

Edgar Filing: MITEK SYSTEMS INC - Form 10-K

MITEK SYSTEMS INC  
Form 10-K  
December 30, 2003

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2003

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.)

14145 Danielson St., Suite B, Poway, CA 92064  
(Address of principal executive offices) (Zip Code)

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

None

Securities registered pursuant to Section 12(b) of the Act

Common Stock, par value \$.001 per share  
Securities registered pursuant to Section 12(g) of the Act

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act) Yes  No .

The aggregate market value of voting stock held by non-affiliates of the registrant was \$8,632,803 as of March 31, 2003 (computed by reference to the last sale price of a share of the registrant's Common Stock on that date as reported by NASDAQ).

There were 11,308,537 shares outstanding of the registrant's Common Stock

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as of December 3, 2003.

Documents incorporated by reference in this report: Part II incorporates certain information by reference from the Annual Report to Stockholders for the year ended September 30, 2003. Part III incorporates certain information by reference from the Proxy Statement for the 2004 Annual Meeting of Stockholders.

MITEK SYSTEMS, INC.

FORM 10-K

For The Fiscal Year Ended September 30, 2003

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

This Form 10-K of Mitek Systems, Inc. (the "Company") contains forward-looking statements concerning anticipated future revenues and earnings,

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adequacy of future cash flow and related matters. These forward-looking statements include, but are not limited to, statements containing the words "expect," "believe," "will," "may," "should," "project," "estimate," "scheduled" and like expressions, and the negative thereof. These statements address matters including, but not limited to, statements relating to the development and pace of sales of the Company's products, expected trends and growth in the Company's results of operations, projections concerning the Company's available cash flow and liquidity, anticipated penetration in new and existing markets for the Company's products and the size of such markets, anticipated acceptance of the Company's products by existing and new customers, and the ability of the Company to achieve or sustain any growth in sales and revenue. The forward-looking statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from the statements, including those risks described in the Company's Securities and Exchange Commission reports, and the risk factors described in this Form 10-K Issues and Uncertainties."

The Company was incorporated under the laws of the State of Delaware in 1986. The Company is primarily engaged in the development and sale of software products with particular focus on intelligent character recognition and forms processing technology, products and services for the document imaging markets.

The Company develops, markets and supports what it believes to be the most accurate Automated Document Recognition ("ADR") products commercially available for the recognition of hand printed characters. The Company's unique proprietary technology recognizes hand printed and machine generated characters with a level of accuracy that renders the Company's ADR products a viable alternative to manual data entry in certain applications. The Mitek solution allows customers that process large volumes of hand printed and machine generated documents to do so more quickly, with greater accuracy and at reduced costs.

### PRODUCTS AND RELATED MARKETS

During fiscal 2003, the Company had one operating segment based on its product and service offerings: Automated Document Processing.

### AUTOMATED DOCUMENT PROCESSING

Since 1992 the Company has developed and marketed ADR products, which enable the automation of costly, labor intensive business functions such as check and remittance processing, forms processing and order entry. The Company's ADR products incorporate proprietary neural network software technology for the recognition and conversion of hand printed and machine generated characters into digital data. Neural networks are powerful tools for pattern recognition

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applications and consist of sets of coupled mathematical equations with adaptive parameters that self adjust to "learn" various forms and patterns. The Company's ADR products combine the Company's neural network software technology with an extensive database of character patterns, enabling them to make fine distinctions across a wide variety of patterns with high speed, accuracy and consistency. The Company leverages its core technology across a family of ADR products that the Company believes offers the highest accuracy commercially available for the recognition of hand printed characters and the automated processing of documents. Mitek's family of ADR products is made up of the three distinct product lines: Recognition Toolkits, Document and Image Processing Solutions and Check Imaging Solutions.

Recognition Toolkits

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The Company's ADR products incorporate the Company's proprietary intelligent character recognition (ICR) software engine QuickStrokes(R) API (Application Programmers Interface), and a licensed ICR software engine CheckScript(TM) (a trademark of Parascript LLC). QuickStrokes(R) API and CheckScript(TM) are sold to original equipment manufacturers (OEMs) such as BancTec, Unisys, and J&B Software, and to systems integrators such as Computer Sciences Corporation. Major end users include Chevron, GTE, CitiBank, NYNEX, Fleet Bank, Chase Manhattan, Comerica Bank, HSBC, and British Telecom. QuickStrokes(R) API can process many foreign character sets.

The CheckScript(TM) product, used in financial document processing, combines the Legal Amount Recognition (LAR) capabilities licensed from Parascript, LLC with the Company's proprietary QuickStrokes(R) API Courtesy Amount Recognition (CAR) technology. This product provides a high level of accuracy in remittance processing, proof of deposit, and lock box processing applications.

### Document and Image Processing Solutions

DynaFind(R) is a software toolkit that captures data from many types of unstructured business documents. DynaFind is used in challenging data capture applications where data must be found and extracted from documents that have no pre-determined format or layout, but share common data elements. DynaFind locates this data on documents using contextual, positional, format- and keyword-specific information, even if it appears in a different location on each document. The Company has supplied DynaFind(R) as a stand alone API to several important OEMs in the document processing field. DynaFind(R) is also available as an add-on feature that has been integrated into Doctus, Mitek's forms processing solution.

Leveraging its core technical competency in ICR, the Company has addressed the forms processing market with its Doctus(R) product. Doctus(R) incorporates the Company's core ICR technology in an application designed for end users in a broad variety of industries that require high volume automated data entry. The Company believes its Doctus(R) software is a major innovation in forms processing because it economically handles both structured and unstructured forms. As a result, it significantly increases the number and types of forms that can be automatically processed. Doctus(R) is able to process unstructured forms because it incorporates Mitek's DynaFind(R) forms understanding technology. With DynaFind(R), Doctus(R) automatically

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classifies unstructured forms and extracts relevant data from the form contents. Major Doctus(R) customers include AIG and Sungard.

QuickFX(R) Pro is a software toolkit that provides automatic form ID, form registration and form/template removal. The Company believes it will significantly improve automatic data capture (ICR/OCR), forms processing, document imaging and storage performance. QuickFX(R) Pro reduces the image size by removing extraneous information such as pre-printed text, lines, and boxes; leaving only the filled-in data. It repairs the characters that are left, ensuring better recognition, enhanced throughput, and higher accuracy rates.

### Check Imaging Solutions

CheckQuest(R) is Mitek's image-enabled check and item processing solution. It is specifically designed for check image processing applications at community and regional banks, such as Proof of Deposit, Retail/Wholesale Lock Box, and

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Remittance Processing. CheckQuest is designed to expand and improve an institution's operational efficiency and customer service without adding staff, while reducing monthly expenses. CheckQuest utilizes Mitek's field-proven CAR/LAR technology, currently in use worldwide for processing billions of checks per year. With the passage of the Check Clearing for the 21st Century Act, or Check 21, in October of 2003, banks can substitute electronic check images for paper checks in the clearance and settlement process. This new electronic format is expected to dramatically reduce bank operating costs and save millions of dollars each year. With Check 21 calling for the use of electronic check images within a year's time, The Company believes CheckQuest can play a strategic role in preparing banks for check truncation and electronic check presentment.

### RESEARCH AND DEVELOPMENT

During fiscal years 2003, 2002, and 2001 research and development expense was approximately \$2,242,000, \$2,049,000, and \$1,830,000, respectively. Those amounts represented 19%, 16%, and 19%, respectively, of revenue in each of those years. We plan to continue spending significant amounts for research and product development.

Most of the Company's software products are developed internally. The Company also purchases technology and licenses intellectual property rights. The Company believes that its future success depends in part on its ability to maintain and improve its core technologies, enhance its existing products and develop new products that meet an expanding range of customer requirements. We do not believe we are materially dependent upon licenses and other agreements with third parties, relating to the development of our products. Internal development allows Mitek to maintain closer technical control over its products and gives the Company the freedom to designate which modifications and enhancements are most important and when they should be implemented. Mitek devises innovative solutions to automated character processing problems, such as the enhancement and improvement of degraded images, and the development of user-manipulated tools to aid in automated document processing. The Company intends to expand its existing product offerings and to introduce new document processing software solutions. In the development of new products and enhancements to existing products, the Company uses its own tools extensively. The Company performs all quality assurance and develops documentation internally. The Company strives to become informed at the earliest

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possible time about changing usage patterns and hardware advances that may affect software design. The Company intends to continue to support industry standard operating environments.

The Company's team of specialists in recognition algorithms, software engineering, user interface design, product documentation and quality improvement is responsible for maintaining and enhancing the performance, quality and usability of all of the Company's products. In addition to research and development, the engineering staff provides customer technical support on an as needed basis, along with technical sales support.

In order to improve the accuracy of its ADR products, the Company focuses research and development efforts on continued enhancement of its core technology and on its database of millions of character images that is used to "train" the neural network software that forms the core of the Company's ICR engine. In addition, the Company has expanded its research and development tasks to include pre- and post-processing of data subject to automated processing.

The Company's research and development organization included nineteen

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software engineers at September 30, 2003, including seven with advanced degrees. The Company balances its engineering resources between development of ICR technology and applications development. Of the nineteen software engineers, approximately ten are involved in ICR research and development of the QuickStrokes(R) API recognition engine. The remaining software engineers are involved in applications development, including the Doctus(R), QuickFX(R) Pro, CheckQuest(R) and FraudProtect(TM) products, and customer services and support.

### INTELLECTUAL PROPERTY

The Company's success and ability to compete is dependent in part upon its proprietary technology. The Company relies on a combination of patent, copyright and trade secret laws and non-disclosure agreements to protect its proprietary technology. The Company holds a U.S. patent for its hierarchical character recognition systems. The patent covers the Company's multiple-pass, multiple-expert system that significantly increases the accuracy of forms processing and item processing applications. The Company may seek to file additional patents to expand the scope of patent coverage. The Company may also file future patents to cover technologies under development. There can be no assurance that patents will be issued with respect to future patent applications or that the Company's patents will be upheld as valid or will prevent the development of competitive products.

The Company also seeks to protect its intellectual property rights by limiting access to the distribution of its software, documentation and other proprietary information. In addition, the Company enters into confidentiality agreements with its employees and certain customers, vendors and strategic partners. There can be no assurance that the steps taken by the Company in this regard will be adequate to prevent misappropriation of its technology or that the Company's competitors will not independently develop technologies that are substantially equivalent or superior to the Company's technologies.

The Company is also subject to the risk of adverse claims and litigation alleging infringement on the intellectual property rights of others. In this regard, there can be no assurance that third parties will not assert infringement claims in the future with respect to the

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Company's current or future products or that any such claims will not require the Company to enter into license arrangements or result in protracted and costly litigation, regardless of the merits of such claims. No assurance can be given that any necessary licenses will be available or that, if available, such licenses can be obtained on commercially reasonable terms.

### SALES AND MARKETING

The Company markets its products and services primarily through its internal, direct sales organization. The Company employs a technically-oriented sales force with management assistance to identify the needs of existing and prospective customers. The Company's sales strategy concentrates on those companies that it believes are key users and designers of automated document processing systems for high-performance, large volume applications, in addition to small and large financial institutions. The Company currently maintains sales offices in California and Virginia and a services and support office in Alabama. In addition, the Company sells and supports its products through foreign resellers in Germany, France, Italy, the United Kingdom and Australia. The sales process is supported with a broad range of marketing programs which include trade shows, direct marketing, public relations and advertising.

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The Company provides maintenance and support on a contractual basis after the initial product warranty has expired. The Company provides telephone support and on-site support. Customers with maintenance coverage receive software updates from the Company. Foreign distributors generally provide customer training, service and support for the products they sell. Additionally, the Company's products are supported internationally by periodic distributor and customer visits by Company management. These visits include attending imaging shows, as well as sales and training efforts. Technical support is provided by telephone as well as technical visits in addition to those previously mentioned.

The Company licenses its software to organizations on a perpetual basis. The Company also licenses software to organizations under Enterprise Agreements that allow the end-user customer to acquire multiple licenses, without having to acquire separate packaged products. These Enterprise Agreements are targeted at large organizations that want to acquire perpetual licenses to software products for their entire enterprise along with rights to unspecified future versions of software products over the term of the agreement.

The ability to support international markets has assisted the Company in its international sales effort. International sales accounted for approximately 3%, 4%, and 3%, of the Company's net sales for the fiscal years ended September 30, 2003, 2002, and 2001, respectively. The Company believes that a significant percentage of the products in its domestic sales are incorporated into systems that are delivered to end users outside the United States. International sales in fiscal 2003 were made to customers in eighteen countries including Australia, Brazil, Canada, Czech Republic, United Kingdom, France, Germany, Hong Kong, Ireland, Israel, India, Italy, Jamaica, Japan, Netherlands, Portugal, Sweden, and Uruguay. The Company sells its products in United States currency only. The Company recorded a significant portion of its revenues from three customers in fiscal 2003, three customers in fiscal 2002, and one customer in fiscal 2001, respectively. Net sales from these customers aggregated 30%, 34%, and 11% for the fiscal years 2003, 2002 and 2001, respectively.

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### MAINTENANCE AND SUPPORT

Following the installation of our software at a customer site, we provide ongoing software support services to assist our customers in operating the systems. The Company has an internal customer service department that handles installation and maintenance requirements. The majority of inquiries are handled by telephone. For more complicated issues, our staff, with our customers' permission, can log on to our customers' systems remotely. Occasionally, visits to the customer's facilities are required to resolve support issues. We maintain our customers' software largely through releases which contain improvements and incremental additions. Nearly all of our in-house customers contract for annual support services from us. These services are a significant source of recurring revenue, and are contracted for on an annual basis and are typically priced at approximately 15% to 18% of the particular software product's license fee. The Company believes that as the installed base of its products grows and as customers purchase additional complementary products, the software support function will become a larger source of recurring revenues. Costs incurred by the Company to supply maintenance and support services are charged to cost of sales.

### COMPETITION

The market for the Company's ADR products is intensely competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. The Company faces direct

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and indirect competition from a broad range of competitors who offer a variety of products and solutions to the Company's current and potential customers. The Company's principal competition comes from (i) customer-developed solutions; (ii) direct competition from companies offering automated document processing systems; (iii) companies offering competing technologies capable of recognizing hand-printed and cursive characters; and (iv) direct competition from companies offering check imaging systems to banks.

It is also possible that the Company will face competition from new competitors. Moreover, as the market for automated document processing, ICR, check imaging and fraud detection software develops, a number of companies with significantly greater resources than the Company could attempt to enter or increase their presence in the Company's market either independently or by acquiring or forming strategic alliances with competitors of the Company or to otherwise increase their focus on the industry. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of the Company's current and prospective customers.

The Company's QuickStrokes(R) API product and licensed CheckScript(TM) product compete, to various degrees, with products produced by a number of substantial competitors such as A2IA, Parascript, and Orbograph. Competition among product providers in this market generally focuses on price, accuracy, reliability and technical support. The Company believes its primary competitive advantages are (i) recognition accuracy with regard to hand printed characters, (ii) flexibility, since it may operate on a broad range of computer operating platforms, (iii) scalability and (iv) an architectural software design, which allows it to be more readily modified, improved with added functionality, configured for new products, and ported to new operating systems and upgrades. Despite these advantages, QuickStrokes(R) API and CheckScript(TM) competitors have

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existed longer and have far greater financial resources and industry connections than the Company.

The Company's Doctus(R) product competes against complete proprietary systems offered by software developers, such as Microsystems Technology, Readsoft, and Cardiff Software, Inc. In addition, Doctus(R) faces competition from providers of recognition systems that incorporate ADR technology such as Microsystems Technology, Inc., and Captiva. Because Doctus(R) is based on the Company's proprietary QuickStrokes(R) API engine, its competitive advantages reflect the advantages of the QuickStrokes(R) engine. The Company believes its Doctus(R) and DynaFind(R) software provides the highest levels of automation in the industry. DynaFind, the Company's document understanding software, does not require extensive rules written by a programmer based on a large set of training documents. The software automatically "learns" how to process unstructured forms by reading only a few examples. Competitors in this market offer both high and low cost systems. The Company's strategy is to position Doctus(R) to compete successfully in a scalable midrange price while offering a higher degree of accuracy and greater flexibility than competing systems currently on the market.

The Company's CheckQuest(R) product competes against complete proprietary systems offered by software developers such as Bankware, AFS, and BISYS/Document Solutions. Because CheckQuest(R) is based on the Company's proprietary QuickStrokes(R) engine, the Company believes its CheckQuest(R) software provides superior workflow technology, combined with the labor-saving recognition capabilities typically found in larger systems. By incorporating our superior



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check reading technology, we are providing our banking customers a streamlined check imaging process. The CheckQuest(R) system allows bank customers to research checks via the Internet and receive check image statements via e-mail. The Company's strategy is to position CheckQuest(R) to compete successfully in the community and regional bank marketplace, while offering superior accuracy, workflow and flexibility than competing systems currently on the market.

Increased competition may result in price reductions, reduced gross margins, and loss of market share, any of which could have a material adverse effect on the Company's business, operating results and financial condition.

### EMPLOYEES AND LABOR RELATIONS

As of September 30, 2003, the Company employed a total of 57 full-time and 2 part-time persons, consisting of 14 in marketing, sales and support, 19 in research and development, 19 in operations, and 7 in finance, administration and other capacities. The Company has never had a work stoppage. None of its employees are represented by a labor organization, and the Company considers its relations with its employees to be good.

### AVAILABLE INFORMATION

Our internet address is [www.miteksys.com](http://www.miteksys.com). There we make available, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, as soon as reasonably practicable after we electronically file.

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such material with, or furnish it to, the SEC. Our SEC reports can be accessed through the investor relations section of our Web site. The information found on our Web site is not part of this or any other report we file with or furnish to the SEC.

### ITEM 2. PROPERTIES

The Company's principal executive offices, as well as its principal research and development facility, is located in approximately 26,455 square feet of leased office building space in Poway, California. The lease on these facilities expires September 30, 2005. During the year, the Company leased a customer services and support facility in Alabama. The Company also leases a sales, customer services and support facility in Virginia. The Company believes that its existing facilities are adequate for its current needs.

### ITEM 3. LEGAL PROCEEDINGS

The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, financial condition, operating results, cash flow or liquidity.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter ended September 30, 2003.

### ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers as of December 29, 2003 were as follows:

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Name	Age	Position with the Company
James B. DeBello	45	President, Chief Executive Officer
John M. Thornton	71	Chairman, Chief Financial Officer
Noel Flynn	43	Vice President - Operations
Murali Narayanan	51	Vice President - Marketing
James Graybeal	44	Vice President - Sales

Mr. DeBello was named President and Chief Executive Officer in May 2003. He has served as a director of the company since 1994. Prior to being named Chief Executive Officer, he served as Chief Executive Officer of Asia Corporation Communications from 2001 to May 2003. Prior to that, he served as Chief Executive Officer of IdeaEdge Ventures from 2000 to 2001. Prior to that, he served as Chief Operating Officer of CollegeClub.com from 1999 to 2000.

Mr. Thornton served as Chairman, President, Chief Executive Officer and Chief Financial Officer from August 1998 to May 2003, when he resigned as President and Chief Executive Officer but remained as Chairman and Chief Financial Officer. He has served as Chairman since 1987.

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Mr. Flynn joined the Company in 1989. He was named Vice President of Operations in November 1999. Prior to that, he served as Director of Operations.

Mr. Narayanan joined the Company in July 2003 as Vice President of Marketing. Prior to joining the Company, he served from May, 2000 as Vice President of Business Development of Embrace Networks. Prior to that, he served from May 1999 to April 2000 as Director of Marketing, Internet and Connectivity Solutions for Motorola, Inc.

### Part II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MITK and the closing bid price on December 3, 2003 was \$1.13. As of December 3, 2003, there were 511 holders of record of Mitek Systems, Inc. Common Stock. The high and low common stock prices per share were as follows(1):

Quarter Ended	Dec. 31	Mar. 31	Jun. 30	Sept. 30	Year
Fiscal 2002					
Common stock price per share					
High	\$2.25	\$2.95	\$2.71	\$1.40	\$2.95
Low	1.15	1.43	1.12	.80	.80
Fiscal 2003					
Common stock price per share					
High	1.44	1.49	1.64	1.49	1.64
Low	.83	.85	1.00	.96	.83

(1) Bid quotations compiled by National Association of Securities Dealers, Inc., represents inter-dealer quotations and not necessarily actual

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transactions

We have not paid any dividends on our common stock. We currently intend to retain earnings for use in our business and do not anticipate paying cash dividends in the foreseeable future. We are prohibited from paying cash dividends under the terms of our line of credit agreement.

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### ITEM 6. SELECTED FINANCIAL DATA

The selected financial data set forth below with respect to our financial statements has been derived from the audited financial statements. The data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes included elsewhere in this filing.

(DOLLARS IN THOUSANDS EXCEPT PER SHARE DATA)	2003	2002	2001	2000	1999
-----	----	----	----	----	----
Statement of Operations Data					
Net Sales	\$ 11,594	\$ 13,083	\$ 9,387	\$ 9,348	\$ 9,741
Net income (loss)	(2,492)	397	(341)	(1,434)	2,026
Net income (loss) per share	(0.22)	0.04	(0.03)	(0.13)	0.19
Balance Sheet Data					
-----					
Cash and short-term investments	\$ 1,819	\$ 760	\$ 865	\$ 537	\$ 1,399
Total assets	5,644	8,231	6,616	7,774	7,389
Long-term liabilities	369	466	175	41	51
Stockholders' equity	2,572	5,028	4,564	4,890	5,622

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD LOOKING STATEMENTS

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

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future experiences and results to differ from the Company's current expectations. The difference may be caused by a variety of factors, including, but not limited to, adverse economic conditions, general decreases in demand for Company products and services, intense competition, including entry of new competitors, increased or adverse federal, state and local government regulation, inadequate capital, unexpected costs, lower revenues and net income than forecast, price increases for supplies, inability to raise prices, the risk of litigation and administrative proceedings involving the Company and its employees, higher than anticipated labor costs, the possible fluctuation and volatility of the Company's operating results and financial condition, adverse publicity and news coverage, inability to carry out marketing and sales plans, loss of key executives, changes in interest rates, inflationary factors, and other specific risks that may be alluded to in this MD&A.

### RESULTS OF OPERATIONS

#### NET SALES

Net sales were \$11,594,000, \$13,083,000 and \$9,387,000 for fiscal 2003, 2002 and 2001, respectively. Net sales decreased by \$1,489,000 in fiscal 2003 compared to fiscal 2002. The decrease from fiscal 2002 to fiscal 2003 was primarily due to reduced sales of Recognition Toolkits, which declined in revenue by \$1,498,000, or 25%, in fiscal 2003. The decrease reflects the Company's efforts that were principally focused on Check Imaging Solutions. Though the Company experienced a nominal increase in the installed customer base for Recognition Toolkits, there were certain existing customers whose Fiscal 2002 enterprise licenses will not renew until fiscal 2004. Prospectively, the Company expects this area to grow during fiscal 2004, given a renewed effort to penetrate additional customer markets, along with renewal of enterprise licenses, which should occur during fiscal 2004.

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Check Imaging Solutions revenue increased by \$98,000, or 2%, during fiscal 2003. This increase reflects additional market penetration during the fiscal year, but was substantially below the Company's expectation. The Company believes there was considerable extension of the sales cycle during fiscal 2003, due to legislation pending during the fiscal year. This legislation, eventually signed into law in October of 2003, mandated changes in how banks process checks, and will eventually eliminate the transportation of paper checks through the Federal Reserve System. The Company believes uncertainty regarding the final form caused many prospective customers to delay purchase of check imaging within their operations. The Company believes the passage of this legislation will encourage banks to reevaluate imaging solutions, and as the 2005 adoption deadline approaches, will shorten the historical sales cycle.

Sales of the Company's Document and Image Processing Solutions decreased by \$270,000, or 26%, for fiscal 2003. This reflects the Company's efforts that were principally focused on Check Imaging Solutions, not on Imaging Processing Solutions. Prospectively, the Company expects this area to yield considerable growth, with the addition of sales staff whose focus will be on this area.

The increase in revenue from fiscal 2001 to fiscal 2002 of \$3,696,000 was due to increased sales of Recognition Toolkits, which increased by \$2,148,000, or 55%. This increase reflected both additional market penetration and renewal of existing enterprise licensing agreements. Check Imaging Solutions increased sales by \$1,082,000, or 26%, for fiscal 2002. This increase reflected additional market penetration of the imaging solution. Sales of the Company's Document and Imaging Processing Solutions increased by \$267,000, or 36%, for fiscal 2002. This increase reflects additional revenue due to the release of new image

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processing tools, which were adopted by the existing customer base.

### COST OF SALES

Cost of sales includes manufacturing and distribution costs for products and programs sold, operation costs related to product support, and costs associated with the delivery of consulting services. Cost of sales were \$4,541,000, \$3,751,000, and \$2,650,000, for fiscal 2003, 2002 and 2001, respectively. The dollar increase in cost of sales in 2003 from 2002 resulted primarily from margin erosion in the Company's Check Imaging Solutions. Due to increased pricing pressures in the marketplace, the Company reduced prices. The dollar increase in cost of sales in 2002 from 2001 resulted primarily from the increased sales of the Company's Check Imaging Solutions and Recognition Toolkits product lines.

Stated as a percentage of net sales, cost of sales for the corresponding periods were 39%, 29% and 28%, respectively. The increase in cost of sales, stated as a percentage of sales, resulted from the reduced gross margin as discussed above. The increase in cost of sales, as a percentage of sales, in fiscal 2002 from 2001 resulted from the mix of product sales shifting to products which have both hardware and software included in the sale, which typically carries lower gross margins, or to products on which the Company pays royalties.

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### OPERATIONS

Gross operations expense include payroll, employee benefits, and other headcount-related costs associated with shipping and receiving, quality assurance, customer support, installation and training. As installation, training, maintenance and customer support revenues are recognized, the amounts expensed are charged to cost of sales, with unabsorbed costs remaining in operations expense.

Operations expenses were \$1,694,000, \$1,872,000, and \$1,279,000 for fiscal 2003, 2002, and 2001, respectively. The dollar decrease in the 2003 expense is primarily attributable to additional amounts charged to cost of sales, reflecting increased activity in installation and training. The dollar increase in the 2001 fiscal year was primarily attributable to staff additions. These increased costs are a result of the growth in the installed base of Checkquest customers, as well as the demand for additional installation and training personnel which the Company deemed necessary to meet the installation and training needs for new customers.

Stated as a percentage of net sales, operations expenses for fiscal 2003, 2002, and 2001 were 15%, 14%, and 14%, respectively. The increase in the 2003 expense, as a percentage of net sales, was primarily attributable to the reduced amount of sales. The fixed amount in the 2002 expense, as a percentage of net sales, is primarily attributable to additions to the Company's staff of CheckQuest support, installation and training specialists, combined with an increase in travel costs.

### SELLING AND MARKETING

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. Selling and marketing expenses were \$3,768,000, \$3,014,000, and \$2,292,000, for fiscal 2003, 2002, and 2001, respectively. The dollar increase in 2003 expense is primarily

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attributable to increased salaries and commission expense, which resulted from the addition of three salespersons primarily focused on the community bank market. The dollar increase in 2002 expense is primarily attributable to increased sales and the use of sales representatives compensated on a commission-only basis

Stated as a percentage of net sales, selling and marketing expenses for fiscal 2003, 2002, and 2001 were 32%, 23%, and 24%, respectively. The increase in 2003 expense, as a percentage of net sales, was primarily attributable to the increased expense, combined with the decreased sales. The decrease in 2002 expense, as a percentage of net sales, was primarily attributable to the effect of the increased Checkquest salespersons, which occurred in fiscal 2002, who accounted for the increased sales. This increase in sales was only partially offset by an increase in dollar expense, primarily commissions.

We expect that we will decrease overall spending on Checkquest sales force, having already eliminated three positions during fiscal 2003, while anticipating adding one position to the Solutions sales force during fiscal 2004.

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### RESEARCH AND DEVELOPMENT

Research and development expenses include payroll, employee benefit, and other headcount-related costs associated with product development. These costs are incurred to maintain and enhance existing products. The Company maintains sufficient staff to maintain the existing product lines, including development of newer, more feature-rich versions of its existing product lines, as the Company determines is demanded by the marketplace. The Company also maintains research personnel, whose efforts are designed to ensure product paths from current technologies to anticipated future generations of products within the Company's area of business.

Research and development expenses were \$2,242,000, \$2,049,000, and \$1,830,000 for fiscal 2003, 2002, and 2001, respectively. The dollar increase in the 2003 expense is primarily due to annual salary adjustments given to engineering personnel. The dollar increase in the 2002 expense is due to additional personnel added to support and enhance the Checkquest product line.

Stated as a percentage of net sales, research and development expense for fiscal 2003, 2002, and 2001, including charges to cost of sales, were 19%, 16%, and 19%, respectively. The increase in 2003 expense, as a percentage of net sales, is primarily attributable to the decrease in sales. The decrease in 2002 expense, as a percentage of net sales, is primarily attributable to the increase in sales.

During fiscal 2004, we expect our research and development expenses to continue to increase due to annual salary adjustments, however we do not expect to increase the number of research and development personnel.

### GENERAL AND ADMINISTRATIVE

General and administrative expenses include payroll, employee benefit, and other headcount-related costs associated with the finance, facilities, and legal and other administrative fees. General and administrative costs were \$1,848,000, \$2,010,000, and \$1,634,000, for fiscal 2003, 2002, and 2001, respectively. The dollar decrease in the 2003 expense is primarily attributable to reduced bad debt expense, resulting from more stringent order acceptance criteria. The dollar increase in the 2002 expense is primarily attributable to costs

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associated with outside professional services, primarily strategic planning services incurred to better focus and direct the Company's efforts, as well as increased bad debt expense.

Stated as a percentage of net sales, general and administrative expense for fiscal 2003, 2002, and 2001 were 16%, 15%, and 17%, respectively. The increase in 2003 expense, as a percentage of net sales, was primarily due to decreased sales. The decrease in 2002 expense, as a percentage of net sales, was primarily attributable to increased sales.

Prospectively, we do not expect any material change in our general and administrative expense growth, based upon our current operating plan for fiscal 2004.

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### OTHER INCOME (EXPENSE)

Net interest income (expense) was \$18,000, \$9,000, and (\$43,000), for fiscal 2003, 2002, and 2001, respectively. Stated as a percentage of net sales, net interest income (expense) for the corresponding periods was 0.2%, 0.1%, and (0.5%), respectively. The increase in interest income in the current year is attributable to interest earned on cash invested during the year. The Company moved from interest expense in 2001 to income in 2002 due to reduced borrowings under the Company's line of credit.

### INCOME TAXES

For the fiscal years 2003, the Company recorded income tax expense, which was primarily franchise taxes paid to states in which the Company operated. In fiscal 2002, and 2001 the Company did not record an income tax provision or benefit for income taxes because the deferred tax assets generated by the current year net benefit was offset by a corresponding decrease in the valuation allowance.

### FINANCIAL CONDITION

At September 30, 2003 the Company had \$1,819,000 in cash as compared to \$760,000 at September 30, 2002. Accounts receivable totaled \$2,901,000, a decrease of \$3,373,000 over the September 30, 2002, balance of \$6,274,000. This decrease was primarily a result of collection of existing receivables.

Unearned revenue as of September 30, 2003 was \$1,204,000, increasing \$335,000 from September 30, 2002, reflecting the addition of new and anniversary multi-year product support agreements, partially offset by continued recognition of unearned revenue from product support agreements licensed in prior periods.

During fiscal 2003, the Company financed its cash needs primarily from operating activities.

Net cash generated from operating activities during the year ended September 30, 2003 was \$1,223,000. The primary use of cash from operating activities was the net loss of \$2,492,000 and a decrease in accounts payable of \$686,000. The primary sources of cash from operating activities was a decrease in accounts receivable of \$3,270,000 and depreciation and amortization expense, which does not require cash, of \$442,000.

Net cash used from investing activities was primarily from the acquisition of fixed assets, primarily a high-speed sorter used for development work, as well as additional computer equipment used in development.

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Net cash from financing activities was primarily the borrowing and repayment on the Company's line of credit.

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The Company's working capital and current ratio was \$2,341,000 and 1.87, respectively, at September 30, 2003, \$4,643,000 and 2.70, respectively, at September 30, 2002. At September 30, 2003, total liabilities to equity ratio was 1.19 to 1 compared to .64 to 1 a year earlier. As of September 30, 2003, total liabilities were reduced by \$132,000 than on September 30, 2002.

On February 19, 2003 the Company revised its working capital revolving line of credit. This line requires interest to be paid at prime plus 1 percentage point, and is subject to a limit on maximum available borrowings of \$1,200,000. The Company had no borrowings under the working capital line of credit on September 30, 2003 or on September 30, 2002. This credit line is subject to a net worth covenant whereby the Company must maintain a tangible net worth of \$3,750,000 in order to use the credit line. The loss sustained during the year ended September 30, 2003 caused the Company's net worth to fall to \$2,680,000. Though the Company had no borrowings under the credit line as of September 30, 2003, the Company is no longer in compliance with the aforementioned net worth covenant. The Company requested, and the lender agreed to, a modification of the net worth covenant, which reduced the maximum available borrowings to \$500,000 subject to a required minimum tangible net worth of \$2,000,000. All other covenants and conditions remained the same.

The existing credit line expires on February 28, 2004. The Company believes that it will be able to renew the current credit line with its current lender. If such renewal cannot be obtained, the Company believes that alternative financing, under terms satisfactory to the Company will be available. However no assurance can be made that the Company will be able to renew its current credit line or that alternative financing can be secured under terms satisfactory to the Company.

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

The Company signed an agreement to lease office space at 14145 Danielson Street, Suite B, Poway, California effective July 1, 2002 through September 30, 2005. The future annual minimum rents have been disclosed in the footnotes to the Financial Statements.

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

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect



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Guarantees. This

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

In December 2002, the FASB issued SFAS No. 148 Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS No. 123 provided for under SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. However, certain provisions of SFAS No. 148 relating to interim financial statements are effective for the Company's second quarter beginning January 1, 2003. The Company has not elected to adopt the fair value accounting provisions of SFAS No. 123 and therefore the adoption of SFAS No. 148 did not have a material effect on our results of operations or financial position.

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

### APPLICATION OF CRITICAL ACCOUNTING POLICIES

Mitek's financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States of

America. Preparing financial

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statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for Mitek include revenue recognition, impairment of accounts and notes receivable, and accounting for income taxes.

#### Revenue Recognition

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

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

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

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

#### Accounts Receivable.

We evaluate the creditworthiness of our customers prior to order fulfillment and we perform ongoing credit evaluations of our customers to adjust credit limits based on payment history and our assessment of the customer's current creditworthiness. We constantly monitor collections from our customers and maintain a provision for estimated credit losses that is based on historical experience and on specific customer collection issues. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that

we will continue to experience the same credit loss rates that we have in the past. Since our revenue recognition policy requires customers to be deemed creditworthy, our accounts receivable are based on customers whose payment is reasonably assured. Our accounts receivable are derived from sales to a wide variety of customers. We do not believe a change in liquidity of any one customer or our inability to collect from any one customer would have a material adverse impact on our financial position.

Deferred Income Taxes.

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

ISSUES AND UNCERTAINTIES

This Annual Report on Form 10-K 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.

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.

We currently derive substantially all of our product revenues from licenses and sales of hardware and software products incorporating its 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 hardware or 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, some of whom 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

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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.

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.

### Delisting from the Nasdaq SmallCap Market

Our common stock is listed on the Nasdaq SmallCap Market. No assurance can be made that our common stock will continue to be listed on the Nasdaq SmallCap Market. If our common stock were not able to be traded on the Nasdaq SmallCap Market, it would likely be traded on the OTC market or the "pink sheets." Securities traded on the Nasdaq SmallCap Market, the OTC market 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.

Additionally, the Nasdaq SmallCap Market has recently experienced extreme price and volume fluctuations. 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.

Our 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.

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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, which may cause downward pressure on our common stock price. We expect quarterly fluctuations to continue for the foreseeable future.

Our historical order flow patterns, which we expect to continue, have caused forecasting difficulties for us.

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. . The Company, however, will base its expense levels, in significant part, on its expectations of future revenue. . As a result, the Company expects its 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, the Company believes that period-to-period comparisons of the Company's 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.

Revenue recognition accounting standards and interpretations may change, causing the Company to recognize lower revenues.

In October 1997, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) No. 97-2, Software Revenue Recognition. The Company adopted SOP 97-2, as amended by SOP 98-4 Deferral of the Effective Date of a Provision of SOP 97-2 as of July 1, 1998. In December 1998, the AICPA issued SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. The Company adopted SOP 98-9 on January 1, 2000. These standards address software revenue recognition matters primarily from a conceptual level and do not include specific implementation guidance. The Company believes that it is currently in compliance with SOP 97-2 and SOP 98-9. In addition, in December 1999, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (SAB 101), which provides further guidance with regard to revenue recognition, presentation and disclosure. The Company adopted SAB 101 during the fourth quarter of fiscal 2000.

The accounting profession and the SEC continue to discuss certain provisions of SOP 97-2, SAB 101 and other revenue recognition standards and related interpretations with the objective of providing additional guidance on potential application of the standards and interpretations. These discussions could lead to unanticipated changes in revenue recognition standards and, as a

result, in the Company's current revenue accounting practices, which could cause the Company to recognize lower revenues. As a result, the Company may need to change its business practices.

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If our products have product defects, it could damage our reputation, sales, profitability and result in other costs.

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.

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.

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.

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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

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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 James B. DeBello, our President and Chief Executive Officer, or John M. Thornton, our Chairman of the Board and 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.

Additionally, there are several proposals in the United States Congress and in the accounting industry to require corporations to include a compensation expense in their statement of operations relating to the issuance of employee stock options. If such a measure is approved, we may decide to issue fewer stock options. As a result, we may be impaired in our efforts to attract and retain necessary 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.

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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 September 30, 2003, John M. Thornton, who is our Chairman of the Board and Chief Financial Officer and his spouse, Director Sally B. Thornton, beneficially owned approximately 24% of our outstanding common stock. Our directors and executive officers as a whole, own approximately 30% of our outstanding common stock. As a result, these stockholders may effectively control 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.

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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.

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 product pricing policies by the Company 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, 2003, our common stock price ranged from \$.83 to \$1.64.

We do not intend to pay dividends on the common stock.

We have not paid any dividends on our common stock and do not intend to pay dividends for the foreseeable future.

We may need additional capital in the future.

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We may need to raise additional funds in the future through public or private financing. No assurance can be given that additional financing will be available or that, if available, it will be available on terms favorable to us. If additional funds are raised through the issuance of equity securities, the percentage ownership of our then current 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 needed financing on terms favorable to us, such could have an adverse effect upon our financial condition, results of operations and ability to maintain operations as planned. Our capital requirements will depend on many factors, including, but not limited to, the rate of market acceptance and competitive position of the products incorporating our technologies, the levels of promotion and advertising required to launch and market such products and attain a competitive position in the marketplace, the extent to which we invest in new technology to support our product development efforts, and the response of competitors to the products we offer.



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Our current credit facility may not be sufficient for our capital requirements.

While we believe that our current credit line is sufficient, together with 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. We had a working capital line of credit with a maximum available credit line of \$1,200,000. As of September 30, 2003, we had no borrowings under this credit line. This credit line was subject to a net worth covenant whereby the Company was required to maintain a tangible net worth of \$3,750,000 in order to use the credit line. The loss sustained during the year ended September 30, 2003 caused the Company's net worth to fall to \$2,680,000. Though the Company had no borrowings under the credit line as of September 30, 2003, the Company is no longer in compliance with the aforementioned net worth covenant. The Company requested, and the lender agreed to, a modification of the net worth covenant, which reduced the maximum available borrowings to \$500,000 subject to a required minimum tangible net worth of \$2,000,000. All other covenants and conditions remained the same. The existing credit line expires on February 28, 2004.

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.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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The Company is exposed to certain market risks arising from adverse changes in interest rates, primarily due to the potential effect of such changes on the Company's variable rate working capital line of credit, as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital." As of September 30, 2003, the Company had no outstanding balance under its line of credit. The Company does not use interest rate derivative instruments to manage exposure to interest rate changes.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED SEPTEMBER 30, 2003, 2002, AND 2001

2003

2002

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SALES		
Software	\$ 7,227,063	\$ 9,688,
Hardware	2,447,252	2,146,
Professional Services, education and other	1,919,748	1,247,
NET SALES	11,594,063	13,083,
COSTS AND EXPENSES:		
Cost of Sales-Software	864,714	1,150,
Cost of Sales-Hardware	2,605,552	2,022,
Cost of Sales-Professional Services, education and other	1,070,939	578,
Operations	1,694,489	1,872,
Selling and marketing	3,767,966	3,013,
Research and development	2,241,804	2,048,
General and administrative	1,848,469	2,009,
Total costs and expenses	14,093,933	12,695,
OPERATING (LOSS) INCOME	(2,499,870)	387,
OTHER INCOME (EXPENSE) - NET	18,334	9,
(LOSS) INCOME BEFORE INCOME TAXES	(2,481,536)	396,
PROVISION FOR INCOME TAXES	10,654	
NET (LOSS) INCOME	\$ (2,492,190)	\$ 396,
NET (LOSS) INCOME PER SHARE - BASIC	\$ (0.22)	\$ 0
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC	11,154,489	11,132,
NET (LOSS) INCOME PER SHARE - DILUTED	\$ (0.22)	\$ 0
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND COMMON SHARE EQUIVALENTS OUTSTANDING - DILUTED	11,154,489	11,327,

See notes to financial statements

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BALANCE SHEETS  
SEPTEMBER 30, 2003 AND 2002

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	2003	
	-----	
ASSETS		
CURRENT ASSETS		
Cash	\$ 1,819,102	\$
Accounts receivable-net of allowances of \$253,697 and \$150,208, respectively	2,900,693	6
Note receivable - related party	195,623	
Inventories - net	43,182	
Prepaid expenses and other assets	84,167	
	-----	
Total current assets	5,042,767	7
PROPERTY AND EQUIPMENT - net	321,029	
OTHER ASSETS	279,985	
	-----	
TOTAL ASSETS	\$ 5,643,781	\$ 8
	=====	
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 881,032	\$ 1
Accrued payroll and related taxes	690,388	
Deferred revenue	884,917	
Other accrued liabilities	245,818	
	-----	
Total current liabilities	2,702,155	2
LONG-TERM LIABILITIES:		
Deferred rent	16,135	
Deferred revenue	318,826	
Long-term payable	34,194	
	-----	
Total long-term liabilities	369,155	
TOTAL LIABILITIES	3,071,310	3
	-----	
COMMITMENTS AND CONTINGENCIES (Note 5)		
STOCKHOLDERS' EQUITY:		
Common stock - \$.001 par value; 20,000,000 shares authorized, 11,185,282 and 11,138,772 issued and outstanding at September 30, 2003 and 2002, respectively	11,185	
Additional paid-in capital	9,327,736	9
Accumulated deficit	(6,766,450)	(4
	-----	
Total stockholders' equity	2,572,471	5
	-----	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 5,643,781	\$ 8
	=====	

See notes to financial statements

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STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED SEPTEMBER 30, 2003, 2002, AND 2001

	2003	
	-----	
OPERATING ACTIVITIES		
Net (loss) income	\$ (2,492,190)	\$
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	441,931	
Provision for bad debts	103,489	
Loss on disposal of property and equipment	986	
Fair value of stock options issued to non-employees	15,576	
Changes in assets and liabilities:		
Accounts receivable	3,269,805	
Inventory, prepaid expenses, and other assets	15,702	
Other long term assets	0	
Accounts payable	(686,089)	
Accrued payroll and related taxes	41,978	
Long-term payable	(34,206)	
Deferred revenue	335,250	
Other accrued liabilities	210,729	
	-----	
Net cash provided by operating activities	1,222,961	
INVESTING ACTIVITIES		
Purchases of property and equipment	(190,616)	
Proceeds from sale of property and equipment	1,203	
Payment received on (Investment in) note receivable-net	3,604	
	-----	
Net cash used in investing activities	(185,809)	
FINANCING ACTIVITIES		
Proceeds from borrowings under line of credit	360,000	
Repayment of borrowings under line of credit	(360,000)	
Proceeds from exercise of stock options and warrants	21,534	
	-----	
Net cash provided by (used in) financing activities	21,534	
	-----	
NET INCREASE (DECREASE) IN CASH	1,058,686	
CASH AT BEGINNING OF YEAR	760,416	
	-----	
CASH AT END OF YEAR	\$ 1,819,102	\$
	=====	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 6,736	\$
	=====	
Cash paid for income taxes	\$ 10,654	\$
	=====	

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See notes to financial statements

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STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED SEPTEMBER 30, 2003, 2002, AND 2001

	Common Stock	Additional Paid-In Capital	Accumu Defi
Balance, October 1, 2000	\$11,120	\$9,208,083	\$ (4,32
Exercise of stock options	1	643	
Fair value of stock options issued to non-employees		15,082	
Net loss			(34
Balance, September 30, 2001	11,121	9,223,808	(4,67
Exercise of stock options	18	12,251	
Fair value of stock options issued to non-employees		54,613	
Net income			39
Balance, September 30, 2002	11,139	9,290,672	(4,27
Exercise of stock options	46	21,488	
Fair value of stock options issued to non-employees		15,576	
Net loss			(2,49
Balance, September 30, 2003	\$11,185	\$9,327,736	\$ (6,76

See notes to financial statements

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MITEK SYSTEMS, INC.  
NOTES TO FINANCIAL STATEMENTS  
FOR THE YEARS ENDED SEPTEMBER 30, 2003, 2002 AND 2001

NOTE 1 - NATURE OF OPERATIONS AND  
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations - Mitek Systems, Inc. (the "Company") is a designer, manufacturer and marketer of advanced character recognition products for intelligent forms processing applications ("Character Recognition") with an emphasis in document imaging system products and solutions systems integration services.

Fiscal 2003 operations resulted in a significant operating loss. Should additional losses occur, the Company may need to raise significant additional

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funds to continue its activities. 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 collaborative agreements or other arrangements that may be on unfavorable terms. The Company's failure to raise sufficient additional funds on favorable terms, or at all, would have a material adverse effect on its business, results of operations and financial position.

**Basis of Accounting** - The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

**Accounting Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include estimates of loss contingencies and product life cycles, and assumptions such as the elements comprising a software arrangement, including the distinction between upgrades/enhancements and new products; and when technological feasibility is achieved for our products. Actual results may differ from management's estimates and assumptions.

**Fair Value of Financial Instruments** - The carrying amount of cash, cash equivalents, accounts receivable, notes receivable, accounts payable, and accrued liabilities are considered representative of their respective fair values because of the short-term nature of those instruments.

**Cash and Cash Equivalents** - Cash equivalents are defined as highly liquid financial instruments with original maturities of three months or less. A substantial portion of the Company's cash is deposited with one financial institution. The Company monitors the financial condition of the financial institution and does not believe that the deposit is subject to a significant degree of risk.

**Allowance for Doubtful Accounts** - The allowance for doubtful accounts reflects the Company's best estimate for probable losses inherent in the accounts receivable balance. The Company determine the allowance based on known troubled accounts, historical experience, and other currently available evidence. Activity in the allowance for doubtful accounts is as follows:

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	Balance at beginning of period -----	Charged to costs and expenses -----	Write-offs and other -----	Balance p -----
Year Ended September 30				
2001	763,912	155,000	579,887	339
2002	339,025	285,000	473,817	150
2003	150,208	103,489	0	253

**Inventories** - Inventories are recorded at the lower of average cost or market.

**Property and Equipment** - Property and Equipment are carried at cost. Following is a summary of property and equipment as of September 30, 2003 and

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2002.

	2003	2002
	-----	-----
Property and equipment - at cost:		
Equipment	\$ 1,367,459	\$ 1,545,795
Furniture and fixtures	159,672	159,672
	-----	-----
Leasehold improvements	6,700	6,611
	1,533,831	1,712,078
	-----	-----
Less: accumulated depreciation and amortization	(1,212,802)	(1,332,545)
	-----	-----
Total	\$ 321,029	\$ 379,533
	=====	=====

Property and Equipment are carried at cost. Depreciation and amortization of property and equipment are provided using the straight-line method over estimated useful lives ranging from three to five years. Depreciation and amortization of property and equipment totaled \$246,931, \$222,468, and \$181,511 for the years ended September 30, 2003, 2002 and 2001, respectively.

Other Assets - The costs of acquiring the Company's software product rights were capitalized and are being amortized over the estimated periods to be benefited, typically 2 to 3 years. Other assets consisted of the following at September 30, 2003 and 2002:

	2003	2002
	-----	-----
Prepaid software rights - Docubase- net	\$243,750	\$438,750
Investment in Mitek Systems Ltd.	4,489	0
Other - net	31,746	31,746
	-----	-----
Total	\$279,985	\$470,496
	=====	=====

Amortization of prepaid software rights, which is charged to cost of sales, for fiscal 2003, 2002 and 2001 was \$195,000, \$332,758, and \$273,902, respectively.

Long-Lived Assets - The Company periodically evaluates the carrying value of license agreements and other intangible assets to determine whether any impairment of these assets has occurred or whether any revision to the related amortization periods should be made. This evaluation is based on management's projections of the undiscounted future cash flows associated with each product or asset. If management's evaluation were to indicate that the

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carrying values of these intangible assets were impaired, the impairment to be recognized is measured by the amount the carrying amount of the assets exceeds the fair value of the assets. The Company did not record any impairment for the years ended September 30, 2003, 2002, or 2001.

Investment in Mitek Systems Ltd. - On September 1, 2000 the Company acquired a 15% investment in Itech Business Solutions Ltd. ("Itech"), which was accounted for under the cost method at September 30, 2000. On October 3, 2000 the Company acquired an additional 15% interest in Itech for \$88,506. After this additional investment, the Company accounted for its 30% interest in Itech under

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the equity method. Subsequent to the additional investment on October 3, 2000, Itech changed their name to Mitek Systems Ltd. During fiscal 2002, the Company acquired an additional 18% interest in consideration for a loan to Mitek Systems Ltd. This loan carries monthly payment terms and a 10% rate of interest. Amounts due from Mitek Systems Ltd at September 30, 2003 and 2002 were \$195,623 and \$199,227, respectively. The additional interest in Mitek Systems Ltd required no additional investment. Included in fiscal 2003, 2002 and 2001 Other Income (Expenses) is \$4,489, (\$11,636), and (\$13,604), respectively, related to the Company's equity in the income (loss) of Mitek Systems, Ltd.

Deferred Revenue - Deferred revenue represents customer billings, paid either upfront or annually at the beginning of each billing period, which are accounted for as subscriptions with revenue recognized ratably over the billing coverage period. For certain other licensing arrangements revenue attributable to undelivered elements, including free post-delivery telephone support and the right to receive unspecified upgrades/enhancements on the Company's software on a when-and-if-available basis, is based upon the sales price of those elements when sold separately and is recognized ratably on a straight-line basis over the term of the agreement. Historically, the percentage of revenue recorded as unearned due to undelivered elements generally ranged from approximately 8% to 15% of the sales price of the software.

Revenue Recognition - Revenues from sales of software licenses sold through direct and indirect channels, which do not contain multiple elements, are recognized upon shipment of the related product, if the requirements of Statement of Position ("SOP") 97-2, as amended, are met. If the requirements of SOP 97-2, including evidence of an arrangement, delivery, fixed or determinable fee, collectibility or vendor specific evidence about the value of an element are not met at the date of shipment, revenue is not recognized until such elements are known or resolved. Software license revenue for arrangements to deliver unspecified additional software products in the future is recognized ratably over the term of the arrangement, beginning with the initial shipment. Revenue from post-contract customer support is recognized ratably over the term of the contract. Revenue from professional services is recognized when such services are delivered and accepted by the customer

In December 1999, SEC Staff Accounting Bulletin ("SAB") No. 101, Revenue Recognition in Financial Statements was issued. SAB 101 provides the SEC staff's view in applying generally accepted accounting principles to selected revenue recognition issues, including software revenue recognition. There was no impact on the financial statements as a result of the adoption of SAB 101. Therefore, no adjustment was recorded.

Research and Development - Research and development costs are expensed in the period incurred.

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Income Taxes - The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Deferred tax assets and liabilities arise from temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years.

Management evaluates the available evidence about future taxable income and other possible sources of realization of deferred tax assets. The valuation allowance reduces deferred tax assets to an amount that represents management's best estimate of the amount of such deferred tax assets that more likely than not will be realized. - see Note 4.



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Net Income (Loss) Per Share - The Company calculates net income (loss) per share in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, Earnings per Share. Basic net income (loss) per share is based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share also gives effect to all potential dilutive common shares outstanding during the period, such as options and warrants, if dilutive. The weighted average number of common shares and common share equivalents outstanding for the year ended September 30, 2002 included 194,296 common share equivalents related to stock options and warrants. Outstanding stock options for fiscal 2003 and 2001 were excluded from this calculation, as they would have been antidilutive.

Stock Based Compensation - As permitted by SFAS No. 123, Accounting for Stock-Based Compensation, the Company accounts for costs of stock-based compensation to employees in accordance with Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, and accordingly, discloses the pro forma effect on net income (loss) and related per-share amounts using the fair value based method to account for stock-based compensation (Note 2). The fair value of stock compensation issued to non-employees is determined using the Black-Scholes option pricing model and compensation expense is recorded pursuant to the provisions of EITF 96-18.

The Company accounts for stock options granted to its employees and members of its board of directors under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 (APB No. 25) Accounting for Stock Issued to Employees, and related interpretations, and with the disclosure requirements of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. The following table illustrates the effect on net (loss) income and net (loss) income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation (in thousands, except per share amounts).

	Year Ended September 30 2003 -----	Year Ended September 30 2002 -----	
Net (loss) income, as reported	\$ 2,492	\$ 397	
Add: Stock-based employee compensation expense included in reported net (loss) income, net of related tax effects	0	0	
Deduct; Total stock-based employee compensation expense determined under the fair value method, net of related tax effects	(5,631)	(962)	
Pro Forma net (loss) income	----- (\$3,139)	----- (\$565)	
Net (loss) income per share	=====	=====	
	(.28)	(.05)	

Segment Reporting - SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, results in the use of a management approach in identifying segments of an enterprise. Management has determined that the

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Company operates in only one segment.

Comprehensive Income (Loss) - There are no differences between net income and comprehensive income and, accordingly, no amounts have been reflected in the accompanying financial statements.

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

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

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

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transactions entered into prior to February 1, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The FASB postponed implementation of FIN 46 in December 2003. The Company has not completed the process of evaluating the impact that the adoption of FIN 46 will have on its financial position or operating results.

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### NOTE 2 - STOCKHOLDERS' EQUITY

Stock Options - The Company has stock option plans for executives and key individuals who make significant contributions to the Company. The 1986 plan provides for the purchase of up to 630,000 shares of common stock through incentive and non-qualified options. The 1986 plan expired on September 30, 1996 and no additional options may be granted under this plan. The 1988 plan provides for the purchase of up to 650,000 shares of common stock through non-qualified options. The 1988 plan expired on September 13, 1998. For both plans, options were granted at fair market value of the Company's stock at the grant date and for a term of not more than six years. Employees owning in excess of 10% of the outstanding stock are excluded from the plans.

The 1996 plan provides for the purchase of up to 1,000,000 shares of common stock through incentive and non-qualified options. Options must be granted at fair market value of the Company's 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 options must be granted at fair market value of the Company's stock at the grant date while non-qualified options may be granted at no less than 85% of fair market value of the Company's 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 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 while non-qualified options may be granted at no less than 85% of fair market value, 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.

Information concerning stock options granted by the Company under all plans for the years ended September 30, 2003, 2002 and 2001 is as follows:

	Shares	Weighted Average Exercise Price Per Share
	-----	-----
Balance, October 1, 2000	1,115,842	\$3.96
Granted	486,500	\$0.98
Exercised	(1,111)	\$0.70
Cancelled	(128,788)	\$5.98
	-----	-----
Balance, September 30, 2001	1,472,443	\$2.84
Granted	510,500	\$1.65
Exercised	(17,818)	\$0.69
Cancelled	(96,528)	\$1.41
	-----	-----
Balance, September 30, 2002	1,868,597	\$2.56

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Granted	856,000	\$1.17
Exercised	(46,510)	\$0.46
Cancelled	(327,124)	\$3.20
	-----	-----
Balance, September 30, 2003	2,350,963	\$2.03
	=====	=====

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The following table summarizes information about stock options outstanding at September 30, 2003:

Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable
\$ 0.43- - \$ 0.80	2,000	5.08	\$ 0.44	2,000
\$ 0.81- - \$ 0.99	468,497	5.99	\$ 0.91	381,936
\$ 1.00- - \$ 2.32	1,372,140	5.60	\$ 1.50	436,529
\$ 2.33- - \$ 3.68	254,903	5.86	\$ 2.85	254,611
\$ 3.69- - \$ 5.09	1,723	6.33	\$ 5.09	1,723
\$ 5.10- - \$ 7.68	245,700	6.70	\$ 6.81	245,639
\$ 7.69- - \$12.37	6,000	6.43	\$ 9.30	6,000
	-----	-----	-----	-----
	2,350,963	6.39	\$ 2.03	1,328,438
	=====	=====	=====	=====

All stock options are granted with an exercise price equal to the fair market value of the Company's common stock at the grant date. The weighted average fair value of the stock options granted was \$.59, \$.93, and \$.88 for fiscal 2003, 2002 and 2001, respectively. The fair value of each stock option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003: risk-free interest rate of 2%; expected dividend yield of 0%; expected life of 3 years; and expected volatility of 78%. In 2002, the assumptions were: risk-free interest rate of 5.5%; expected dividend yield of 0%; expected life of 3 years; and expected volatility of 82%. In 2001, the assumptions were: risk-free interest rate of 4.5%; expected dividend yield of 0%; expected life of 3 years; and expected volatility of 192%. Stock options generally expire between six to ten years from the grant date. Stock options generally vest over a three-year period, with one thirty-sixth becoming exercisable on each of the monthly anniversaries of the grant date.

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The Company has also issued 18,000 stock options to non-employees which are accounted for as variable arrangements under the provisions of EITF 96-18. Compensation expense related to such awards were \$15,576, \$54,612, and \$15,082 for the years ended September 30, 2003, 2002 and 2001, respectively, and are included in general and administrative expense. Future increases in the fair value of the Company's common stock could result in additional compensation

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expense.

### NOTE 3 - LINE OF CREDIT - BANK

On February 19, 2003 the Company revised its working capital revolving line of credit. This line requires interest to be paid at prime plus 1 percentage point, and is subject to a limit on maximum available borrowings of \$1,200,000. The Company had no borrowings under the working capital line of credit on September 30, 2003 or on September 30, 2002. This credit line was subject to a net worth covenant whereby the Company was required to maintain a tangible net worth of \$3,750,000 in order to use the credit line. The loss sustained during the year ended September 30, 2003 caused the Company's net worth to fall to \$2,680,000. Though the Company had no borrowings under the credit line as of September 30, 2003, the Company is no longer in compliance with the aforementioned net worth covenant. The Company requested, and the lender agreed to, a modification of the net worth covenant, which reduced the maximum available borrowings to \$500,000 subject to a required minimum tangible net worth of \$2,000,000. All other covenants and conditions remained the same. The existing credit line expires on February 28, 2004.

### NOTE 4 - INCOME TAXES

For the years ended September 30, 2003 and 2002, the provision for income taxes were as follows:

	2003	2002	2001
	----	----	----
Federal - Current	0	0	0
State - Current	11,000	0	0
	-----	-----	-----
Total	11,000	0	0
	=====	=====	=====

Under SFAS No. 109, deferred income tax liabilities and assets 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.

Significant components of the Company's net deferred tax liabilities and assets as of September 30, 2003 and 2002 are as follows:

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	2003	2002
	-----	-----
Deferred tax liabilities:		
Reserves not currently deductible	\$ 159,000	\$ 64,000
Book depreciation and amortization in excess of tax	333,000	330,000
Research credit carryforwards	529,000	529,000
AMT credit carryforward	69,000	69,000
Net operating loss carryforwards	3,088,000	2,235,000
Capitalized research and development costs	104,000	182,000
Uniform capitalization	(19,000)	(13,000)
Other	132,000	124,000
	-----	-----
Total deferred tax assets	4,395,000	3,520,000
Valuation allowance for net deferred tax assets	(4,395,000)	(3,520,000)

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Total	----- \$ 0 =====	----- \$ 0 =====
-------	------------------------	------------------------

The Company has provided a valuation allowance against deferred tax assets recorded as of September 30, 2003 and 2002 due to uncertainties regarding the realization of such assets.

The research credit and net operating loss carryforwards expire during the years 2005 to 2020. The federal and California net operating loss carryforwards at September 30, 2003 are approximately \$8,143,000 and \$4,232,000, respectively.

The differences between the provision for income taxes and income taxes computed using the U.S. federal income tax rate were as follows for the years ended September 30:

	2003 -----	2002 -----	2001 -----
Amount computed using statutory rate (34%)	\$ (844,000)	\$ 135,000	\$ (116,000)
Net change in valuation allowance for net deferred tax assets	919,000	(157,000)	178,000
Non-deductible items	26,000	22,000	13,000
State income taxes	(90,000)	0	(75,000)
	-----	-----	-----
Provision for income taxes	\$ 11,000 =====	\$ 0 =====	\$ 0 =====

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Legal Matters - In the normal course of business, the Company, at various times, has been named in lawsuits. As previously disclosed, the Company, and officers of the Company, William Boersing, John M. Thornton, Dennis A. Brittain, Noel Flynn, and Board of Directors member, James De Bello, were sued in five lawsuits filed in October and November 2000. The same or similar allegations are made in all five lawsuits. These lawsuits were settled during the third quarter of fiscal 2001. The settlement did not have a material adverse effect on the Company's financial condition or results of operations. As previously disclosed, the Company was also a defendant in a case filed by DMS, Inc., d/b/a Document Management & Support. The plaintiff sought damages against the Company on a number of theories. This lawsuit was dismissed during the third quarter of fiscal 2001.

Employee 401(k) Plan - The Company has a 401(k) plan that allows participating employees to contribute up to 15% of their salary, subject to annual limits. The Board may, at its sole discretion, approve Company contributions. During fiscal 2003, 2002 and 2001, the Company elected not to make any contributions to the plan.

Leases - The Company's offices and manufacturing facilities are leased under non-cancelable operating leases. The primary facilities lease expires on September 30, 2005. In addition, the Company leases office space in Sterling, Virginia which expires December 31, 2003, and in Pelham, Alabama which expires July 31, 2004. The lease costs are expensed on a straight-line basis over the lease term.

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Future annual minimum rental payments payable by the Company under non-cancelable leases are as follows:

	Operating Leases
Year Ending September 30:	
2004	502,789
2005	463,408
2006	56,725
Thereafter	49,354
	-----
Total	\$1,072,276
	=====

Rent expense for operating leases, net of sub-lease income, for the years ended September 30, 2003, 2002 and 2001 totaled \$505,711, \$314,872, and \$184,445, respectively.

The Company, as part of the lease on its headquarters in June 2002, agreed to purchase the furniture located on the premises. This lease agreement requires a portion of the rent payments be applied to the purchase of this furniture. The long-term payable of \$34,194 at September 30, 2003 is the portion of the lease attributable to the purchase of the furniture, which is to be paid beyond one year, concurrent with the term of the lease.

### NOTE 6 - Related Party Transactions

During the second and third quarter of 2002, the Company engaged the services of a director of the Company, to provide financial consulting services unrelated to service as a board member. The total amount paid for these services was \$105,875.

### NOTE 7 - PRODUCT REVENUES AND SALES CONCENTRATIONS

Product Revenues - During fiscal years 2003, 2002 and 2001, the Company's revenues were derived primarily from the Character Recognition Product line. Revenues by product line as a percentage of net sales are summarized as follows:

	Year Ended September 30,		
	2003	2002	2001
Character recognition	90%	95%	95%
Maintenance & Other	10%	5%	5%

Sales Concentrations - The Company sells its products primarily to community depository institutions. For the years ended September 30, 2003, 2002 and 2001, the Company had the following sales concentrations:

	Year Ended September 30,		
	2003	2002	2001
Customers to which sales were in excess of 10% of total sales			
Number of customers	3	3	1
Aggregate percentage of sales	30%	34%	11%
Foreign Sales - primarily Europe	3%	4%	3%

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Below is a summary of the revenues by product lines.

	2003 -----	2002 -----	2001 -----
Revenue (000's)			
Recognition Toolkits	\$ 4,465	\$ 5,963	\$3,815
Check Image Solutions	5,391	5,293	4,211
Document and Image Processing Solutions	740	1,010	743
Maintenance and other	998	817	618
	-----	-----	-----
Total Revenue	\$11,594	\$13,083	\$9,387
	=====	=====	=====

NOTE 8 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial information for the years ended September 30, 2003 and 2002 is as follows (In thousands, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fou Qua
=====				
Year Ended September 30, 2003				
Net Sales	\$ 2,971	\$ 3,858	\$ 3,042	\$ 1
Income (Loss) from Operations	63	29	(957)	(1
Net Income (Loss)	61	26	(953)	(1
Net Income (Loss) per share-Basic	.03	.01	(.09)	
Net Income (Loss) per share-Diluted	.03	.01	(.09)	
Year Ended September 30, 2002				
Net Sales	\$ 3,388	\$ 3,080	\$ 2,763	\$ 3
Income (Loss) from Operations	377	(131)	162	
Net Income (Loss)	380	(141)	173	
Net Income (Loss) per share-Basic	.03	(.01)	.02	
Net Income (Loss) per share-Diluted	.03	(.01)	.02	

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Mitek Systems, Inc.:

We have audited the accompanying balance sheets of Mitek Systems, Inc. (the "Company") as of September 30, 2003 and 2002, and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and



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perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at September 30, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2003, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP  
San Diego, California  
December 29, 2003

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### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

### ITEM 9A. 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-14(c) 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. There were no changes in our internal control over financial reporting during the quarter ended September 30, 2003 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" of our Proxy Statement for the Annual Meeting of Shareholders to be held February 4, 2004 (the "Proxy Statement"). Such information is incorporated herein by reference.

The information in the Proxy Statement set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated herein by reference.

We have adopted the Mitek Systems, Inc. financial Code of Professional Conduct (the "finance code of ethics"), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Corporate Controller and other finance organization employees. The finance code of ethics is publicly available on our website at [www.miteksys.com](http://www.miteksys.com). If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer or Corporate Controller, we will disclose the nature of such amendment or waiver

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on that website or in a report on Form 8-K.

### ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" and "Information Regarding the Board and its Committees - Director Compensation" is incorporated herein by reference.

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### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions "Equity Compensation Plan Information" and "Information Regarding Beneficial Ownership of Principal Shareholders, Directors, and Management" is incorporated herein by reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth under the captions "Certain Relationships and Related Transactions" of the Proxy Statement is incorporated herein by reference.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the proxy statement under the heading "Fees Paid to Deloitte & Touche LLP" and is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) The following documents are included in the Company's Annual Report to Stockholders for the year ended September 30, 2003:

Independent Auditors' Report

Balance Sheets -

As of  
September 30, 2003 and 2002

Statements of Operations -

For the Years Ended  
September 30, 2003, 2002, and 2001

Statements of Stockholders' Equity -

For the Years Ended  
September 30, 2003, 2002, and 2001

Statements of Cash Flows -

For the Years Ended  
September 30, 2003, 2002, and 2001

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Notes to Financial Statements -  
For the years Ended  
September 30, 2003, 2002, and 2001

With the exception of the financial statements listed above and the other information incorporated by reference herein, the Annual Report to Stockholders for the fiscal year ended September 30, 2003, is not to be deemed to be filed as part of this report.

(a) (2) Exhibits:

- 3.1 Certificate of Incorporation of Mitek Systems of Delaware Inc. (now Mitek Systems, Inc.), a Delaware corporation, as amended. (1)
- 3.2 Bylaws of Mitek Systems, Inc. as Amended and Restated. (1)
- 10.1 1986 Stock Option Plan (2)
- 10.2 1988 Non Qualified Stock Option Plan (2)
- 10.3 1996 Stock Option Plan(3)
- 10.4 1999 Stock Option Plan (4)
- 10.5 401(k) Plan (2)
- 13. Annual Report to Stockholders for the year ended September 30, 2003.
- 23. Independent Auditors' Consent
- 31.1 Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification by Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification by Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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99.1 Certification by Chief Executive Officer

99.2 Certification by Chief Financial Officer

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(1) Incorporated by reference to the exhibits to the Company' Annual Report on Form 10-K for the fiscal year ended September 30, 1987

(2) Incorporated by reference to the exhibits to the Company's Registration Statement on Form SB-2 originally filed with the SEC on July 9, 1996

Upon request, the Registrant will furnish a copy of any of the listed exhibits for \$0.50 per page.

(3) Incorporated by reference to the exhibits to the Company's Registration Statement on Form 10-K for the fiscal year ended September 30, 2001

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(b) The following is a list of Current Reports on Form 8-K filed by the Company during or subsequent to the last quarter of the fiscal year ended September 30, 2003:

None

(4) Incorporated by reference to the exhibits to the Company's Registration Statement on Form S-8 originally filed with the SEC on June 10, 1999.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: December 29, 2003

MITEK SYSTEMS, INC.

By: /s/ James B. DeBello

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James B. DeBello,  
President, Chief Executive Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ John M. Thornton December 29, 2003

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John M. Thornton,  
Chairman of the Board  
and Chief Financial Officer

/s/ James B. DeBello December 29, 2003

-----  
James B. DeBello,  
President  
and Chief Executive Officer

/s/ Gerald I. Farmer December 29, 2003

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Gerald I. Farmer, Director

/s/ Daniel E. Steimle December 29, 2003

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Daniel E. Steimle, Director

/s/ Sally B. Thornton December 29, 2003

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Sally B. Thornton, Director

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/s/ John G. Rebelo, Jr  
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December 29, 2003

John G. Rebelo, Jr., Director

/s/ David Holvey  
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December 29, 2003

David Holvey, Director

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