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and the registrant believes the transactions were exempt from the registration requirements of the Securities Act of 1933 in reliance on Section 4(2) thereof and/or, with respect to the issuance of common stock upon exercise of warrants, Section 3(a)(9) thereof, and the rules and regulations promulgated thereunder, as transactions by an issuer not involving a public offering. All recipients of securities disclosed above were accredited or sophisticated and either received adequate information about the registrant or had access, through their relationships with the registrant, to such information. Appropriate legends were affixed to the share certificates and instruments issued in such transactions.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See the exhibit index immediately following signature page to this report.

SIGNATURES

In accordance with 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.

August 16, 2010	By:	/s/ James B. DeBello James B. DeBello President, Chief Executive Officer, and Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	Exhibit Title
31.1	Certification of Periodic Report by the Chief Executive Officer Pursuant to Rules 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Periodic Report by the Chief Financial Officer Pursuant to Rules 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

* Furnished herewith