

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-KSB**

(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, 2005

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.**

(Name of small business issuer 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)

Issuer's telephone number **(858) 513-4600**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$.001 per share**

(Title of class)

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

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

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

State issuer's revenues for its most recent fiscal year. \$6,594,000

The aggregate market value of voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of October 7, 2005 (See definition of affiliate in Rule 12b-2 of the Exchange Act.) is \$10,576,364.

There were 14,832,337 shares outstanding of the registrant's Common Stock as of October 19, 2005

## MITEK SYSTEMS, INC.

## FORM 10-KSB

For The Fiscal Year Ended September 30, 2005

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

This Form 10-KSB of Mitek Systems, Inc. contains forward-looking statements concerning anticipated future revenues and earnings, 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 our products, expected trends and growth in our results of operations, projections concerning our available cash flow and liquidity, anticipated penetration in new and existing markets for our products and the size of such markets, anticipated acceptance of our products by existing and new customers, and our ability 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 our Securities and Exchange Commission reports, and the risk factors described in this Form 10-KSB Issues and Uncertainties.

We were incorporated under the laws of the State of Delaware in 1986. We are 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.

We develop, market and support what we believe to be the most accurate Automated Document Recognition (“ADR”) products commercially available for the recognition of hand printed characters. Our unique proprietary technology recognizes hand printed and machine generated characters with a level of accuracy that renders our 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 year ending 2005, we had one operating segment based on our product and service offerings: Automated Document Processing.

#### AUTOMATED DOCUMENT PROCESSING

Since 1992 we have 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. Our 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 applications and consist of sets of coupled mathematical equations with adaptive parameters that self adjust to “learn” various forms and patterns. Our ADR products combine our 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. We leverage our core technology across a family of ADR products that we believe 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.

## Intelligent Recognition Toolkits

Our Intelligent Recognition Toolkits include a suite of products that leverage our proprietary intelligent character recognition (ICR), image processing, and dynamic data extraction software engines. The suite of recognition toolkits includes QuickStrokes<sup>®</sup>, QuickFX Pro<sup>™</sup>, ImageScore<sup>™</sup>, and Dynafind<sup>™</sup>. These products are sold to original equipment manufacturers (OEMs) such as Advanced Financial Solutions a Metavante Company, Harland Financial Solutions a John Harland Company, Sungard, BancTec and J&B Software, and to systems integrators such as Computer Sciences Corporation.

Products used in financial document processing, are a combination of the Legal Amount Recognition (LAR) capabilities licensed from Parascript, LLC with our proprietary QuickStrokes<sup>®</sup> 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.

The QuickStrokes<sup>®</sup> product allows for the automatic reading of machine and hand print information found on scanned documents and forms from any structured form as well as all bank documents (checks, deposit slips, remittance coupons etc). Quickstrokes integrates technology components from the 'CheckReader' product licensed from A2iA Corporation or CheckScript<sup>®</sup> product licensed from Parascript, LLC which specifically increases read rates of the courtesy and legal amounts of US and Canadian checks.

QuickFX<sup>®</sup> Pro is a software toolkit that provides automatic form ID, form registration and form/template removal. We believe it will significantly improve automatic data capture (ICR/OCR), forms processing, document imaging and storage performance. QuickFX<sup>®</sup> 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.

ImageScore is Mitek's Check 21 readiness solution for any financial institution that truncates or uses check images in an accounts receivables conversion environment. Integrated solution providers for financial institutions can also buy ImageScore to enhance their products. ImageScore can quickly, accurately and comprehensively analyze check images to provide the usability and quality information needed to help financial institutions act in accordance with regulatory and industry mandates. As a result, institutions minimize their risk by ensuring the integrity of check images they process, and they eliminate costly manual processes associated with managing transactions from bad check images.

DynaFind<sup>â</sup> 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. We have supplied DynaFind<sup>â</sup> as a stand alone API to several important OEMs in the document processing field. DynaFind<sup>â</sup> is also available as an add-on feature that has been integrated into Doctus, which is Mitek's forms processing solution.

## **Document and Image Processing Solution**

Leveraging our core technical competency in Intelligent Recognition, we have addressed the forms processing market with its Doctus<sup>â</sup> product. Doctus<sup>â</sup> incorporates our core Intelligent Recognition technologies in an application designed for end users in a broad variety of industries that require high volume automated data entry. The Doctus<sup>â</sup> software handles both structured and unstructured forms. As a result, it significantly increases the number and types of forms that can be automatically processed. Doctus<sup>â</sup> is able to process unstructured forms through the integration of its DynaFind<sup>â</sup> dynamic data extraction technology. With DynaFind<sup>â</sup>, Doctus<sup>â</sup> automatically classifies unstructured forms and extracts relevant data from the form contents. Major Doctus<sup>â</sup> customers and resell partners include AIG, IKON Office Solutions, Sungard, and J&B Software.

## **IDENTITY VALIDATION AND FORGERY DETECTION**

Since 2001, we have applied and adapted our core competency in Automatic Document processes and Image Analytics to create a product offering Mitek's Image Analytics, which are built on Mitek's portfolio of innovative recognition technologies used to test, clean, read and authenticate imaged documents.

Our capabilities include:

- Image analysis of signatures
- Image repair and optimization
- OCR/ICR
- Dynamic data finding on any document or check
- Distributed Capture CAR/LAR

## **Forgery Detection Toolkits**

Mitek's FraudProtect<sup>TM</sup> Toolkit is an innovative product for detecting check fraud and forgery using Image analytics to uncover inconsistencies and alterations in checks as they are processed by banks. These products are sold to OEMs such as SoftPro and CSC.

Signature & Check Stock Verification API is fully automated and incorporates advanced imaging, image analysis and data extraction technologies that can help verify the authenticity of every signature on every check that passes through a bank, and analyzes paper stock for any indication that an item is a counterfeit.

Mitek's PADsafe toolkit is the first toolkit of its kind to detect fraudulent preauthorized drafts. It automatically identifies PADs from checks, then notifies the user of any potentially suspicious PADs. As a result, the withdrawal of unauthorized funds due to fraudulent PAD transactions is reduced and often prevented. Mitek's PayeeFind prevents payee-altered checks from clearing. As a result, PayeeFind can substantially reduce losses and cut administrative costs by eliminating the need for organizations to complete and file affidavits to recover funds from checks that have cleared with fraudulent payees. With PayeeFind, this type of fraud can be stopped before recovery becomes an issue.

### **Forgery Detection Solution**

Mitek's FraudProtect™ System is a comprehensive, automated software application that allows banks to detect the most common forms of check fraud from forged signatures and counterfeit checks, as well as the detection of pre-authorized drafts and payee name alterations. Banks can significantly reduce losses due to Check Fraud by using the FraudProtect System.

### **RESEARCH AND DEVELOPMENT**

During fiscal years 2005 and 2004 research and development expense was approximately \$1,508,000 and \$2,204,000 respectively. Those amounts represented 23% and 42% respectively, of revenue in each of those years. The reduction in Research and Development in fiscal 2005 was due to the reclassification of \$802,000 from Research and Development to cost of goods sold for engineering services provided to our customers. The total Research and Development expense would have been \$2,310,000 before reclassification. We plan to continue spending significant amounts for research and product development.

Most of our software products are developed internally. We also purchase technology and license intellectual property rights. We believe that our future success depends in part on our ability to maintain and improve our core technologies, enhance our 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 us to maintain closer technical control over our products and gives us the freedom to designate which modifications and enhancements are most important and when they should be implemented. We devise 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. We intend to expand our existing product offerings and to introduce new document processing software solutions. In the development of new products and enhancements to existing products, we use our own tools extensively. We perform all quality assurance and develop documentation internally. We strive to become informed at the earliest possible time about changing usage patterns and hardware advances that may affect software design. We intend to continue to support industry standard operating environments.

Our 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 our 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, we focus research and development efforts on continued enhancement of our core technology and on our database of millions of character images that is used to "train" the neural network software that forms the core of our ICR engine. In addition, we have expanded our research and development tasks to include pre- and post-processing of data subject to automated processing.

Our research and development organization included fourteen software engineers on September 30, 2005, including four with advanced degrees. We balance our engineering resources between development of ICR technology and applications development. All the software engineers are involved in applications development, including ICR research and development of the QuickStrokes<sup>®</sup> API recognition engine , Doctus<sup>®</sup>, QuickFX<sup>®</sup> Pro, and FraudProtect<sup>™</sup> products, quality assurance, and customer services and support.

## **INTELLECTUAL PROPERTY**

Our success and ability to compete is dependent in part upon its proprietary technology. We rely on a combination of patent, copyright and trade secret laws and non-disclosure agreements to protect its proprietary technology. We hold a U.S. patent for our hierarchical character recognition systems. The patent covers our multiple-pass, multiple-expert system that significantly increases the accuracy of forms processing and item processing applications. We may seek to file additional patents to expand the scope of patent coverage. We 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 our patents will be upheld as valid or will prevent the development of competitive products.

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

We are 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 our current or future products or that any such claims will not require us 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**

We market our products and services primarily through our internal, direct sales organization. We employ a technically-oriented sales force with management assistance to identify the needs of existing and prospective customers. Our sales strategy concentrates on Original Equipment Manufacturers (OEM), Distributors and companies that we believe are key users and designers of automated document processing systems for high- performance, large volume applications, in addition to small and large financial institutions. We currently maintain our sales and support office in California. In addition, we sell and support our products through foreign resellers in Canada, Greece, Portugal France, Italy, the United Kingdom, India, and Japan. The sales process is supported with a broad range of marketing programs which include trade shows, direct marketing, public relations and advertising.

We license our software to organizations on a perpetual basis. We also license 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.

Our ability to support international customers has helped in increasing international sales. International sales accounted for approximately 23% and 4%, of our net sales for the fiscal years ended September 30, 2005 and 2004, respectively. We believe that a significant percentage of the products in our domestic sales are incorporated into systems that are delivered to end users outside the United States. International sales in fiscal year 2005 were made to customers in fourteen countries including Australia, Greece, Canada, Czech Republic, United Kingdom, France, Germany, Spain, India, Italy, Japan, New Zealand, Portugal, and Sweden. We sell our products in United States currency only. We recorded a significant portion of our revenues from two customers in fiscal year 2005, and from one customer in fiscal year 2004. Net sales from these customers aggregated 31% and 12% for the fiscal years 2005 and 2004, respectively.

## **MAINTENANCE AND SUPPORT**

Following the installation of Mitek's software at a customer site, we provide ongoing software support services to assist our customers in operating the systems. We have 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, after customer consent, can log on to our customers' systems remotely. Occasionally, visits to the customers' 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 an annual basis and are typically priced at approximately 8% to 18% of the particular software product's license fee.



We provide maintenance and support on a contractual basis after the initial product warranty has expired. We provide telephone support and on-site support. Customers with maintenance coverage receive software updates from us. Foreign distributors generally provide customer training, service and support for the products they sell. Additionally, our products are supported internationally by periodic distributor and customer visits by our 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.

We believe that as the installed base of our products grows and as customers purchase additional complementary products, the software support function will become a larger source of recurring revenues. Maintenance and support service fees are deferred and recognized into income over the contract period on a straight-line basis. Costs incurred by us to supply maintenance and support services are charged to cost of sales.

## COMPETITION

The market for our ADR products is intensely competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. We face direct and indirect competition from a broad range of competitors who offer a variety of products and solutions to our current and potential customers. Our 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 we 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 we have could attempt to enter or increase their presence in our market either independently or by acquiring or forming strategic alliances with our competitors 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 our current and prospective customers.

Our QuickStrokes<sup>®</sup> API product and licensed CheckScript<sup>™</sup> 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. We believe our 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<sup>®</sup> API and CheckScript<sup>®</sup> competitors have existed longer and have far greater financial resources and industry connections than we have.

Our Doctus<sup>®</sup> product competes against complete proprietary systems offered by software developers, such as Microsystems Technology, Readsoft, and Cardiff Software, Inc. In addition, Doctus<sup>®</sup> faces competition from providers of recognition systems that incorporate ADR technology such as Microsystems Technology, Inc., and Captiva. Because Doctus<sup>®</sup> is based on our proprietary QuickStrokes<sup>®</sup> API engine, its competitive advantages reflect the advantages of the QuickStrokes<sup>®</sup> engine. We believe our Doctus<sup>®</sup> and DynaFind<sup>®</sup> software provides the highest levels of automation in the industry. DynaFind, our 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. Our strategy is to position Doctus<sup>®</sup> 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.

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, 2005, we employed a total of 31 full-time and 1 part-time person, consisting of 6 in sales and marketing, 19 in research and development, product management and support, 1 in operations, and 6 in finance, administration and other capacities. We have never had a work stoppage. None of our employees are represented by a labor organization, and we consider our relations with our 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-KSB, quarterly reports on Form 10-QSB, current reports on Form 8-K and any amendments to those reports, as soon as reasonably practicable after we electronically file 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 public may also obtain such information on the operation of the SEC Public Reference Room by calling the SEC at 1-800-SEC-0330. 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**

Our 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 this facility expired on September 30, 2005 and we continued to occupy the building on a month to month basis. We have signed a seven year lease with Arden Properties for a 16,000 square foot building located at 8911 Balboa Avenue, San Diego California. We expect to move to the new location in December 2005. We believe that our new facilities are adequate.

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 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, 2005.

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

Our executive officers as of October 19, 2005 were as follows:

Name	Age	Position with Mitek
James B. DeBello	47	President, Chief Executive Officer
John M. Thornton	73	Chairman
Tesfaye Hailemichael	56	Chief Financial Officer
Murali Narayanan	53	Vice President - Marketing
Emmanuel deBoucaud	39	Vice President - Sales

Mr. DeBello was named President and Chief Executive Officer in May 2003. He has served as a director of Mitek 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. Mr. Thornton resigned as Chief Financial Officer in May 2005 but remains as Chairman. He has served as Chairman since 1987.

Mr. Hailemichael joined Mitek in May 2005 as Chief Financial Officer. Prior to joining Mitek, he served as Chief Financial Officer at Maxwell Technologies from 2003 to 2005. Prior to that, he served as Chief Financial Officer at Raidtec Ltd from 2001 to 2003. Prior to that, he served as Executive Vice President of Transnational Computer Technology, Inc. from 1998 to 2001. Mr. Hailemichael served as Vice President of Finance and Chief Financial Officer of Dothill Systems, Inc. from 1990 to 1998.

Mr. Narayanan joined Mitek in July 2003 as Vice President of Marketing. Prior to joining Mitek, 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.

Mr. deBoucaud joined Mitek in July 2004. Prior to joining Mitek, he served from September 1995 to March 2004 as Vice President of Sales for Cardiff Software, Inc.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS**

Our common stock is traded on the OTC Bulletin Board under the symbol MITK.OB and the closing bid price on November 18, 2005 was \$0.82. As of November 18, 2005, there were 450 holders of record of Mitek Systems, Inc. Common Stock.

Our Common Stock initially traded on the Nasdaq SmallCap Market under the symbol "MITK". The Common Stock was delisted from the Nasdaq SmallCap Market, because it failed to satisfy the requirement that it maintain at least \$2.5 million in shareholders equity. The delisting was effective on May 24, 2004, and since that time, the Common Stock has traded on the OTC Bulletin Board maintained by the NASD.

The following table sets forth, for the fiscal period indicated, the high and low closing bid prices for the Common Stock as reported on the Nasdaq National Market or the OTC Bulletin Board. The quotations for the Common Stock traded on the OTC Bulletin Board may reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent actual transactions.

Quarter Ended	Dec. 31	Mar. 31	Jun. 30	Sept. 30	Year
<b>Fiscal 2005</b>					
Common stock price per share					
High	\$ .56	\$ 1.03	\$ .88	\$ .94	1.03
Low	.33	.36	.55	.55	.33
<b>Fiscal 2004</b>					
Common stock price per share					
High	\$ 3.32	\$ 2.72	\$ 1.47	\$ 0.87	3.32
Low	0.98	1.40	0.40	.46	.40

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 convertible note agreement.

In June 2005, we issued 25,000 shares of our common stock at the conversion price of \$.70 per share to Laurus Master Fund, Ltd. ("Laurus") in connection with the payment of \$17,500 of the principal related to a convertible term note of \$3,000,000, issued to Laurus in June 2004 (the "Note"). In August 2005, we issued 775,000 shares of common stock at the conversion price of \$.70 per share to Laurus in connection with the payment of \$542,500 of the principal related to the Note. In October 2005, we issued 500,000 shares of our common stock at the conversion price of \$.70 per share to Laurus in connection with the payment of \$350,000 of the principal related to the Note. These conversions were made pursuant to Section 4(2) of the Securities Act of 1933, as amended, as Laurus is a sophisticated investor who had access to information about Mitek.

**PART II**

**ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF OR PLAN OF OPERATION**

**FORWARD LOOKING STATEMENTS**

In addition to historical information, this Management's Discussion and Analysis of or Plan of Operation (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 Mitek, 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 Mitek, please be advised that our actual financial condition, operating results and business performance may differ materially from that projected or estimated by Mitek in forward-looking statements. We have attempted to identify, in context, certain factors that we currently believe may cause actual future experiences and results to differ from our current expectations. The difference may be caused by a variety of factors, including, but not limited to, adverse economic conditions, general decreases in demand for our 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 Mitek and its employees, higher than anticipated labor costs, the possible fluctuation and volatility of our 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 \$6,594,000 and \$5,240,000 for fiscal 2005 and 2004, respectively. Net sales increased by \$1,354,000 in fiscal 2005 compared to fiscal 2004. The increase in fiscal 2005 revenue is due to engineering services provided to Harland and significant sales to International customers. Throughout 2004, the we experienced decreased check imaging solutions revenue, which we believe was due to continued customer hesitancy to adopt check imaging solutions, pending finalization of Check 21 Imaging Standards. Though image acceptance is mandated by the passage of Check 21, the imaging standards required under this legislation were not final until September 2004. We also experienced substantial purchasing hesitancy from customers who expressed concern over our recent quarterly losses and the delisting of our stock from NASDAQ. We substantially exited this product line, by agreeing to the transaction with Harland Financial Solutions described in Note 7 of the accompanying financial statements.

Sales of our Document Processing Solutions decreased by 64% or \$279,000 and \$301,000 or 41%, for fiscal year of 2005 and 2004, respectively. This reflects our efforts that were principally focused on Check Imaging Solutions and recognition toolkits, not on Imaging Processing Solutions. Prospectively, expect this area to yield moderate growth, with revenue from existing customers likely to remain constant.

## 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 \$1,130,000 and \$1,980,000 for fiscal year 2005 and 2004, respectively. Cost of sales for 2005 decreased by \$850,000 due to product mix and reduction in operations expenses and discontinuation of hardware sales and related costs.

Stated as a percentage of net sales, cost of sales for the corresponding periods were 17% and 38%, respectively. There was no significant percentage change from 2004 to 2005.

## OPERATIONS

Gross operations expense for the current fiscal year included payroll, employee benefits, and other headcount-related costs associated with shipping and receiving, and in fiscal year 2004 operations expense also included 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 \$145,000 and \$1,136,000 for fiscal 2005 and 2004, respectively. Net operations expenses were \$145,000 and \$1,136,000 for fiscal year 2005 and 2004, respectively. For fiscal year 2005, there was a decrease in operation expenses of \$991,000, which was due to our sale to Harland in July of 2004, of certain assets used in the Item Processing product line. The dollar decrease in the gross 2005 expense is primarily attributable to the costs associated with the Item Processing product line being reduced as a result of our sale to Harland in July of 2004, of certain assets used in the Item Processing product line. The sale of the Item Processing assets to Harland, is described in Note 7 of the accompanying financial statement. A majority of the operations expenses were related to the support, installation and training function for the Item Processing product line. Upon our exit from the Item Processing product line, certain of the Mitek employees associated with the product line were terminated and were hired by Harland.

Stated as a percentage of net sales, operations expenses for fiscal year 2005 and 2004 were 2% and 22%, respectively. The decrease in fiscal year 2005 from 2004 was due primarily to the sale of the Item Processing product line and revenue increase in 2005.

## 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 \$2,074,000 and \$1,942,000 for fiscal 2005 and 2004, respectively. The dollar increase in 2005 expense compared to 2004 is primarily attributable to commission expense which increased approximately \$215,000 as compared to fiscal year 2004.

Stated as a percentage of net sales, selling and marketing expenses for fiscal year 2005 and 2004 were 32% and 37%, respectively. The percentage decrease in fiscal year 2005, compared to fiscal year 2004, was primarily due to an increase in sales in fiscal year 2005.

## RESEARCH AND DEVELOPMENT

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

Research and Development expenses for fiscal year 2005 was \$1,508,000 after the reclassification of \$802,000 from Research and Development to the cost of goods sold in relation to engineering services to our customers. Total Research and Development would have been \$2,310,000 if there was no reclassification. Research and Development expenses for fiscal year 2004 was \$2,204,000. The dollar decrease in the 2005 expense is primarily due to the reduction of personnel whose primary focus was in the Item Processing product line. These individuals were terminated, as we substantially exited this product line, by agreeing to the transaction with Harland Financial Solutions described in Note 7 of the accompanying financial statements. This cost savings was somewhat offset by the hiring of two personnel, whose primary focus will be in the Recognition toolkits area, with a principal focus on fraud detection.

Stated as a percentage of net sales, research and development expense for fiscal year 2005 and 2004, including charges to cost of sales, were 23% and 42%, respectively. The percentage decrease in fiscal year 2005 was due to the increase in revenue over fiscal 2004 and the reclassification of \$802,000 or 12% to cost of goods sold as mentioned above.

## 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 \$3,050,000 and \$2,720,000 for fiscal year 2005 and 2004, respectively. The expense increase in 2005 over 2004 was primarily due to legal expenses related to legal matters resolved in 2005.

Stated as a percentage of net sales, general and administrative expense for fiscal year 2005 and 2004 were 46% and 52%, respectively. The decrease in the 2005 expense, as a percentage of net sales, was primarily due to increased sales.

## GAIN ON SALE OF ASSETS

In fiscal year 2005, the gain on the sale of assets of \$1,106,000 related to the contingent payment on the sale of the CheckQuest product line as discussed in Note 7 to the accompanying financial statements. In fiscal year 2004, the gain on sale of assets consisted of the \$1,270,000 gain on the disposition of the CheckQuest product line, as discussed in Note 7 to the accompanying financial statements.

## OTHER INCOME (EXPENSE)

Other Income (Expense) for fiscal year 2005 consists of interest expense on the Convertible Note, as discussed in Note 5 of the accompanying financial statements, of which \$765,000 represents amortization of the beneficial conversion feature and interest paid, \$82,000 represents the change in fair value of warrant liability, and \$25,000 represents interest and other income. Other Income (Expense) for fiscal year 2004 consisted of interest expense on the Convertible Note, as discussed in Note 5 of the accompanying financial statements, \$208,000 in interest expense for late registration fees, \$48,000 for a change in fair value of the warrant liability, as discussed in Note 7 of the accompanying financial statements and \$31,000 in interest and other income. Net other (expenses) was \$822,000 and \$372,000 for fiscal year 2005 and 2004, respectively. Stated as a percentage of net sales, net other expense for the corresponding periods were 12% and 7%, respectively.

## INCOME TAXES

For the fiscal year 2005, we recorded a tax benefit of \$714 for income taxes which was primarily franchise taxes over paid to states in which we operated. For the fiscal year 2004, we recorded an income tax expense of \$2,168, which was primarily franchise taxes paid to states in which we operated.

## FINANCIAL CONDITION

On September 30, 2005, we had \$2,387,000 in cash as compared to \$2,607,000 on September 30, 2004 which is a decrease of \$220,000. Accounts receivable totaled \$773,000, an increase of \$203,000 from the September 30, 2004 balance of \$570,000. This increase was primarily a result of an increase in revenue in 2005 over 2004.

Unearned revenue as of September 30, 2005 was \$428,000, an increase of \$30,000 from September 30, 2004, which reflects the addition of new and anniversary product support agreements offset by continued recognition of unearned revenue from product support agreements licensed in prior periods.



During fiscal year 2005, we financed our cash needs primarily from financing and investing activities.

Net cash used by operating activities during the year ended September 30, 2005 was \$2,022,000. The primary use of cash from operating activities was the net loss of \$1,027,000, an increase in deferred revenue of \$30,000, a decrease in accounts payable of \$82,000, an increase in accrued payroll and related taxes of \$111,000, and a decrease in other accrued liabilities of \$127,000. The primary sources of cash from operating activities was an increase in accounts receivable of \$172,000, a gain on sale of CheckQuest assets of \$1,106,000, amortization of debt discount of \$527,000 and depreciation and amortization expense of \$92,000 both of which do not require cash.

Net cash provided from investing activities was primarily from the transaction with Harland Financial Solutions as described in Note 7 of the accompanying financial statements and collections on the note receivable from Mitek Systems, Ltd., which were in part offset by the acquisition of fixed assets, primarily computer equipment.

Net cash from financing activities was primarily the proceeds from the Convertible debt, net of debt issuance costs, described in Note 5 of the accompanying financial statements, which was offset by the borrowings of \$801,000, as well as the proceeds from the sale of common stock to John H. Harland Company.

Our working capital and current ratio was \$1,323,000 and 1.67, respectively on September 30, 2005 and \$847,000 and 1.32, respectively, on September 30, 2004. On September 30, 2005, total liabilities to equity ratio was 2.36 to 1 compared to -7.81 to 1 year earlier. As of September 30, 2005, total liabilities decreased by \$1,646,000 compared to total liabilities on September 30, 2004.

On June 11, 2004, we secured a financing arrangement with Laurus. The financing consists of a \$3 million Secured Note that bears interest at the rate of prime (as published in the Wall Street Journal) plus one percent and has a term of three years (June 11, 2007). The Secured Note is convertible into shares of the our common stock at an initial fixed price of \$0.70 per share, a premium to the 10-day average closing share price as of June 11, 2004. The conversion price of the Secured Note is subject to adjustment upon the occurrence of certain events. The Secured Notes stipulates that the Secured Note is to be repaid using cash payment along with an equity conversion option; the details of both methods for repayment are as follows: The cash repayments stipulate that beginning on December 1, 2004, or the first amortization date, we shall make monthly payments to Laurus on each repayment date until the maturity date, each in the amount of \$90,909.09, together with any accrued and unpaid interest to date, with the final payment of any unpaid principal and interest due on June 11, 2007. The conversion repayment states that each month by the fifth business day prior to each amortization date, Laurus shall deliver to Mitek a written notice converting the monthly amount payable on the next repayment date in either cash or shares of common stock, or a combination of both. If a repayment notice is not delivered by Laurus on or before the applicable notice date for such repayment date, then we pay the monthly amount due in cash. Any portion of the monthly amount paid in cash shall be paid to Laurus in an amount equal to 102% of the principal portion of the monthly amount due. In connection with this transaction, we issued warrants to Laurus for the purchase of up to 860,000 shares of common stock at prices ranging from \$0.79 to \$0.92 per share. An additional 200,000 warrants exercisable at \$0.70 per share were issued in October 2004 in connection with our Registration Rights Agreement with Laurus as consideration for settlement of late registration and effectiveness charges. The Common shares underlying the Convertible Debt and the 1,060,000 warrants have registration rights which require Mitek to file and have these underlying shares effective by a certain date. Pursuant to the Registration Rights agreement, failure to have these underlying shares registered and effective by January 1, 2005 would trigger substantial cash penalties. The registration was not effective by that time so we incurred liquidated damages, payable in cash, in the amount of \$215,000 for the period January 1, 2005 to May 13, 2005. The registration became effective May 13, 2005, and we do not anticipate there will be future penalties associated with the registration. The Note is secured by a general lien on all of our assets, and as a condition of this transaction, our line of Credit with First National Bank was cancelled.

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

Our lease of 14145 Danielson Street, Suite B, Poway, California expired on September 30, 2005 and a month to month lease has been in place. We have signed a seven year lease for 16,000 square feet office space located at 8911 Balboa Avenue, San Diego, California with Arden Properties.

We evaluate our cash requirements on a quarterly basis. Historically, we have managed our cash requirements principally from cash generated from operations. Although our strategy for fiscal 2005 is to grow the identified markets for its new products and enhance the functionality and marketability of our character recognition technology, we have not yet observed a significant change in liquidity or future cash requirements as a result of this strategy. Anticipated cash requirements over the next twelve months are principally to fund operations, including spending on research and development. We believe that it will have sufficient liquidity to finance our operations for the next twelve months using existing cash and cash generated from operations, as discussed above.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued the Statement of Financial Accounting Standard (SFAS) No.123 (revised 2004), "Share-Based Payment" Statement 123(R) which will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That compensation cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. We are continuously evaluating the impact of the adoption of SFAS 123(R), and currently believe the impact will be significant to our overall results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. ("FIN") 46, "Consolidation of Variable Interest Entities" ("FIN 46"). In December 2003, FIN 46 was replaced by FASB interpretation No. 46(R) "Consolidation of Variable Interest Entities." FIN 46(R) clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46(R) requires an enterprise to consolidate a variable interest entity if that enterprise will absorb a majority of the entity's expected losses, is entitled to receive a majority of the entity's expected residual returns, or both. FIN 46(R) is effective for entities being evaluated under FIN 46(R) for consolidation no later than the end of the first reporting period that ends after March 15, 2004. We do not currently have any variable interest entities that will be impacted by adoption of FIN 46(R).

In March 2004, the FASB approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting provisions of EITF 03-1 are effective for all reporting periods beginning after June 15, 2004, while the disclosure requirements for certain investments are effective for annual periods ending after December 15, 2003, and for other investments such disclosure requirements are effective for annual periods ending after June 15, 2004. We do not currently have any investments that will be impacted by this provision.

In September 2004, the EITF delayed the effective date for the recognition and measurement guidance previously discussed under EITF Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-01") as included in paragraphs 10-20 of the proposed statement. The proposed statement will clarify the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method. We do not currently have any investments that will be impacted by this provision.

Effective April 1, 2004, the SEC adopted Staff Accounting Bulletin No. 105, "Application of Accounting Principles to Loan Commitments" ("SAB 105"). SAB 105 clarifies the requirements for the valuation of loan commitments that are accounted for as derivatives in accordance with SFAS 133. Management does not expect the implementation of this new bulletin to have any impact on our financial position, results of operations and cash flows. We do not have any loan commitments.

In July 2004, the EITF issued a draft abstract for EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" ("EITF 04-08"). EITF 04-08 reflects the Task Force's tentative conclusion that contingently convertible debt should be included in diluted earnings per share computations regardless of whether the market price trigger has been met. If adopted, the consensus reached by the Task Force in this Issue will be effective for reporting periods ending after December 15, 2004. Prior period earnings per share amounts presented for comparative purposes would be required to be restated to conform to this consensus and we would be required to include the shares issuable upon the conversion of the Notes in the diluted earnings per share computation for all periods during which the Notes are outstanding. Management does not expect the implementation of this new standard to have a material impact on its computation of diluted earnings per share.

In December 2004, the FASB issued two Staff Positions (FSP) that provide accounting guidance on how companies should account for the effect of the American Jobs Creation Act of 2004 that was signed into law on October 22, 2004. In FSP FAS 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004", the FASB concluded that the special tax deduction for domestic manufacturing, created by the new legislation, should be accounted for as a "special deduction" instead of a tax rate reduction. As such, the special tax deduction for domestic manufacturing is recognized no earlier than the year in which the deduction is taken on the tax return. FSP FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004", allows additional time to evaluate the effects of the new legislation on any plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. We do not anticipate that this legislation will impact our results of operations or financial condition. Accordingly, FSP FAS 109-1 and FSP FAS 109-2 are not currently expected to have any material impact on our financial statements. These FSPs were effective December 21, 2004.

In December 2004, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in nondiscretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization or depletion method for long-lived, non-financial assets be accounted for as a change in an accounting estimate effected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date this Statement is issued. Management does not expect the implementation of this new standard to have a material impact on our financial position, results of operations and cash flows.

In March 2005, the SEC released Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"), which provides interpretive guidance related to the interaction between SFAS 123(R) and certain SEC rules and regulations. It also provides the SEC staff's views regarding valuation of share-based payment arrangements. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of their next fiscal year, instead of the next reporting period beginning after June 15, 2005. Management is currently evaluating the impact SAB 107 will have on our financial statements.

On June 15-16, 2005 the Emerging Issue Task Force meeting discussed Effect of a Liquidated Damages Clause on a Free standing Financial Instrument Subject to EITF 05-04 Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." The Task Force further discussed (a) whether a registration rights penalty meets the definition of a derivative and (b) whether the registration rights agreement and the financial instrument to which it pertains should be considered as a combined freestanding instrument or as separate freestanding instruments. Additionally, some Task Force members expressed a preference for evaluating a liquidated damages provision based on the probable amount that the issuer would pay rather than the maximum amount. The Task Force was not asked to reach a consensus on this Issue. The Task Force asked the FASB staff to obtain additional information about how entities currently evaluate and account for registration rights agreements in practice. Additionally, the Task Force asked the FASB staff to analyze registration rights penalties in comparison with other penalties that do not meet the definition of a derivative. Further discussion is expected at a future meeting.

Management cannot determine the impact this new standard will have on our financial position, results of operations and cash flows until the standard is issued.

## **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 statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates by management are affected by management's application of accounting policies are subjective and may differ from actual results. Critical accounting policies for Mitek include revenue recognition, allowance for accounts receivable, fair value of equity instruments and accounting for income taxes.

### **Revenue Recognition**

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

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

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

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, 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 our future revenues and operating results.

*Accounts Receivable.*

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

*Loss Contingencies*

The financial statements presented include accruals for a loss contingency.

*Fair Value of Equity Instruments*

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

*Deferred Income Taxes.*

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

**ISSUES AND UNCERTAINTIES**

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

***Risks Associated With Our Business***

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

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

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

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

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

Our ability to compete effectively with our character recognition product line will depend upon our ability to meet changing market conditions and develop enhancements to our products on a timely basis in order to maintain our competitive advantage. Rapidly advancing technology and rapidly changing user preferences characterize the markets for products incorporating character recognition technology. Our continued growth will ultimately depend upon our ability to develop additional technologies and attract strategic alliances for related or separate product lines. There can be no assurance that we will be successful in developing and marketing product enhancements and additional technologies, that we will not experience difficulties that could delay or prevent the successful development, introduction and marketing of these products, or that our new products and product enhancements will adequately meet the requirements of the marketplace, will be of acceptable quality, or will achieve market acceptance.

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

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

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

We closed on a \$3.0 million debt financing with Laurus Master Funds Ltd., and issued a three year term note in June 2004, with monthly payments of interest commencing July 1, 2004, and monthly principal payments commencing December 1, 2004. See "COMPANY OVERVIEW - Laurus Debt Investment" below. Based on current interest rates, our monthly cash payments of principal and interest beginning December 1, 2004 is approximately \$91,000. Our actual required cash payments on the note will vary depending on interest rates and whether amounts under the note are converted into our common stock. Laurus has converted \$910,000 of debt to equity from January 1, 2005 to October 31, 2005. We have made principal payments of \$801,000 through October 31, 2005. The principal balance as of October 31, 2005 is \$1,289,318.

Our ability to make scheduled monthly payments under the note primarily depends on our future performance and working capital, including our ability to increase revenues and cash flows. To a certain extent our ability to increase revenues and control costs are subject to a number of economic, financial, competitive, regulatory and other factors beyond our control. Based upon the current level of operations and our business development efforts, we believe that we should have adequate available cash and cash flows from operations to meet our anticipated future requirements for working capital, capital expenditures, and scheduled payments of principal and interest on our debt through November 30, 2006.

However, if our cash flow is insufficient to enable us to service our debt, we may be forced to find alternative sources of financing, or to take further drastic measures, including significantly reducing operations, seeking to sell Mitek, or pursuing a liquidation. Any future alternative sources of debt or equity financing may not be available to us when needed or in amounts required, and we currently do not have available to us a bank line of credit or other general borrowing facility. Alternatively, we may be forced to attempt to negotiate with our debt holders on our payment terms, which may not be successful or may be on terms onerous to us.

We granted a blanket security interest in all of our assets to the holders of our secured debt. If we are unable to make our required monthly payments on the debt, or any other event of default occurs, it could have a material adverse effect on our business and operations, and the debt holders may foreclose on our assets.

As part of our debt financing with Laurus Master Fund, Ltd., we granted to Laurus, a blanket security interest in all of our assets. See "COMPANY OVERVIEW - Laurus Debt Investment" below. In the event we default in payment on the debt, or any other event of default occurs under the investment documents, 130% of the outstanding principal amount of the note and accrued interest will accelerate and be due and payable in full. Events of default include the following:

- a failure to pay interest or principal payments under the note within three days of when due;
- a breach by us of any material covenant or term or condition of the note or in any of the investment agreements, if not cured within 15 days of such breach;
- a breach by us of any material representation or warranty made in the note or in any of the investment agreements;
- if we make an assignment for the benefit of our creditors, or a receiver or trustee is appointed for us, or any form of bankruptcy or insolvency proceeding is instituted by us, or any involuntary proceeding is instituted against us;
- the filing of any money judgment or similar final process against us for more than \$50,000, which remains unvacated, unbonded or unstayed for a period of 30 days;
- if our common stock is suspended for 5 consecutive days or for 5 days during any 10 consecutive days from a principal market or pursuant to an SEC stop order; and
- a failure by us to timely deliver shares of common stock when due upon conversions of the note.

The cash required to pay such accelerated amounts on the note following an event of default would most likely come out of our working capital. As we rely on our working capital for our day to day operations, such a default could have a material adverse effect on our business, operating results, or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. In addition, upon an event of default, the holders of the secured debt could foreclose on our assets or exercise any other remedies available to them. If our assets were foreclosed upon, we were forced to file for bankruptcy or cease operations, stockholders may not receive any proceeds from disposition of our assets and may lose their entire investment in our stock.

As part of our debt financing with Laurus Master Fund, Ltd., we entered into a registration rights agreement with Laurus, under which we were obligated to register the common stock into which the debt is convertible. We have registered the common stock on May 13, 2005 and paid \$215,000 in liquidated damages.

**We have the right at any time to prepay our secured debt obligation only upon payment of 120% of the then current principal balance, plus all other amounts owing under the note. As such, any prepayment would require a significant amount of cash and may limit our ability to prepay, even if we wanted to.**

We have the right at any time to prepay our secured debt obligation only upon payment of 120% of the then principal balance, plus all other amounts owing under the note. See "COMPANY OVERVIEW - Laurus Debt Investment" below. Based on a principal balance of \$1,639,318, as of September 30, 2005, a prepayment would require a cash payment of \$1,967,182. As we make principal payments over time on the secured debt, the prepayment amount would also decrease. As of September 30, 2005, we had \$2.4 million in cash and cash equivalents, and \$3.3 million in current assets. Accordingly, if at any time during the term of the note we desire to prepay the debt, we may not be able to, unless we were able to obtain additional available cash, which we may not be able to do. This could impact our ability to enter into any potential significant transaction in which we would need to have the debt paid off and security interests released (such as a merger, sale of substantially all our assets, joint venture, or similar transaction).

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

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

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

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

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

Historically, a significant portion of our sales have resulted from shipments during the last few weeks of the quarter from orders received in the last month of the applicable quarter. We do, however, base our expense levels, in significant part, on our expectations of future revenue. As a result, we expect our expense levels to be relatively fixed in the short term. Any concentration of sales at the end of the quarter may limit our ability to plan or adjust operating expenses. Therefore, if anticipated shipments in any quarter do not occur or are delayed, expenditure levels could be disproportionately high as a percentage of sales, and our operating results for that quarter would be adversely affected. As a result, we believe that period-to-period comparisons of our results of operations are not and will not necessarily be meaningful, and you should not rely upon them as an indication of future performance. If our operating results for a quarter are below the expectations of public market analysts and investors, the price of our common stock may be materially adversely affected.



**Revenue recognition accounting standards and interpretations may change, causing us 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. We 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. We 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. We believe that we are 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. We 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 our current revenue accounting practices, which could cause us to recognize lower revenues and lead to a decrease in our stock price.

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

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

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

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

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

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

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

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

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

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

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

**We depend upon our key personnel.**

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

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

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

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

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

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

### *Risks Related to Our Stock*

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

As of September 30, 2005, John M. Thornton, who is our Chairman of the Board and his spouse, Director Sally B. Thornton, beneficially owned 2,699,959 shares of common stock or approximately 18.8% of our outstanding common stock. Our directors and executive officers as a whole, own approximately 19% of our outstanding common stock. Laurus Master Funds Ltd. may acquire up to 2,413,311 shares of common stock in the aggregate, which would amount to approximately 14% of our outstanding common stock, assuming Laurus converts its balance of promissory note of \$1,639,318 into approximately 2,413,311 shares of common stock. Laurus may acquire up to a total of 3,473,311 shares if it exercises its 1,060,000 warrant or approximately 18% of the outstanding common stock. Harland Financial Solution has 321,428 warrants which was included in the calculation of the percentage of Laurus Funds potential holdings. Because the Laurus promissory note is subject to anti-dilution provisions and accrues interest which may be converted into common stock, Laurus could acquire an even greater number of shares of common stock than described.

Laurus has converted \$350,000 of its convertible note since September 30, 2005 and its promissory note balance as of October 31, 2005 was \$1,289,318

The above-described significant 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.

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

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

**As we issue additional equity securities in the future, including upon conversion of any of our secured convertible debt, your share ownership will be diluted. In particular, the secured convertible debt has a full ratchet anti-dilution provision that could significantly dilute our stockholders.**

In connection with our debt financing, we issued a \$3.0 million convertible note and warrants to Laurus. See “COMPANY OVERVIEW — Laurus Debt Investment” below. The note is convertible into shares of our common stock at an initial conversion price of \$.70 per share. Laurus Fund has converted \$560,000 to stock and has \$1,639,318 convertible debt as of September 30, 2005. Laurus has converted \$350,000 into stock after September 30, 2005. At this initial conversion rate, for example, we would issue 1,841,883 shares upon conversion of \$1,289,318 owing under the note as of October 31, 2005. The actual number of shares to be issued will depend on the actual dollar amount of principal being converted. In addition, the note carries a full ratchet anti-dilution provision, such that if we issue in the future convertible or equity securities (subject to certain exceptions, including stock option grants) at a price less than the initial \$.70 conversion price, the note conversion price will be automatically adjusted down to that lesser price. For example, if we had a non-exempted issuance at \$0.50 per share, the note conversion price would become \$0.50, and upon an assumed conversion of \$1,289,318 we would have to issue 2,578,636 shares. In addition to the conversion rights of the convertible debt, as we issue stock or convertible securities in the future, including for any future equity financing or upon exercise of any of the outstanding stock purchase warrants and stock options, those issuances would also dilute our stockholders. If any of these additional shares are issued and are sold into the market, it could decrease the market price of our common stock and could also encourage short sales. Short sales and other hedging transactions could place further downward pressure on the price of our common stock.

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

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

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

The market price of our common stock has been, and is likely to continue to be, highly volatile. Future announcements concerning us or our competitors, quarterly variations in operating results, announcements of technological innovations, the introduction of new products or changes in the product pricing policies of Mitek or its competitors, claims of infringement of proprietary rights or other litigation, changes in earnings estimates by analysts or other factors could cause the market price of our common stock to fluctuate substantially. In addition, the stock market has from time-to-time experienced significant price and volume fluctuations that have particularly affected the market prices for the common stocks of technology companies and that have often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. During the fiscal year ended September 30, 2005, our common stock price ranged from \$0.33 to \$1.03.

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

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

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

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

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

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

**ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited the accompanying balance sheet of Mitek Systems, Inc. (the "Company") as of September 30, 2005, and the related statements of operations, stockholders' equity (deficit), and cash flows for the years in the period ended September 30, 2005 and 2004. 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 standards of the Public Company Accounting Oversight Board (United States of America). These standards require that we plan and 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, 2005, and the results of its operations and its cash flows for the years in the period ended September 30, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ Stonefield Josephson, Inc.  
STONEFIELD JOSEPHSON, INC.  
Santa Monica, California  
November 21, 2005

MITEK SYSTEMS, INC.  
BALANCE SHEET  
SEPTEMBER 30, 2005

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 2,387,204
Accounts receivable-net of allowances for doubtful accounts of \$48,631	773,210
Inventory, prepaid expenses and other current assets	162,337
Total current assets	<u>3,322,751</u>
PROPERTY AND EQUIPMENT - net	82,626
OTHER ASSETS	148,580
TOTAL ASSETS	<u>\$ 3,553,957</u>
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	206,936
Accrued payroll and related taxes	351,105
Deferred revenue	427,507
Other accrued liabilities	300,341
Current portion of Convertible Debt, net of unamortized financing costs of \$376,723	714,187
Total current liabilities	<u>2,000,076</u>
Convertible Debt, net of unamortized financing costs of \$41,363	507,046
TOTAL LIABILITIES	<u>\$ 2,507,122</u>
COMMITMENTS AND CONTINGENCIES (Note 5)	
STOCKHOLDERS' EQUITY:	
Common stock - \$.001 par value; 40,000,000 shares authorized, 14,332,337 issued and outstanding at September 30, 2005	14,332
Additional paid-in capital	12,672,635
Accumulated deficit	<u>(11,640,132)</u>
Total stockholders' equity	1,046,835
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 3,553,957</u>

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

MITEK SYSTEMS, INC.  
STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

	2005	2004
<b>SALES</b>		
Software, including \$195,880 to related party in 2005	\$ 4,432,043	\$ 2,229,812
Hardware	-	858,571
Professional Services, education and other, including \$750,000 to related party in 2005	2,161,802	2,151,929
<b>NET SALES</b>	<b>6,593,845</b>	<b>5,240,312</b>
<b>COSTS AND EXPENSES:</b>		
Cost of Sales-Software	300,606	497,950
Cost of Sales-Hardware	0	805,080
Cost of Sales-Professional Services, education and other	829,088	676,860
Operations	145,223	1,136,024
Selling and marketing	2,073,977	1,942,064
Research and development	1,507,510	2,204,101
General and administrative	3,050,037	2,720,452
Gain on sale of CheckQuest assets to Harland	(1,106,129)	(1,270,355)
Total costs and expenses	6,800,312	8,712,176
<b>OPERATING LOSS</b>	<b>(206,467)</b>	<b>(3,471,864)</b>
<b>OTHER INCOME (EXPENSE):</b>		
Interest expense	(765,080)	(355,426)
Change in fair value of warrant liability	(81,993)	(48,000)
Interest and other income	25,470	31,132
Total other income (expense)	(821,603)	(372,294)
<b>LOSS BEFORE INCOME TAXES</b>	<b>(1,028,070)</b>	<b>(3,844,158)</b>
<b>PROVISION (BENEFIT) FOR INCOME TAXES</b>	<b>(714)</b>	<b>2,168</b>
<b>NET LOSS</b>	<b>\$ (1,027,356)</b>	<b>\$ (3,846,326)</b>
<b>NET LOSS PER SHARE - BASIC AND DILUTED</b>	<b>\$ (0.08)</b>	<b>\$ (0.34)</b>
<b>WEIGHTED AVERAGE NUMBER OF</b>		
<b>COMMON SHARES OUTSTANDING - BASIC AND DILUTED</b>	<b>12,569,617</b>	<b>11,353,171</b>

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



MITEK SYSTEMS, INC.  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

	2005	2004
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (1,027,356)	\$ (3,846,326)
Adjustments to reconcile net loss used in operating activities:		
Depreciation and amortization	92,320	441,171
Provision for bad debts	(31,000)	519,776
Loss on disposal of property and equipment	0	3,564
Gain on sale of checkquest assets	(1,106,129)	(1,270,355)
Change in fair value of warrant liability	(81,993)	48,020
Amortization of debt discount	526,938	96,247
Provision for sales returns & allowances	(14,583)	(29,336)
Fair value of stock options issued to non-employees	2,580	15,698
Gain on sale of equity investment	(16,159)	
Changes in assets and liabilities:		
Accounts receivable	(172,056)	1,357,328
Inventory, prepaid expenses, and other assets	(126,434)	(95,685)
Accounts payable	(81,973)	(592,123)
Accrued payroll and related taxes	111,105	(450,388)
Long-term payable	0	(34,194)
Deferred revenue	29,783	181,995
Other accrued liabilities	(127,217)	273,651
Net cash used in operating activities	(2,022,174)	(3,380,957)
<b>INVESTING ACTIVITIES</b>		
Purchases of property and equipment	(48,932)	(70,803)
Proceeds from sale of property and equipment	569	0
Proceeds from sale of assets, net of expenses	1,000,000	1,139,992
Proceeds (advances) on related party note receivable-net	150,000	46,619
Net cash provided by investing activities	1,101,637	1,115,808
<b>FINANCING ACTIVITIES</b>		
Repayment of borrowings	(800,682)	0
Proceeds from convertible debt	0	3,000,000
Financing costs related to convertible debt	0	(151,000)
Proceeds from sale of common stock	1,501,250	0
Proceeds from exercise of stock options	0	204,220
Net cash provided by financing activities	700,568	3,053,220
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(219,969)	788,071
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	2,607,173	1,819,102
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	\$ 2,387,204	\$ 2,607,173
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 402,127	\$ 51,159
Cash paid for income taxes	\$ 1,056	\$ 2,166
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES</b>		
Options issued in exchange for services	\$ 2,580	\$ 15,698
Warrants issued in connection with financing	\$ 73,159	\$ 367,887
Beneficial conversion feature of convertible debt	\$ -	\$ 522,384
Conversion of debt to equity	\$ 560,000	\$ -
Settlement of indemnification liability	\$ 106,129	\$ -
Settlement of registration penalty that of issuance of warrant	\$ 208,000	\$ -
Reclassification of warrants with registration obligation to liability	\$ 73,159	\$ -
Reclassification of warrants upon fulfillment of registration obligation to equity	\$ 407,074	\$ -



MITEK SYSTEMS, INC.  
 STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)  
 FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

	<b>Common Stock Outstanding</b>		<b>Common Stock</b>		<b>Additional Paid-In Capital</b>		<b>Accumulated Deficit</b>		<b>Net</b>
Balance, October 1, 2003	11,185,282	\$	11,185	\$	9,327,736	\$	(6,766,450)	\$	2,572,471
Exercise of stock options	204,199		204		204,016				204,220
Fair value of stock options issued to non-employees					15,698				15,698
Beneficial conversion feature embedded in convertible debt					522,383				522,383
Net loss							(3,846,326)		(3,846,326)
Balance, September 30, 2004	11,389,481		11,389		10,069,833		(10,612,776)		(531,554)
Exercise of stock options									0
Fair value of stock options issued to non-employees					2,580				2,580
Proceeds from issuance of common stock	2,142,856		2,143		1,499,107				1,501,250
Common stock issued in exchange for convertible debt	800,000		800		559,200				560,000
Settlement of registration penalty through issuance of warrants					208,000				208,000
Reclassification of warrants with registration obligation to liability					(73,159)				(73,159)
Reclassification of warrants upon fulfillment of registration obligations to equity					407,074				407,074
Net loss							(1,027,356)		(1,027,356)
Balance, September 30, 2005	14,332,337	\$	14,332	\$	12,672,635	\$	(11,640,132)	\$	1,046,835

The accompanying note form an integral part to these financial statements.

**MITEK SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED SEPTEMBER 30, 2005 and 2004**

**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.

The Company has a cash balance of \$2.4 million as of September 30, 2005. The cash balance and cash to be generated from operations for the next twelve months will be adequate to satisfy its working capital needs for the next twelve months. The company has incurred losses in 2005 and 2004. However, its losses have improved in 2005 compared with 2004. In 2004, the Company addressed its cash requirements by issuing Convertible Debt as discussed in Note 5 of the accompanying financial statements. Additionally, the Company received equity investment and reduced its expected future cash needs by entering into the agreement with Harland Financial Solutions whereby certain personnel and overhead expenses were assumed by Harland in the transactions discussed in Note 7 of the accompanying financial statements. Should additional losses occur, the Company may need to raise significant additional 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 additional 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 our cash is deposited with one financial institution. We monitor the financial condition of the financial institution and we do not believe that the deposit is subject to a significant degree of risk. However, the bank has FDIC insurance of up to \$100,000. Any financial problem with the bank may impact the company.

Reclassification - Certain prior year's balances have been reclassified to conform to the 2005 presentation.

Allowance for Doubtful Accounts - The allowance for doubtful accounts reflects our best estimate for probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

**Inventories, prepaid expenses and other current assets consisted of the following at September 30, 2005.**

Inventories	\$	4,822
Prepaid insurance		48,493
Prepaid rent		24,687
Deposits		44,316
Prepaid - other		40,019
<b>Total</b>	<b>\$</b>	<b>162,337</b>

Inventories - Inventories are recorded at the lower of 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, 2005.

Property and equipment - at cost:		
Equipment	\$	700,152
Furniture and fixtures		164,254
Leasehold improvements		5,331
	\$	869,737
Less: accumulated depreciation and amortization		
		(787,111)
<b>Total</b>	<b>\$</b>	<b>82,626</b>

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 \$92,320 and \$177,770 for the years ended September 30, 2005 and 2004, respectively.

Other Assets - Other assets consisted of the following at September 30, 2005:

Prepaid rent	\$	79,635
Prepaid licenses		45,927
Prepaid - other		23,018
<b>Total</b>	<b>\$</b>	<b>148,580</b>

Long-Lived Assets - We periodically evaluate 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 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. We did not record any impairment for the years ended September 30, 2005 and 2004.

Investment in Mitek Systems Ltd. - Between September 1, 2000 and fiscal 2001, we acquired an investment in Itech Business Solutions Ltd., who subsequently changed their name to Mitek Systems Ltd. In fiscal year 2002, we made an interest bearing loan to Mitek Systems Ltd. which was later converted to equity. In the first quarter of fiscal 2005, our entire interest in Mitek Systems Ltd. was repurchased by the principal stockholder of Mitek Systems Ltd., which resulted in net proceeds of \$150,000. Included in fiscal 2005 and 2004 Other Income (Expenses) is \$15,710 and (\$19,652), respectively, related to the gain (loss) in equity investment in 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 our 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 18% 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, collectability 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.

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

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 3.

Net Income (Loss) Per Share - We calculate 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 convertible debt, options and warrants, if dilutive. Outstanding stock options for fiscal 2005 and 2004 of 2,006,719 and 1,834,238, respectively, were excluded from this calculation, as they would have been antidilutive. In addition, 2,341,883 shares issuable upon conversion of debt to equity, 1,060,000 Laurus warrants and 321,428 Harland warrants were excluded from this calculation in fiscal 2005, as they would reduce net loss per share. In fiscal 2004, 4,285,714 shares issuable upon conversion of debt to equity and exercise of 860,000 warrants were excluded from this calculation, as they would reduce net loss per share.

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 we operate 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 and a statement of comprehensive loss is not presented.

### **Recent Accounting Pronouncements**

In December 2004, the FASB issued SFAS No.123 (revised 2004), "Share-Based Payment" Statement 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That compensation cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. We are continuously evaluating the impact of the adoption of SFAS 123(R), and currently believe the impact will be significant to our overall results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. ("FIN") 46, "Consolidation of Variable Interest Entities" ("FIN 46"). In December 2003, FIN 46 was replaced by FASB interpretation No. 46(R) "Consolidation of Variable Interest Entities." FIN 46(R) clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46(R) requires an enterprise to consolidate a variable interest entity if that enterprise will absorb a majority of the entity's expected losses, is entitled to receive a majority of the entity's expected residual returns, or both. FIN 46(R) is effective for entities being evaluated under FIN 46(R) for consolidation no later than the end of the first reporting period that ends after March 15, 2004. We do not currently have any variable interest entities that has been impacted by the adoption of FIN 46(R).

In March 2004, the Financial Accounting Standards Board (FASB) approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting provisions of EITF 03-1 are effective for all reporting periods beginning after June 15, 2004, while the disclosure requirements for certain investments are effective for annual periods ending after December 15, 2003, and for other investments such disclosure requirements are effective for annual periods ending after June 15, 2004. We do not currently have any investments that has been impacted by this provision.

In September 2004, the EITF delayed the effective date for the recognition and measurement guidance previously discussed under EITF Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-01") as included in paragraphs 10-20 of the proposed statement. The proposed statement will clarify the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method. We are currently evaluating the effect of this proposed statement on its financial position and results of operations.

Effective April 1, 2004, the SEC adopted Staff Accounting Bulletin No. 105, "Application of Accounting Principles to Loan Commitments" ("SAB 105"). SAB 105 clarifies the requirements for the valuation of loan commitments that are accounted for as derivatives in accordance with SFAS 133. Management does not expect the implementation of this new bulletin to have any impact on our financial position, results of operations and cash flows. We do not have any loan commitments.

In July 2004, the EITF issued a draft abstract for EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" ("EITF 04-08"). EITF 04-08 reflects the Task Force's tentative conclusion that contingently convertible debt should be included in diluted earnings per share computations regardless of whether the market price trigger has been met. If adopted, the consensus reached by the Task Force in this Issue will be effective for reporting periods ending after December 15, 2004. Prior period earnings per share amounts presented for comparative purposes would be required to be restated to conform to this consensus and we would be required to include the shares issuable upon the conversion of the Notes in the diluted earnings per share computation for all periods during which the Notes are outstanding. We did not have a material impact on our computation of diluted earnings per share upon implementation of this new standard.



In December 2004, the FASB issued two Staff Positions (FSP) that provide accounting guidance on how companies should account for the effect of the American Jobs Creation Act of 2004 that was signed into law on October 22, 2004. In FSP FAS 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004", the FASB concluded that the special tax deduction for domestic manufacturing, created by the new legislation, should be accounted for as a "special deduction" instead of a tax rate reduction. As such, the special tax deduction for domestic manufacturing is recognized no earlier than the year in which the deduction is taken on the tax return. FSP FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004", allows additional time to evaluate the effects of the new legislation on any plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. We do not anticipate that this legislation will impact its results of operations or financial condition. Accordingly, FSP FAS 109-1 and FSP FAS 109-2 are not currently expected to have any material impact on its financial statements. These FSPs were effective December 21, 2004.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 154, Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in nondiscretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date this Statement is issued. Management does not expect the implementation of this new standard to have a material impact on our financial position, results of operations and cash flows.

In March 2005, the SEC released Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"), which provides interpretive guidance related to the interaction between SFAS 123(R) and certain SEC rules and regulations. It also provides the SEC staff's views regarding valuation of share-based payment arrangements. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of their next fiscal year, instead of the next reporting period beginning after June 15, 2005. Management is currently evaluating the impact SAB 107 will have on our consolidated financial statements.

On June 15-16, 2005 the Emerging Issue Task Force meeting discussed Effect of a Liquidated Damages Clause on a Free standing Financial Instrument Subject to EITF 05-04 Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock. The Task Force further discussed (a) whether a registration rights penalty meets the definition of a derivative and (b) whether the registration rights agreement and the financial instrument to which it pertains should be considered as a combined freestanding instrument or as separate freestanding instruments. Additionally, some Task Force members expressed a preference for evaluating a liquidated damages provision based on the probable amount that the issuer would pay rather than the maximum amount. The Task Force was not asked to reach a consensus on this Issue. The Task Force asked the FASB staff to obtain additional information about how entities currently evaluate and account for registration rights agreements in practice. Additionally, the Task Force asked the FASB staff to analyze registration rights penalties in comparison with other penalties that do not meet the definition of a derivative. Further discussion is expected at a future meeting.

Management cannot determine the impact this new standard will have on our financial position, results of operations and cash flows until the standard is issued.

## NOTE 2 - STOCK BASED COMPENSATION

As permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*, we account 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.

We account for stock options granted to our employees and members of our 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 we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation.

	Year Ended September 30 2005	Year Ended September 30 2004
Net loss, as reported	(\$1,027,000)	(\$3,846,000)
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	(322,000)	(302,000)
Pro Forma net loss	(\$1,349,000)	(\$4,148,000)
Pro Forma net loss per share	(.12)	(.37)

## NOTE 3 - INCOME TAXES

For the years ended September 30, 2005 and 2004 the provision (benefit) for income taxes were as follows (rounded):

	2005	2004
Federal - Current	\$ 0	\$ 0
State - Current	\$ (1,000)	\$ 2,000
Total	\$ (1,000)	\$ 2,000

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 our net deferred tax liabilities and assets as of September 30, 2005 and 2004 are as follows:

	2005	2004
Deferred tax assets (liabilities):		
Reserves not currently deductible	\$ 34,000	\$ 531,000
Book depreciation and amortization in excess of tax	33,000	28,000
Research credit carryforwards	551,000	551,000
AMT credit carryforward	69,000	69,000
Net operating loss carryforwards	4,485,000	4,028,000
Capitalized research and development costs	548,000	24,000
Uniform capitalization	1,000	4,000
Other	610,000	635,000
<b>Total deferred tax assets</b>	<b>6,331,000</b>	<b>5,870,000</b>
Valuation allowance for net deferred tax assets	(6,331,000)	(5,870,000)
<b>Total</b>	<b>\$ 0</b>	<b>\$ 0</b>

We have provided a valuation allowance against deferred tax assets recorded as of September 30, 2005 and 2004 due to uncertainties regarding the realization of such assets.

The research credit and net operating loss carryforwards expire during the years 2005 to 2025. The federal and California net operating loss carryforwards at September 30, 2005 are approximately \$17,500,000 and \$11,100,000, 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:

	2005	2004
Amount computed using statutory rate (34%)	\$ (372,000)	\$ (1,308,000)
Net change in valuation allowance for net deferred tax assets	461,000	1,331,000
Non-deductible items	8,000	15,000
State income taxes	( 98,000)	( 36,000)
<b>Provision for income taxes</b>	<b>\$ ( 1,000)</b>	<b>\$ 2,000</b>

**NOTE 4 - COMMITMENTS AND CONTINGENCIES**

*Legal Matters* - We are not aware of any legal proceedings or claims that Management believes may have, individually or in the aggregate, a material adverse effect on the business, financial condition, operating results, cash flow or liquidity.

*Employee 401(k) Plan* - We have 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 Mitek's contributions. During fiscal 2005 and 2004, the Board elected not to make any contributions to the plan.

*Leases* - Our office is leased under a non-cancelable operating lease. The facilities lease expired on September 30, 2005 and we have retained the space on a month to month lease until we move to the new location. The lease costs are expensed on a straight-line basis over the lease term. We signed a seven year lease for a property located at 8911 Balboa Avenue, San Diego, California and intend to move some time in early December of 2005. The Lease is effective and binding on the parties as of September 19, 2005; however, the term of the Lease will begin on date on which the Landlord achieves substantial completion of certain improvements in accordance with the terms of the Lease (the "Commencement Date"). The initial term of the Lease is seven years. The Lease will be terminable by the Company after the calendar month which is forty-eight (48) full calendar months after the Commencement Date; however, termination will require certain penalties to be paid equal to two months of base rent and all unamortized improvements and commissions.

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

Year Ending September 30:	<u>Operating Leases</u>
2006	\$ 271,555
2007	305,002
2008	314,558
2009	324,814
2010	333,671
Thereafter	724,775
<b>Total</b>	<b>\$ 2,274,375</b>

Rent expense for operating leases, net of sub-lease income of \$60,000 and \$0, for the years ended September 30, 2005 and 2004 totaled \$410,128 and \$524,180, respectively.

We have, as part of the lease 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. At September 30, 2005, there was no further obligations on the furniture purchase.

**NOTE 5 - ISSUANCE OF CONVERTIBLE DEBT**

On June 11, 2004, we secured a financing arrangement with Laurus. The financing consists of a \$3 million Secured Note that bears interest at the rate of prime (as published in the Wall Street Journal), plus one percent (6.75% as of September 30, 2005) and has a term of three years (June 11, 2007). The Secured Note is convertible into shares of our common stock at an initial fixed price of \$0.70 per share, a premium to the 10-day average closing share price as of June 11, 2004. The conversion price of the Secured Note is subject to adjustment upon the occurrence of certain events. The effective annual interest rate of this Convertible Debt, after considering the total debt issue costs (discussed below), is approximately 36%

In connection with the financing, Laurus was also issued warrants to purchase up to 860,000 shares of our common stock. The warrants are exercisable as follows: 230,000 shares at \$0.79 per share; 230,000 shares at \$0.85 per share and the balance at \$0.92 per share. The gross proceeds of the convertible debt were allocated to the debt instrument and the warrants on a relative fair value basis. Then we computed the beneficial conversion feature embedded in the debt instrument using the effective conversion price in accordance with EITF 98-5 and 00-27. We have recorded a debt discount of (i) \$367,887 for the valuation of the 860,000 warrants issued with the note (computed using a Black-Scholes model with an interest rate of 2.53%, volatility of 81%, zero dividends and expected term of three years); (ii) \$522,384 for a beneficial conversion feature inherent in the Secured Note and (iii) \$151,000 for debt issue costs paid to affiliates of the lender, for a total discount of \$1,041,271. The \$1,041,271 is being amortized over the term of the Secured Note. Amortization of the debt discounts for fiscal 2005 was \$526,938, and \$96,247 for fiscal 2004.

A registration rights agreement was executed requiring us to register the shares of our common stock underlying the Secured Note and warrants so as to permit the public resale thereof. Liquidated damages of 2% of the Secured Note balance per month accrued if stipulated deadlines were not met. Prior to the end of fiscal 2004, we incurred a penalty of \$208,000 to Laurus Funds for failing to register the securities underlying the Debt Instrument. On October 4, 2004, the Company settled this penalty with Laurus Master Fund, LLC by agreeing to issue an additional warrant for the purchase of 200,000 shares at a price of \$0.70 per share. The value of this additional warrant was calculated by us to be \$73,159, using a Black-Scholes option pricing model. The registration statement was filed with the Securities and Exchange Commission on October 4, 2004. We were required to have received an effective registration no later than December 31, 2004. The registration was not effective by that time, so we incurred liquidated damages, payable in cash, in the amount of \$215,000 for the period January 1, 2005 to May 13, 2005. The registration became effective on May 13, 2005, and we do not anticipate there will be future penalties associated with the registration

In conjunction with raising capital through the issuance of convertible debt, the Company has issued various warrants that have registration rights for the underlying shares. As the contracts must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet (\$367,887) and the change in fair value from the date of issuance to September 30, 2004 has been included in other (expense) income.

For the year ended September 30, 2005, the change in fair value of the warrants issued with registration rights decreased by \$82,000. Upon effectiveness of the registration statement, the remaining warrant value of \$407,073 was reclassified to additional-paid-in-capital. For the year ended September 30, 2004, the change in fair value of the warrants issued with registration rights for the underlying shares increased by approximately \$48,020 to \$415,907 at September 30, 2004 and is recognized in other expense.

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

The Secured Notes stipulates that the Secured Note is to be repaid using cash payment along with an equity conversion option; the details of both methods for repayment are as follows: The cash repayments stipulate that beginning on December 1, 2004, or the first amortization date, we shall make monthly payments to Laurus on each repayment date until the maturity date, each in the amount of \$90,909.09, together with any accrued and unpaid interest to date. The conversion repayment states that each month by the fifth business day prior to each amortization date, Laurus shall deliver to us a written notice converting the monthly amount payable on the next repayment date in either cash or shares of common stock, or a combination of both. If a repayment notice is not delivered by Laurus on or before the applicable notice date for such repayment date, then we pay the monthly amount due in cash. Any portion of the monthly amount paid in cash shall be paid to Laurus in an amount equal to 102% of the principal portion of the monthly amount due. If Laurus converts all or a portion of the monthly amount in shares of our common stock, the number of such shares to be issued by us will be the number determined by dividing the portion of the monthly amount to be paid in shares of common stock, by the applicable fixed conversion price, which is presently \$0.70 per share.

The following table reflects the Convertible Debt on September 30, 2005:

Convertible Debt	\$	1,639,318
Deferred financing costs		(418,085)
		<u>1,221,233</u>
Less: Current Portion		(714,187)
	\$	<u>507,046</u>

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

Year ended 9/30/06	\$	1,090,909
Year ended 9/30/07		548,409

#### NOTE 6 - RELATED PARTY TRANSACTIONS

In fiscal 2005, we realized revenue of approximately \$750,000 with John H. Harland Company ("John Harland") for engineering development services, unrelated to the sale of assets (Note 7). In addition, we invoiced Harland Financial Solutions, a subsidiary of John Harland, for software license purchases and software maintenance for approximately \$196,000. Harland Financial Solutions sub-leased office space from us during fiscal 2005 which totaled \$60,000. John H. Harland Company made an investment in Mitek in February and May 2005, which is discussed in detail in Note 8 under Stockholders' Equity resulting in classification as related parties. There were no related party transactions in fiscal 2004 (at the time of the Checkquest sale to Harland Financial Solutions in July 2004, management determined that Harland Financial Services and John Harland were not related parties).

**NOTE 7 - SALE OF ASSETS**

On July 7, 2004, we entered into an agreement with Harland Financial Solutions (HFS) wherein HFS acquired certain of our trade assets relating to its Item Processing line of business. In addition, HFS assumed the trade liabilities and hired certain of our personnel relating to this line of business. In connection with this transaction, we entered into a reseller agreement wherein HFS will be the exclusive reseller of this line of business. The consideration for this transaction was \$1,425,000, plus the assumption of liabilities. The consideration was reduced by \$100,000, which was placed in escrow pending delivery of our Fraud Protect System to certain customers. Mitek fulfilled the required obligations and HFS released the \$100,000 in the 4<sup>th</sup> Quarter of fiscal 2005 and was applied against the indemnification. The agreement required us to Indemnify HFS for future liabilities. The indemnification is limited to \$250,000. The Indemnification was settled for a total amount of \$144,000 in the fourth quarter of fiscal 2005 and the indemnification has expired as of September 30, 2005. A summary of asset sold in 2004 is as follows:

	2004
Total Consideration	\$ 1,425,000
Less: amounts held in escrow	(100,000)
Less: indemnifications	(250,000)
Plus: liabilities and deferred revenue assumed by Harland	988,014
Less: expenses of sale	(181,160)
Cost basis of receivables sold	(453,436)
Cost basis of fixed assets sold	(95,237)
Cost basis of licenses sold	(60,938)
Cost basis of inventory sold	(1,888)
Gain on Sale	<u>\$ 1,270,355</u>

Under the agreement, HFS had the right to acquire certain additional assets for an additional consideration of \$1 million if we were able to comply with certain closing conditions such as resolution on BSM, Inc. arbitration hearing. In March 2005, we delivered certain executed documents according to terms satisfactory to the buyer, and received the additional \$1,000,000 in April 2005. In addition, we recognized a gain of \$106,129 relating to the indemnification as stated above.

**NOTE 8 - STOCKHOLDERS' EQUITY***Shares Sold For Cash*

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

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

#### Shares Issued For Conversion Of Debt To Equity

We issued 800,000 shares to Laurus upon conversion of \$560,000 of principal to equity during the year ended September 30, 2005.

#### Stock Options

We have stock option plans for executives and key individuals who make significant contributions to Mitek. 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 our 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 our stock at the grant date and for a term of not more than ten years. Employees owning in excess of 10% of the outstanding stock are included in the plan on the same terms except that the options must be granted for a term of not more than five years. The 1996 plan maximized in February 1999 and no additional options may be granted under this plan.

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

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

Information concerning stock options granted by Mitek under all plans for the years ended September 30, 2005 and 2004 is as follows:

	Shares	Weighted Average Exercise Price Per Share
Balance, September 30, 2003	2,350,963	\$ 2.03
Granted	629,750	\$ 1.02
Exercised	(204,199)	\$ 1.00
Cancelled	(942,276)	\$ 2.46
Balance, September 30, 2004	1,834,238	\$ 1.58
Granted	890,500	\$ 1.02
Exercised	0	\$ 1.00
Cancelled	(718,019)	\$ 2.46
Balance, September 30, 2005	2,006,719	\$ 1.06



The following table summarizes information about stock options outstanding on September 30, 2005:

Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price of Exercisable Options
\$ 0.43 - \$ 0.69	871,000	8.64	\$ 0.56	308,583	\$ 0.57
\$ 0.72 - \$ 0.92	238,667	8.11	\$ 0.78	98,701	\$ 0.86
\$ 1.06 - \$ 1.39	638,000	7.45	\$ 1.15	484,667	\$ 1.16
\$ 1.60 - \$ 1.68	132,000	6.27	\$ 1.60	88,944	\$ 1.60
\$ 2.13 - \$ 2.68	80,558	6.26	\$ 2.32	80,558	\$ 2.33
\$ 3.25 - \$ 12.37	46,494	4.58	\$ 6.69	46,494	\$ 6.64
	<u>2,006,719</u>	<u>7.85</u>	<u>\$ 1.06</u>	<u>1,107,947</u>	<u>\$ 1.32</u>

All stock options are granted with an exercise price equal to the fair market value of our common stock at the grant date. The weighted average fair value of the stock options granted was \$.69 and \$.63 for fiscal 2005 and 2004, 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 2005: risk-free interest rate of 3.72%; expected dividend yield of 0%; expected life of 3 years; and expected volatility of 74%. In 2004 the assumptions were: risk-free interest rate of 2.6%; expected dividend yield of 0%; expected life of 3 years; and expected volatility of 77%. Stock options generally expire between three to ten years from the grant date. Incentive 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. Non-qualified stock options vest immediately and expire in three years from the date of the grant.

We have also issued 20,000 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 \$2,580 and \$15,698 for the years ended September 30, 2005 and 2004, respectively, and are included in general and administrative expense. Future increases in the fair value of our common stock could result in additional compensation expense.

**NOTE 9 - PRODUCT REVENUES AND SALES CONCENTRATIONS**

Product Revenues - During fiscal years 2005 and 2004, our 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,	
	2005	2004
Character recognition	64%	71%
Maintenance & Other	36%	29%

Sales Concentrations - The Company sells its products primarily to community depository institutions. For the years ended September 30, 2005 and 2004, the Company had the following sales concentrations:

	Year Ended September 30,	
	2005	2004
Customers to which sales were in excess of 10% of total sales		
Number of customers	2	1
Aggregate percentage of sales	31%	12%
Foreign Sales - primarily Europe & Asia	23%	4%

Below is a summary of the revenues by product lines.

	2005	2004
Revenue (000's)		
Recognition Toolkits	\$ 4,059	\$ 1,859
Check Image Solutions	0	1,406
Document and Image Processing Solutions	160	439
Maintenance and other	2,375	1,536
Total Revenue	<u>\$ 6,594</u>	<u>\$ 5,240</u>

**NOTE 10 - SUBSEQUENT EVENTS**

Laurus Funds has converted its note in the amount of \$350,000 to 500,000 shares. The balance of Laurus Funds convertible note on October 30, 2005 was approximately \$1.3 million.

On October 19, 2005, the Board of Directors approved stock option grants to our employees, officers and directors in the amount of 974,000. The exercise price was the fair market value as of the date of the grant and vests periodically over the next 3 years. Options granted to directors vests immediately.

**ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES**

NONE

**ITEM 8A. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective as of the year ended September 30, 2005.

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d - 15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART III**

**ITEM 9. 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 22, 2006 (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 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 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 Office and Chief Financial Officer that requires disclosure under applicable SEC rules, we intend to disclose the nature of such amendment or waiver on our website.

**ITEM 10. 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.

**ITEM 11. 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 12. 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 13. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information concerning principal accountant fees and services appears in the proxy statement under the heading "Fees Paid to Stonefield Josephson, Inc.", is incorporated herein by reference.

**PART IV**

**ITEM 14. 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, 2005:

Reports of Independent Registered Public Accounting Firm

Balance Sheet - As of September 30, 2005

Statements of Operations - For the Years Ended September 30, 2005 and 2004

Statements of Stockholders' Equity (Deficit) - For the Years Ended September 30, 2005 and 2004

Statements of Cash Flows - For the Years Ended September 30, 2005 and 2004

Notes to Financial Statements - For the years Ended September 30, 2005 and 2004

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, 2005, 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)

10.6 Office Lease between Arden Realty Finance V, L.L.C. and the Company

13. Annual Report to Stockholders for the year ended September 30, 2005.

23. Consents of Independent Registered Public Accounting Firms

31.1 Certification of Periodic Report by the Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of Periodic Report by the Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of Periodic Report by the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Periodic Report by the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 
- (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
- (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
- (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.

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

(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, 2005:

## 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.

### MITEK SYSTEMS, INC.

Dated: November 28, 2005

By: /s/ James B. DeBello

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James B. DeBello  
President, Chief Executive Officer

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 November 28, 2005

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John M. Thornton,  
Chairman of the Board and Director)

/s/ James B. DeBello November 28, 2005

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James B. DeBello,  
President and Chief Executive Officer  
(Principal Executive Officer and Director)

/s/ Tesfaye Hailemichael November 28, 2005

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Tesfaye Hailemichael  
Chief Financial officer

/s/ Gerald I. Farmer November 28, 2005

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Gerald I. Farmer, Director

/s/ Michael Bealmear November 28, 2005

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Michael Bealmear, Director

/s/ Sally B. Thornton November 28, 2005

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Sally B. Thornton, Director

/s/ William P. Tudor November 28, 2005

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William P. Tudor, Director

/s/ Vinton Cunningham November 28, 2005

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Vinton Cunningham, Director

## SUPPLEMENTAL INFORMATION

### **CORPORATE OFFICE**

Mitek Systems, Inc.  
14145 Danielson Street, Suite B  
Poway, California 92064  
(858) 513-4600

### **CORPORATE OFFICERS**

James B. DeBello , President and Chief Executive Officer  
Tesfaye Hailemichael, Chief Financial Officer  
Murali Narayanan, Vice President of Development  
Emmanuel deBoucaud, Vice President of Sales

### **TRANSFER AGENT**

Mellon Investor Services LLC  
480 Washington Blvd., Jersey City, N 07310-1900  
[www.melloninvestor.com/isd](http://www.melloninvestor.com/isd)

### **AUDITORS**

Stonefield & Josephson, Inc.  
1620 26<sup>th</sup> St, Suite 400 South, Santa Monica, California 90404

### **DIRECTORS**

John M. Thornton, Chairman of the Board  
Sally B. Thornton, Investor  
Michael Bealmear (1) (2)  
James B. DeBello, President, Chief Executive Officer  
Gerald I. Farmer, Ph.D. (2)  
William P. Tudor (1)  
Vinton Cunningham (2)

### **NOTES**

(1) Compensation Committee  
(2) Audit Committee

**FORM 10-K REPORT**

Copies of our Form 10-KSB report to the Securities and Exchange Commission, are available free to stockholders and may be obtained by writing or calling Secretary, Mitek Systems, Inc., 14145 Danielson St., Suite B, Poway, California 92064, phone (858) 513-4600.

Subsequent to December 9, 2005, submit your request to Mitek Systems, Inc., 8911 Balboa Ave., Suite B, San Diego, CA 92123.

STANDARD OFFICE LEASE

BY AND BETWEEN

ARDEN REALTY FINANCE V, L.L.C.,  
a Delaware limited liability company,

AS LANDLORD,

AND

MITEK SYSTEMS, INC.,  
a Delaware corporation,

AS TENANT

SUITE B

Balboa Corporate Center

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STANDARD OFFICE LEASE

This Standard Office Lease ("Lease") is made and entered into as of the 13th day of September, 2005, by and between ARDEN REALTY FINANCE V, L.L.C., a Delaware limited liability company ("Landlord"), and MITEK SYSTEMS, INC., a Delaware corporation ("Tenant").

Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the premises described as Suite B, as designated on the plan attached hereto and incorporated herein as Exhibit "A" ("Premises"), of the project ("Project") now known as Balboa Corporate Center whose address is 8911 Balboa Avenue, San Diego, California, for the Term and upon the terms and conditions hereinafter set forth, and Landlord and Tenant hereby agree as follows:

ARTICLE 1

BASIC LEASE PROVISIONS

A. Term: Seven (7) years.

Commencement Date: The earlier of (i) the date Tenant first commences to conduct business in the Premises, or (ii) the date of Substantial Completion of Improvements in the Premises. The Commencement Date is estimated to occur on or about November 15, 2005.

Expiration Date: The date immediately preceding the seventh (7th) anniversary of the Commencement Date; provided, however, that if the Commencement Date is a date other than the first (1st) day of a month, the Expiration Date shall be the last day of the month which is eighty-four (84) months after the month in which the Commencement Date falls, unless extended or earlier terminated pursuant to this Lease.

B. Square Footage: 15,927 rentable square feet.

C. Basic Rental:

Lease Year	Annual Basic Rental	Monthly Basic Rental	Monthly Basic Rental Per Rentable Square Foot*
1	\$296,242.20	\$24,686.85	\$1.55
2	\$305,798.40	\$25,483.20	\$1.60
3	\$315,354.60	\$26,279.55	\$1.65
4	\$324,910.80	\$27,075.90	\$1.70
5	\$334,467.00	\$27,872.25	\$1.75
6	\$344,023.20	\$28,668.60	\$1.80
7	\$353,579.40	\$29,464.95	\$1.85

\* In addition, Tenant shall pay for electricity and janitorial service separately pursuant to Article 11 below.

- D. Base Year: 2006
- E. Tenant's Proportionate Share: 22.79% (based on a total of 69,890 rentable square feet in the Project).
- F. Security Deposit: A security deposit of \$79,635.00 shall be due and payable by Tenant to Landlord upon Tenant's execution of this Lease.
- G. Permitted Use: General office use and uses incidental thereto which are permitted by law and are consistent with the character of the Project as a first-class office project.
- H. Brokers: CB Richard Ellis, Inc. (for Landlord) and Burnham Real Estate (for Tenant).
- I. Parking Passes: Tenant shall rent three point nine (3.9) parking passes for each 1,000 rentable square feet contained in the Premises, which equals sixty-two (62) passes, at the rate provided in Article 23 hereof.
- J. Initial Installment of Basic Rental: The first full month's Basic Rental of \$24,686.85 shall be due and payable by Tenant to Landlord upon Tenant's execution of this Lease.

## ARTICLE 2

### TERM/PREMISES

The Term of this Lease shall commence on the Commencement Date as set forth in Article 1.A. of the Basic Lease Provisions and shall end on the Expiration Date set forth in Article 1.A. of the Basic Lease Provisions. For purposes of this Lease, the term "Lease Year" shall mean each consecutive twelve (12) month period during the Term, with the first (1st) Lease Year commencing on the Commencement Date; however, (a) if the Commencement Date falls on a day other than the first (1st) day of a calendar month, the first (1st) Lease Year shall end on the last day of the eleventh (11th) month after the Commencement Date and the second (2nd) and each succeeding Lease Year shall commence on the first (1st) day of the next calendar month, and (b) the last Lease Year shall end on the Expiration Date. If Landlord does not deliver possession of the Premises to Tenant on or before the anticipated Commencement Date (as set forth in Article 1.A, above), except as provided in Section 5.3 of the Tenant Work Letter, Landlord shall not be subject to any liability for its failure to do so, and such failure shall not affect the validity of this Lease nor the obligations of Tenant hereunder. Landlord and Tenant hereby stipulate that the Premises

contains the number of square feet specified in Article 1.B. of the Basic Lease Provisions. Landlord may deliver to Tenant a Commencement Letter in a form substantially similar to that attached hereto as Exhibit "C", which Tenant shall execute and return to Landlord within fifteen (15) days of receipt thereof. Failure of Tenant to timely execute and deliver the Commencement Letter shall constitute acknowledgment by Tenant that the statements included in such notice are true and correct, without exception.

### ARTICLE 3

#### RENTAL

(a) Basic Rental. Tenant agrees to pay to Landlord during the Term hereof, at Landlord's office or to such other person or at such other place as directed from time to time by written notice to Tenant from Landlord, the initial monthly and annual sums as set forth in Article 1.C. of the Basic Lease Provisions, payable in advance on the first (1st) day of each calendar month, without demand, setoff or deduction, and in the event this Lease commences or the date of expiration of this Lease occurs other than on the first (1st) day or last day of a calendar month, the rent for such month shall be prorated. Notwithstanding the foregoing, the first full month's Basic Rental shall be paid to Landlord in accordance with Article 1.J. of the Basic Lease Provisions.

(b) Increase in Direct Costs. The term "Base Year" means the calendar year set forth in Article 1.D. of the Basic Lease Provisions. If, in any calendar year during the Term of this Lease, the "Direct Costs" (as hereinafter defined) paid or incurred by Landlord shall be higher than the Direct Costs for the Base Year, Tenant shall pay an additional sum for each such subsequent calendar year equal to the product of the amount set forth in Article 1.E. of the Basic Lease Provisions multiplied by such increased amount of "Direct Costs." In the event either the Premises and/or the Project is expanded or reduced, then Tenant's Proportionate Share shall be appropriately adjusted, and as to the calendar year in which such change occurs, Tenant's Proportionate Share for such calendar year shall be determined on the basis of the number of days during that particular calendar year that such Tenant's Proportionate Share was in effect. In the event this Lease shall terminate on any date other than the last day of a calendar year, the additional sum payable hereunder by Tenant during the calendar year in which this Lease terminates shall be prorated on the basis of the relationship which the number of days which have elapsed from the commencement of said calendar year to and including said date on which this Lease terminates bears to three hundred sixty five (365). Any and all amounts due and payable by Tenant pursuant to this Lease (other than Basic Rental) shall be deemed "Additional Rent" and Landlord shall be entitled to exercise the same rights and remedies upon default in these payments as Landlord is entitled to exercise with respect to defaults in monthly Basic Rental payments.

(c) Definitions. As used herein the term "Direct Costs" shall mean the sum of the following:

(i) "Tax Costs", which shall mean any and all real estate taxes and other similar charges on real property or improvements, assessments, water and sewer charges, and all other charges assessed, reassessed or levied upon the Project and appurtenances thereto and the parking or other facilities thereof,

or the real property thereunder (collectively the "Real Property") or attributable thereto or on the rents, issues, profits or income received or derived therefrom which are assessed, reassessed or levied by the United States, the State of California or any local government authority or agency or any political subdivision thereof, and shall include Landlord's reasonable legal fees, costs and disbursements incurred in connection with proceedings for reduction of Tax Costs or any part thereof; provided, however, if at any time after the date of this Lease the methods of taxation now prevailing shall be altered so that in lieu of or as a supplement to or a substitute for the whole or any part of any Tax Costs, there shall be assessed, reassessed or levied (a) a tax, assessment, reassessment, levy, imposition or charge wholly or partially as a net income, capital or franchise levy or otherwise on the rents, issues, profits or income derived therefrom, or (b) a tax, assessment, reassessment, levy (including but not limited to any municipal, state or federal levy), imposition or charge measured by or based in whole or in part upon the Real Property and imposed upon Landlord, then except to the extent such items are payable by Tenant under Article 6 below, such taxes, assessments, reassessments or levies or the part thereof so measured or based, shall be deemed to be included in the term "Direct Costs." Tax Costs includable in Direct Costs shall be reduced to the extent that Landlord prevails in any proceeds for a reduction of such charges, provided that (A) Tax Costs shall only include Landlord's legal fees incurred in connection with such proceedings to the extent such proceedings are reasonably expected to result in a reduction of Tax Costs, and (B) in no event shall Tax Costs included in Direct Costs for any year subsequent to the Base Year be less than the amount of Tax Costs included in Direct Costs for the Base Year (in such case Tenant shall not be responsible for the payment of any Tax Costs for such subsequent year). In addition, when calculating Tax Costs for the Base Year, special assessments shall only be deemed included in Tax Costs for the Base Year to the extent that such special assessments are included in Tax Costs for the applicable subsequent calendar year during the Term. Any real estate tax assessments which are payable in installments shall be included in Tax Costs as if such costs were paid over the maximum number of installments permitted by law.

(ii) "Operating Costs", which shall mean all costs and expenses incurred by Landlord in connection with the maintenance, operation, replacement, ownership and repair of the Project, the equipment, the intrabuilding cabling and wiring, adjacent walks, malls and landscaped and common areas and the parking structure, areas and facilities of the Project, including, but not limited to, salaries, wages, medical, surgical and general welfare benefits and pension payments, payroll taxes, fringe benefits, employment taxes, workers' compensation, uniforms and dry cleaning thereof for all persons who perform duties connected with the operation, maintenance and repair of the Project, its equipment, the intrabuilding cabling and wiring and the adjacent walks and landscaped areas, including janitorial, gardening, security, parking, operating engineer, elevator, painting, plumbing, electrical, carpentry, heating, ventilation, air conditioning, window washing, hired services, a reasonable allowance for depreciation of the cost of acquiring or the rental expense of personal property used in the maintenance, operation and repair of the Project, accountant's fees incurred in the preparation of rent adjustment statements, legal fees, real estate tax consulting fees, personal property taxes on property used in the maintenance and operation of the Project, fees, costs, expenses or dues payable pursuant to the terms of any covenants, conditions or restrictions' or owners' association pertaining to the Project, capital expenditures incurred where the economies reasonably expected to be achieved each year are in excess of the reasonably expected annual amortized cost of such expenditure and capital expenditures required by governmental regulations, law, or ordinances not in effect as of the Commencement Date and costs incurred (capital or otherwise) on

a regular recurring basis every three (3) or more years for certain maintenance projects (e.g., parking lot slurry coat or replacement of lobby and elevator cab carpeting), provided that any such permitted capital improvements shall be amortized over the reasonably determined useful life of the capital improvement and the amount considered as Operating Costs in any one (1) year shall be limited to the amount of such yearly amortization; the cost of all charges for electricity, gas, water and other utilities furnished to the Project, including any taxes thereon; the cost of all charges for fire and extended coverage, liability and all other insurance in connection with the Project carried by Landlord; the cost of all building and cleaning supplies and materials; the cost of all charges for cleaning, maintenance and service contracts and other services with independent contractors and administration fees; a property management fee (which fee may be imputed if Landlord has internalized management or otherwise acts as its own property manager) and license, permit and inspection fees relating to the Project. In the event, during any calendar year, the Project is less than ninety-five percent (95%) occupied at all times, Operating Costs shall be adjusted to reflect the Operating Costs of the Project as though ninety-five percent (95%) were occupied at all times, and the increase or decrease in the sums owed hereunder shall be based upon such Operating Costs as so adjusted. In no event shall costs for any item of utilities included in Direct Costs for any year subsequent to the Base Year be less than the amount included in Direct Costs for the Base Year for such utility item. Notwithstanding anything to the contrary set forth in this Article 3, when calculating Operating Costs for the Base Year, unless Operating Costs for the applicable subsequent calendar year include the applicable following items, Operating Costs shall exclude (a) increases due to extraordinary circumstances including, but not limited to, labor-related boycotts and strikes, utility rate hikes, utility conservation surcharges, or other surcharges, insurance premiums resulting from terrorism coverage, catastrophic events and/or the management of environmental risks, and (b) amortization of any capital items including, but not limited to, capital improvements, capital repairs and capital replacements (including such amortized costs where the actual improvement, repair or replacement was made in prior years).

Notwithstanding anything to the contrary contained herein, the aggregate Controllable Operating Costs, as that term is defined below, shall not increase more than six percent (6%) in any calendar year over the maximum amount of Controllable Operating Costs chargeable for the immediately preceding calendar year, with no limit on the Controllable Operating Costs during the Base Year (i.e., the actual Controllable Operating Costs for the Base Year shall be the maximum amount for the Base Year for purposes of this provision). "Controllable Operating Costs" shall mean all Direct Costs except Tax Costs, utility charges and insurance charges.

In addition, notwithstanding anything above to the contrary, Operating Costs shall not include (1) the cost of providing any service directly to and paid directly by any tenant (outside of such tenant's Direct Cost payments); (2) the cost of any items for which Landlord is reimbursed by insurance proceeds, condemnation awards, a tenant of the Project, or otherwise to the extent so reimbursed; (3) any real estate brokerage commissions or other costs incurred in procuring tenants, or any fee in lieu of commission; (4) amortization of principal and interest on mortgages or ground lease payments (if any); (5) costs of items considered capital repairs, replacements, improvements and equipment under generally accepted accounting principles consistently applied except as expressly included in Operating Costs pursuant to the definition above; (6) costs incurred by Landlord due to the violation by Landlord or any tenant of the terms and conditions of any lease of space in the Project or any law, code, regulation, ordinance or the like; (7) any compensation paid to clerks,



attendants or other persons in commercial concessions operated by Landlord (other than in the parking facility for the Project); (8) costs incurred in connection with upgrading the Project to comply with disability, life, seismic, fire and safety codes, ordinances, statutes, or other laws in effect prior to the Commencement Date, including, without limitation, the then applicable requirements of the Americans with Disabilities Act ("ADA"), including penalties or damages incurred due to such non-compliance; (9) bad debt expenses and interest, principal, points and fees on debts (except in connection with the financing of items which may be included in Operating Costs); (10) marketing costs, including those costs described in (3) above, attorneys' fees in connection with the negotiation and preparation of letters, deal memos, letters of intent, leases, subleases and/or assignments, space planning costs, and other costs and expenses incurred in connection with lease, sublease and/or assignment negotiations and transactions with present or prospective tenants or other occupants of the Project, including attorneys' fees and other costs and expenditures incurred in connection with disputes with present or prospective tenants or other occupants of the Project; (11) costs, including permit, license and inspection costs, incurred with respect to the installation of other tenants' or occupants' improvements made for tenants or other occupants in the Project or incurred in renovating or otherwise improving, decorating, painting or redecorating vacant space for tenants or other occupants in the Project; (12) any costs expressly excluded from Operating Costs elsewhere in this Lease; (13) costs of any items (including, but not limited to, costs incurred by Landlord for the repair of damage to the Project) to the extent Landlord receives reimbursement from insurance proceeds or from a third party (except that any deductible amount under any insurance policy shall be included within Operating Costs); (14) rentals and other related expenses for leasing an HVAC system, elevators, or other items (except when needed in connection with normal repairs and maintenance of the Project) which if purchased, rather than rented, would constitute a capital improvement not included in Operating Costs pursuant to this Lease; (15) depreciation, amortization and interest payments, except as specifically included in Operating Costs pursuant to the terms of this Lease and except on materials, tools, supplies and vendor-type equipment purchased by Landlord to enable Landlord to supply services Landlord might otherwise contract for with a third party, where such depreciation, amortization and interest payments would otherwise have been included in the charge for such third party's services, all as determined in accordance with generally accepted accounting principles, consistently applied, and when depreciation or amortization is permitted or required, the item shall be amortized over its reasonably anticipated useful life; (16) expenses in connection with services or other benefits which are not offered to Tenant or for which Tenant is charged for directly but which are provided to another tenant or occupant of the Project, without charge; (17) electric power costs or other utility costs for which any tenant directly contracts with the local public service company (but Landlord shall have the right to "gross up" as if such space was vacant); (18) costs incurred in connection with the operation of retail stores selling merchandise and restaurants in the Project to the extent such costs are in excess of the costs Landlord reasonably estimates would have been incurred had such space been used for general office use; (19) costs (including in connection therewith all attorneys' fees and costs of settlement, judgments and/or payments in lieu thereof) arising from claims, disputes or potential disputes in connection with potential or actual claims litigation or arbitrations pertaining to Landlord and/or the Project, other than such claims or disputes respecting any services or equipment used in the operation of the Building by Landlord; (20) costs

associated with the operation of the business of the partnership which constitutes Landlord as the same are distinguished from the costs of operation of the Project; (21) costs incurred in connection with the original construction of the Project; (22) costs of correcting defects in or inadequacy of the initial design or construction of the Project; (23) costs incurred to (i) comply with laws relating to the removal of any "Hazardous Material," as that term is defined in Article 28 of this Lease, which was in existence on the Project prior to the Commencement Date, and was of such a nature that a federal, state or municipal governmental authority, if it had then had knowledge of the presence of such Hazardous Material, in the state, and under the conditions that it then existed on the Project, would have then required the removal of such Hazardous Material or other remedial or containment action with respect thereto, and (ii) remove, remedy, contain, or treat any Hazardous Material, which Hazardous Material is brought onto the Project after the date hereof by Landlord or any other tenant of the Project and is of such a nature, at that time, that a federal, state or municipal governmental authority, if it had then had knowledge of the presence of such Hazardous Material, in the state, and under the conditions, that it then exists on the Project, would have then required the removal of such Hazardous Material or other remedial or containment action with respect thereto; (24) costs incurred due to violation by Landlord or any tenant of the terms and conditions of any lease; (25) any overhead and/or profit increment paid to Landlord or to subsidiaries of affiliates of Landlord for services or materials in the Project to the extent the same exceeds the amount which would generally be expected to be the cost of such services or materials rendered or provided by comparably qualified unaffiliated third parties; (26) any reserves for equipment or capital replacement; and (27) Landlord's costs of any services sold or provided to tenants or other occupants to the extent Landlord is entitled to be reimbursed by such tenants or other occupants as an additional charge or rental (other than pursuant to a comparable Direct Cost provision under the lease or other agreement with such tenant or other occupant).

(d) Determination of Payment.

(i) If for any calendar year ending or commencing within the Term, Tenant's Proportionate Share of Direct Costs for such calendar year exceeds Tenant's Proportionate Share of Direct Costs for the Base Year, then Tenant shall pay to Landlord, in the manner set forth in Sections 3(d)(ii) and (Hi), below, and as Additional Rent, an amount equal to the excess (the "Excess").

(ii) Landlord shall give Tenant a yearly expense estimate statement (the "Estimate Statement") which shall set forth Landlord's reasonable estimate (the "Estimate") of what the total amount of Direct Costs for the then-current calendar year shall be and the estimated Excess (the "Estimated Excess") as calculated by comparing Tenant's Proportionate Share of Direct Costs for such calendar year, which shall be based upon the Estimate, to Tenant's Proportionate Share of Direct Costs for the Base Year. Landlord shall use reasonable efforts to provide the Estimate Statement on or before June 30 of each year after the Base Year; however, the failure of Landlord to timely furnish the Estimate Statement for any calendar year shall not preclude Landlord from subsequently enforcing its rights to collect any Estimated Excess under this Article 3, once such Estimated Excess has been determined by Landlord. If pursuant to the Estimate Statement an Estimated Excess is calculated for the then-current calendar year, Tenant shall pay, with its next installment of Monthly Basic Rental due, a fraction of the Estimated Excess for the then-current calendar

year (reduced by any amounts paid pursuant to the last sentence of this Section 3(d)(ii)). Such fraction shall have as its numerator the number of months which have elapsed in such current calendar year to the month of such payment, both months inclusive, and shall have twelve (12) as its denominator. Until a new Estimate Statement is furnished, Tenant shall pay monthly, with the Monthly Basic Rental installments, an amount equal to one-twelfth (1/12) of the total Estimated Excess set forth in the previous Estimate Statement delivered by Landlord to Tenant.

(iii) In addition, Landlord shall endeavor to give to Tenant as soon as reasonably practicable following the end of each calendar year, a statement (the "Statement") which shall state the Direct Costs incurred or accrued for such preceding calendar year, and which shall indicate the amount, if any, of the Excess. Upon receipt of the Statement for each calendar year during the Term, if amounts paid by Tenant as Estimated Excess are less than the actual Excess as specified on the Statement, Tenant shall pay, with its next installment of monthly Basic Rental due, the full amount of the Excess for such calendar year, less the amounts, if any, paid during such calendar year as Estimated Excess. If, however, the Statement indicates that amounts paid by Tenant as Estimated Excess are greater than the actual Excess as specified on the Statement, such overpayment shall be credited against Tenant's next installments of Estimated Excess. Landlord shall use reasonable efforts to provide the Statement on or before June 30 of each year after the Base Year and shall in any event provide the Statement on or before December 31 of each year after the Base Year; however, the failure of Landlord to timely furnish the Statement for any calendar year shall not prejudice Landlord from enforcing its rights under this Article 3 for a period of two (2) years after the expiration of the calendar year for which the Statement applies, except where the failure to timely furnish the Statement as to any particular item includable in the Statement is beyond Landlord's reasonable control (e.g. tax assessments that are late in arriving from the assessor), in which case such two (2) year limit shall not be applicable. Even though the Term has expired and Tenant has vacated the Premises, when the final determination is made of Tenant's Proportionate Share of the Direct Costs for the calendar year in which this Lease terminates, if an Excess is present, Tenant shall immediately pay to Landlord an amount as calculated pursuant to the provisions of this Section 3(d). The provisions of this Section 3(d)(iii) shall survive the expiration or earlier termination of the Term.

(iv) If the Project is a part of a multi-building development, those Direct Costs attributable to such development as a whole (and not attributable solely to any individual building therein) shall be allocated by Landlord to the Project and to the other buildings within such development on an equitable basis.

(e) Audit Right. Within one hundred twenty (120) days after receipt of a Statement by Tenant ("Review Period"), if Tenant disputes the amount set forth in the Statement, Tenant's employees or an independent certified public accountant (which accountant is a member of a nationally or regionally recognized accounting firm and is not retained on a contingency fee basis), designated by Tenant, may, after reasonable notice to Landlord and at reasonable times, inspect Landlord's records at Landlord's offices, provided that Tenant is not then in default after expiration of all applicable cure periods (although Tenant shall be entitled to make payments "under protest" thereby preserving Tenant's right to contest such payments) and provided further that Tenant and such accountant or representative shall, and each of them shall use their commercially reasonable efforts to cause their respective agents and employees to, maintain all information contained in Landlord's records in strict

confidence. Notwithstanding the foregoing, Tenant shall only have the right to review Landlord's records one (1) time during any twelve (12) month period. Tenant's failure to dispute the amounts set forth in any Statement within the Review Period shall be deemed to be Tenant's approval of such Statement and Tenant, thereafter, waives the right or ability to dispute the amounts set forth in such Statement. If after such inspection, but within thirty (30) days after the Review Period, Tenant notifies Landlord in writing that Tenant still disputes such amounts, a certification as to the proper amount shall be made in accordance with Landlord's standard accounting practices, at Tenant's expense, by an independent certified public accountant selected by Landlord and who is a member of a nationally or regionally recognized accounting firm. Landlord shall cooperate in good faith with Tenant and the accountant to show Tenant and the accountant the information upon which the certification is to be based. However, if such certification by the accountant proves that the Direct Costs set forth in the Statement were overstated by more than ten percent (10%), then the cost of the accountant and the cost of such certification shall be paid for by Landlord. Promptly following the parties receipt of such certification, the parties shall make such appropriate payments or reimbursements, as the case may be, to each other, as are determined to be owing pursuant to such certification.

#### ARTICLE 4

##### SECURITY DEPOSIT

Tenant has deposited with Landlord the sum set forth in Article 1.F. of the Basic Lease Provisions as security for the full and faithful performance of every provision of this Lease to be performed by Tenant. If Tenant breaches any provision of this Lease, including but not limited to the payment of rent, Landlord may use all or any part of this security deposit for the payment of any rent or any other sums in default, or to compensate Landlord for any other loss or damage which Landlord may suffer by reason of Tenant's default. If any portion of said deposit is so used or applied, Tenant shall, within five (5) days after written demand therefor, deposit cash with Landlord in an amount sufficient to restore the security deposit to its full amount. Tenant agrees that Landlord shall not be required to keep the security deposit in trust, segregate it or keep it separate from Landlord's general funds, but Landlord may commingle the security deposit with its general funds and Tenant shall not be entitled to interest on such deposit. At the expiration of the Term, or earlier termination of this Lease (including any termination under Article 33 below), and provided there exists no default by Tenant hereunder, the security deposit or any balance thereof shall be returned to Tenant (or, at Landlord's option, to Tenant's "Transferee", as such term is defined in Article 15 below), provided that subsequent to the expiration of this Lease, Landlord may retain from said security deposit (i) an amount reasonably estimated by Landlord to cover potential Direct Cost reconciliation payments due with respect to the calendar year in which this Lease terminates or expires (such amount so retained shall not, in any event, exceed ten percent (10%) of estimated Direct Cost payments due from Tenant for such calendar year through the date of expiration or earlier

termination of this Lease and any amounts so retained and not applied to such reconciliation shall be returned to Tenant within thirty (30) days after Landlord's delivery of the Statement for such calendar year), (ii) any and all amounts reasonably estimated by Landlord to cover the anticipated costs to be incurred by Landlord to remove any signage provided to Tenant under this Lease, to remove cabling and other items required to be removed by Tenant under Section 29(b) below and to repair any damage caused by such removal (in which case any excess amount so retained by Landlord shall be returned to Tenant within thirty (30) days after such removal and repair), and (iii) any and all amounts permitted by law or this Article 4. Notwithstanding anything to the contrary contained in this Article 4, in the event that Tenant, at the expiration of the twelfth (12th) and thirteenth (13th) full calendar months of the Lease Term is not in default of any of its obligations under this Lease after expiration of applicable cure periods, Landlord shall reduce the amount of the Security Deposit by the amount of the monthly Basic Rental due and payable to Landlord for such months and Landlord shall apply such amounts against Tenant's monthly Basic Rental obligations for such months. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code and all other provisions of law, now or hereafter in effect, which provide that Landlord may claim from a security deposit only those sums reasonably necessary to remedy defaults in the payment of rent, to repair damage caused by Tenant or to clean the Premises, it being agreed that Landlord may, in addition, claim those sums specified in this Article 4 above, all of Landlord's damages under this Lease and California law including, but not limited to, any damages accruing upon termination of this Lease in accordance with this Lease and Section 1951.2 of the California Civil Code and/or those sums reasonably necessary to compensate Landlord for any other loss or damage, foreseeable or unforeseeable, caused by the acts or omissions of Tenant or any officer, employee, agent, contractor or invitee of Tenant.

#### ARTICLE 5

##### HOLDING OVER

Should Tenant, without Landlord's written consent, hold over after termination of this Lease, Tenant shall become a tenant at sufferance upon each and all of the terms herein provided as may be applicable to such a tenancy and any such holding over shall not constitute an extension of this Lease. During such holding over, Tenant shall pay in advance, monthly, Basic Rental at a rate equal to one hundred fifty percent (150%) of the rate in effect for the last month of the Term of this Lease, in addition to, and not in lieu of, all other payments required to be made by Tenant hereunder including but not limited to Tenant's Proportionate Share of any increase in Direct Costs. Nothing contained in this Article 5 shall be construed as consent by Landlord to any holding over of the Premises by Tenant, and Landlord expressly reserves the right to require Tenant to surrender possession of the Premises to Landlord as provided in this Lease upon the expiration or earlier termination of the Term. If Tenant fails to surrender the Premises upon the expiration or termination of this Lease, Tenant agrees to indemnify, defend and hold Landlord harmless from all costs, loss, expense or liability, including without limitation, claims made by any succeeding tenant and real estate brokers claims and attorney's fees and costs.

#### ARTICLE 6

##### OTHER TAXES

Tenant shall pay, prior to delinquency, all taxes assessed against or levied upon trade fixtures, furnishings, equipment and all other personal property of Tenant located in the Premises. In the event any or all of Tenant's trade fixtures, furnishings, equipment and other personal property shall be assessed and taxed with property of Landlord, or if the cost or value of any

leasehold improvements in the Premises exceeds the cost or value of a Project-standard buildout as determined by Landlord and, as a result, real property taxes for the Project are increased, Tenant shall pay to Landlord, within ten (10) days after delivery to Tenant by Landlord of a written statement setting forth such amount, the amount of such taxes applicable to Tenant's property or above-standard improvements. Tenant shall assume and pay to Landlord at the time Basic Rental next becomes due (or if assessed after the expiration of the Term, then within ten (10) days), any excise, sales, use, rent, occupancy, garage, parking, gross receipts or other taxes (other than net income taxes) which may be assessed against or levied upon Landlord on account of the letting of the Premises or the payment of Basic Rental or any other sums due or payable hereunder, and which Landlord may be required to pay or collect under any law now in effect or hereafter enacted. In addition to Tenant's obligation pursuant to the immediately preceding sentence, Tenant shall pay directly to the party or entity entitled thereto all business license fees, gross receipts taxes and similar taxes and impositions which may from time to time be assessed against or levied upon Tenant, as and when the same become due and before delinquency. Notwithstanding anything to the contrary contained herein, any sums payable by Tenant under this Article 6 shall not be included in the computation of "Tax Costs."

#### ARTICLE 7

##### USE

Tenant shall use and occupy the Premises only for the use set forth in Article 1.G. of the Basic Lease Provisions and shall not use or occupy the Premises or permit the same to be used or occupied for any other purpose without the prior written consent of Landlord, which consent may be given or withheld in Landlord's sole and absolute discretion, and Tenant agrees that it will use the Premises in such a manner so as not to interfere with or infringe upon the rights of other tenants or occupants in the Project. Tenant shall, at its sole cost and expense, promptly comply with all laws, statutes, ordinances, governmental regulations or requirements now in force or which may hereafter be in force relating to or affecting (i) the condition, use or occupancy of the Premises or the Project (excluding structural changes to the Project not related to Tenant's particular use of the Premises), and (ii) improvements installed or constructed in the Premises by or for the benefit of Tenant. Tenant shall not permit more than six (6) people per one thousand (1,000) rentable square feet of the Premises to occupy the Premises at any time. Tenant shall not do or permit to be done anything which would invalidate or increase the cost of any fire and extended coverage insurance policy covering the Project and/or the property located therein and Tenant shall comply with all rules, orders, regulations and requirements of any organization which sets out standards, requirements or recommendations commonly referred to by major fire insurance underwriters, and Tenant shall promptly upon demand reimburse Landlord for any additional premium charges for any such insurance policy assessed or increased by reason of Tenant's failure to comply with the provisions of this Article.

#### ARTICLE 8

##### CONDITION OF PREMISES

Landlord shall ensure that the systems of the Project serving the Premises are in good working order as of the Commencement Date. Tenant hereby agrees that except as provided in this Article 8 above and in the Tenant Work Letter attached hereto as Exhibit "D" and made a part hereof, the Premises shall be

taken "as is", "with all faults", "without any representations or warranties", and Tenant hereby agrees and warrants that it has investigated and inspected the condition of the Premises and the suitability of same for Tenant's purposes, and Tenant does hereby waive and disclaim any objection to, cause of action based upon, or claim that its obligations hereunder should be reduced or limited because of the condition of the Premises or the Project or the suitability of same for Tenant's purposes. Tenant acknowledges that neither Landlord nor any agent nor any employee of Landlord has made any representations or warranty with respect to the Premises or the Project or with respect to the suitability of either for the conduct of Tenant's business and Tenant expressly warrants and represents that Tenant has relied solely on its own investigation and inspection of the Premises and the Project in its decision to enter into this Lease and let the Premises in the above-described condition. The Premises shall be initially improved as provided in, and subject to, the Tenant Work Letter. The existing leasehold improvements in the Premises as of the date of this Lease, together with the Improvements (as defined in the Tenant Work Letter) may be collectively referred to herein as the "Tenant Improvements." Subject to the completion/correction of "punch list" items as provided in Section 6.4 of the Tenant Work Letter, the taking of possession of the Premises by Tenant shall conclusively establish that the Premises and the Project were at such time in satisfactory condition. Tenant hereby waives subsection 1 of Section 1932 and Sections 1941 and 1942 of the Civil Code of California or any successor provision of law.

## ARTICLE 9

### REPAIRS AND ALTERATIONS

(a) Landlord's Obligations. Landlord shall maintain the structural portions of the Project, including the foundation, floor/ceiling slabs, roof, curtain wall, exterior glass, columns, beams, shafts, stairs, stairwells, elevator cabs and common areas, and shall also maintain and repair the basic mechanical, electrical, life safety, plumbing, sprinkler systems and heating, ventilating and air-conditioning systems (provided, however, that Landlord's obligation with respect to any such systems shall be to repair and maintain those portions of the systems located in the core of the Project or in other areas outside of the Premises, but Tenant shall be responsible to repair and maintain any distribution of such systems throughout the Premises).

(b) Tenant's Obligations. Except as expressly provided as Landlord's obligation in this Article 9, Tenant shall keep the Premises in good condition and repair, reasonable wear and tear excepted. All damage or injury to the Premises or the Project resulting from the act or negligence of Tenant, its employees, agents or visitors, guests, invitees or licensees or by the use of the Premises, shall be promptly repaired by Tenant at its sole cost and expense, to the satisfaction of Landlord; provided, however, that for damage to the Project as a result of casualty or for any repairs that may impact the mechanical, electrical, plumbing, heating, ventilation or air-conditioning systems of the Project, Landlord shall have the right (but not the obligation) to select the contractor and oversee all such repairs. Landlord may make any repairs which are not promptly made by Tenant after Tenant's receipt of written notice and the reasonable opportunity of Tenant to make said repair within five (5) business days from receipt of said written notice, and charge Tenant for the cost thereof, which cost shall be paid by Tenant within five (5) days from invoice from Landlord. Tenant shall be responsible for the design and function of all non-standard improvements of the Premises, whether or not installed by Landlord at Tenant's request. Tenant waives all rights to make repairs at the expense of Landlord, or to deduct the cost thereof from the rent.

(c) Alterations. Tenant shall make no alterations, installations, changes or additions in or to the Premises or the Project (collectively, "Alterations") without Landlord's prior written consent, which shall not be unreasonably withheld. Notwithstanding anything to the contrary contained herein, Tenant may make strictly cosmetic changes to the finish work in the Premises (the "Cosmetic Alterations"), without Landlord's consent, provided that the aggregate cost of any such alterations does not exceed \$25,000.00 in any twelve (12) month period, and further provided that such alterations do not (i) require any structural or other substantial modifications to the Premises, (ii) require any changes to, nor adversely affect, the systems and equipment of the Project, or (iii) affect the exterior appearance of the Project. If the contractor(s) for any such Cosmetic Alterations could potentially place a lien on the Project, Tenant shall give Landlord at least fifteen (15) days prior notice of such Cosmetic Alterations, which notice shall be accompanied by reasonably adequate evidence that such changes meet the criteria contained in this Section 9(c). Any Alterations approved by Landlord must be performed in accordance with the terms hereof, using only contractors or mechanics approved by Landlord in writing and upon the approval by Landlord in writing of fully detailed and dimensioned plans and specifications pertaining to the Alterations in question, to be prepared and submitted by Tenant at its sole cost and expense. Tenant shall at its sole cost and expense obtain all necessary approvals and permits pertaining to any Alterations approved by Landlord. Tenant shall cause all Alterations to be performed in a good and workmanlike manner, in conformance with all applicable federal, state, county and municipal laws, rules and regulations, pursuant to a valid building permit, and in conformance with Landlord's construction rules and regulations. If Landlord, in approving any Alterations, specifies a commencement date therefor, Tenant shall not commence any work with respect to such Alterations prior to such date. Tenant hereby agrees to indemnify, defend, and hold Landlord free and harmless from all liens and claims of lien, and all other liability, claims and demands arising out of any work done or material supplied to the Premises by or at the request of Tenant in connection with any Alterations.

(d) Insurance; Liens. Prior to the commencement of any Alterations, Tenant shall provide Landlord with evidence that Tenant carries "Builder's All Risk" insurance in an amount approved by Landlord covering the construction of such Alterations, and such other insurance as Landlord may reasonably require, it being understood that all such Alterations shall be insured by Tenant pursuant to Article 14 of this Lease immediately upon completion thereof. In addition, Landlord may, in its discretion, require Tenant to obtain a lien and completion bond or some alternate form of security satisfactory to Landlord in an amount sufficient to ensure the lien free completion of such Alterations and naming Landlord as a co-obligee.

(e) Costs and Fees; Removal. If permitted Alterations are made, they shall be made at Tenant's sole cost and expense and shall be and become the property of Landlord, except that Landlord may, by written notice to Tenant given at the time of Tenant's request for consent to such Alteration (provided Tenant requests that Landlord make such determination at the time of Tenant's request for consent), require Tenant at Tenant's expense to remove all partitions, counters, railings, cabling and other Alterations installed by Tenant, and to repair any damage to the Premises and the Project caused by such removal. Any and all costs attributable to or related to the applicable building codes of the city in which the Project is located (or any other authority having jurisdiction



over the Project) arising from Tenant's plans, specifications, improvements, Alterations or otherwise shall be paid by Tenant at its sole cost and expense. With regard to repairs, Alterations or any other work arising from or related to this Article 9, Landlord shall be entitled to receive an administrative/coordination fee (which fee shall vary depending upon whether or not Tenant orders the work directly from Landlord) sufficient to compensate Landlord for all overhead, general conditions, fees and other costs and expenses arising from Landlord's involvement with such work. The construction of initial improvements to the Premises shall be governed by the terms of the Tenant Work Letter and not the terms of this Article 9.

#### ARTICLE 10

##### LIENS

Tenant shall keep the Premises and the Project free from any mechanics' liens, vendors liens or any other liens arising out of any work performed, materials furnished or obligations incurred by Tenant, and Tenant agrees to defend, indemnify and hold Landlord harmless from and against any such lien or claim or action thereon, together with costs of suit and reasonable attorneys' fees and costs incurred by Landlord in connection with any such claim or action. Before commencing any work of alteration, addition or improvement to the Premises (other than Cosmetic Alterations), Tenant shall give Landlord at least ten (10) business days' written notice of the proposed commencement of such work (to afford Landlord an opportunity to post appropriate notices of non-responsibility). In the event that there shall be recorded against the Premises or the Project or the property of which the Premises is a part any claim or lien arising out of any such work performed, materials furnished or obligations incurred by Tenant and such claim or lien shall not be removed or discharged within ten (10) days of filing, Landlord shall have the right but not the obligation to pay and discharge said lien without regard to whether such lien shall be lawful or correct, or to require that Tenant promptly deposit with Landlord in cash, lawful money of the United States, one hundred fifty percent (150%) of the amount of such claim, which sum may be retained by Landlord until such claim shall have been removed of record or until judgment shall have been rendered on such claim and such judgment shall have become final, at which time Landlord shall have the right to apply such deposit in discharge of the judgment on said claim and any costs, including attorneys' fees and costs incurred by Landlord, and shall remit the balance thereof to Tenant.

#### ARTICLE 11

##### PROJECT SERVICES

(a) Basic Services. Landlord agrees to furnish to the Premises, at a cost to be included in Operating Costs, from 8:00 a.m. to 6:00 p.m. Mondays through Fridays and 8:00 a.m. to noon on Saturdays, excepting local and national holidays, air conditioning and heat all in such reasonable quantities as in the judgment of Landlord is reasonably necessary for the comfortable occupancy of the Premises. In addition, Landlord shall provide electric current for normal lighting and normal office machines, elevator service and water on the same floor as the Premises for lavatory and drinking purposes in such reasonable quantities as in the judgment of Landlord is reasonably necessary for general office use and in compliance with applicable codes. To the extent reasonably determined by Landlord to be practicable, all such electricity (including, without limitation, electricity in order to power the heating, ventilation and air conditioning system serving the Premises), shall be separately metered or submetered and Tenant shall make payment directly to the entity providing such

electricity if such separate meters are installed. If, however, separate meters are not installed and the Premises are submetered or are jointly metered, then Landlord shall determine and Tenant shall pay the amount reasonably determined by Landlord to be Tenant's equitable share of the monthly charge for such electricity, as Additional Rent. Tenant shall be solely responsible for retaining a bonded janitorial company to provide janitorial service to the Premises on a regular basis as reasonably approved by Landlord and Landlord shall have no obligation to provide janitorial services to the Premises. Tenant shall comply with all rules and regulations which Landlord may establish for the proper functioning and protection of the common area air conditioning, heating, elevator, electrical, intrabuilding cabling and wiring and plumbing systems. Landlord shall not be liable for, and there shall be no rent abatement as a result of, any stoppage, reduction or interruption of any such services caused by governmental rules, regulations or ordinances, riot, strike, labor disputes, breakdowns, accidents, necessary repairs or other cause. Except as specifically provided in this Article 11, Tenant agrees to pay for all utilities and other services utilized by Tenant and any additional building services furnished to Tenant which are not uniformly furnished to all tenants of the Project, at the rate generally charged by Landlord to tenants of the Project for such utilities or services.

(b) Excess Usage. Tenant will not, without the prior written consent of Landlord, use any apparatus or device in the Premises which will in any way increase the amount of electricity or water usually furnished or supplied for use of the Premises as general office space; nor connect any apparatus, machine or device with water pipes or electric current (except through existing electrical outlets in the Premises), for the purpose of using electric current or water.

(c) Additional Electrical Service. If Tenant shall require electric current in excess of that which Landlord is obligated to furnish under Section 1.1(a) above, Tenant shall first obtain the written consent of Landlord, which Landlord may refuse in its reasonable discretion; provided, however, that Tenant shall be responsible for the cost of any additional equipment required in order to provide such additional electric current.

(d) HVAC Balance. If any lights, machines or equipment (including but not limited to computers and computer systems and appurtenances) are used by Tenant in the Premises which materially affect the temperature otherwise maintained by the air conditioning system, or generate substantially more heat in the Premises than would be generated by the building standard lights and usual office equipment, Landlord shall have the right to install any machinery and equipment which Landlord reasonably deems necessary to restore temperature balance, including but not limited to modifications to the standard air conditioning equipment, and the cost thereof, including the cost of installation and any additional cost of operation and maintenance occasioned thereby, shall be paid by Tenant to Landlord upon demand by Landlord.

(e) Telecommunications. Upon request from Tenant from time to time, Landlord will provide Tenant with a listing of telecommunications and media service providers serving the Project, and Tenant shall have the right to contract directly with the providers of its choice. Landlord confirms to Tenant that SBC and Time Warner Telecom are currently providers serving the Project. If Tenant wishes to contract with or obtain service from any provider which does not currently serve the Project or wishes to obtain from an existing carrier services which will require the installation of additional equipment, such

provider must, prior to providing service, enter into a written agreement with Landlord setting forth the terms and conditions of the access to be granted to such provider. In considering the installation of any new or additional telecommunications cabling or equipment at the Project, Landlord will consider all relevant factors in a reasonable and non-discriminatory manner, including, without limitation, the existing availability of services at the Project, the impact of the proposed installations upon the Project and its operations and the available space and capacity for the proposed installations. Landlord may also consider whether the proposed service may result in interference with or interruption of other services at the Project or the business operations of other tenants or occupants of the Project. In no event shall Landlord be obligated to incur any costs or liabilities in connection with the installation or delivery of telecommunication services or facilities at the Project. All such installations shall be subject to Landlord's prior approval and shall be performed in accordance with the terms of Article 9. If Landlord approves the proposed installations in accordance with the foregoing, Landlord will deliver its standard form agreement upon request and will use commercially reasonable efforts to promptly enter into an agreement on reasonable and non-discriminatory terms with a qualified, licensed and reputable carrier confirming the terms of installation and operation of telecommunications equipment consistent with the foregoing.

(f) After-Hours Use. If Tenant requires heating, ventilation and/or air conditioning during times other than the times provided in Section 11(a) above, Tenant shall give Landlord such advance notice as Landlord shall reasonably require and shall pay Landlord's standard charge for such after-hours use.

(g) Reasonable Charges. Landlord may impose a reasonable charge for any utilities or services (other than electric current and heating, ventilation and/or air conditioning which shall be governed by Sections 11(c) and (f) above) utilized by Tenant in excess of the amount or type that Landlord reasonably determines is typical for general office use.

(h) Sole Electrical Representative. Tenant agrees that Landlord shall be the sole and exclusive representative with respect to, and shall maintain exclusive control over, the reception, utilization and distribution of electrical power, regardless of point or means or origin, use or generation. Tenant shall not have the right to contract directly with any provider of electrical power or services.

(i) Independent HVAC Unit. Tenant shall be entitled to have Landlord install, as an initial Improvement, a dedicated heating, ventilation and air conditioning unit ("Package Unit") within the Premises with specifications reasonably determined by Landlord and at Landlord's sole cost and expense. If Tenant elects to install a Package Unit within the Premises, Landlord shall also install, at Landlord's sole cost and expense, a separate meter or at Landlord's option, submeter, in order to measure the amount of electricity furnished to such unit and Tenant shall be responsible for Landlord's actual cost of supplying electricity to such unit as reflected by such meter or submeter, which amounts shall be payable on a monthly basis as Additional Rent. Tenant shall be solely responsible for maintenance and repair of the Package Unit and such unit shall, at Landlord's option, be considered to be a fixture within the Premises and shall remain upon the Premises upon the expiration or earlier termination of the Lease Term or any applicable Option Term.

ARTICLE 12

RIGHTS OF LANDLORD

(a) Right of Entry. Landlord and its agents shall have the right to enter the Premises at all reasonable times upon twenty-four (24) hours prior notice (except that no notice shall be required in the case of an emergency) for the purpose of examining or inspecting the same, serving or posting and keeping posted thereon notices as provided by law, or which Landlord deems necessary for the protection of Landlord or the Project, showing the same to prospective tenants (during the last nine (9) months of the Lease Term), lenders or purchasers of the Project, in the case of an emergency, and for making such alterations, repairs, improvements or additions to the Premises or to the Project as Landlord may deem necessary or desirable. If Tenant shall not be personally present to open and permit an entry into the Premises at any time when such an entry by Landlord is necessary or permitted hereunder, Landlord may enter by means of a master key, or may forcibly enter in the case of an emergency, in each event without liability to Tenant and without affecting this Lease.

(b) Maintenance Work. Landlord reserves the right from time to time, but subject to payment by and/or reimbursement from Tenant as otherwise provided herein: (i) to install, use, maintain, repair, replace, relocate and control for service to the Premises and/or other parts of the Project pipes, ducts, conduits, wires, cabling, appurtenant fixtures, equipment spaces and mechanical systems, wherever located in the Premises or the Project, (ii) to alter, close or relocate any facility in the Premises or the common areas or otherwise conduct any of the above activities for the purpose of complying with a general plan for fire/life safety for the Project or otherwise, and (iii) to comply with any federal, state or local law, rule or order. Landlord shall attempt to perform any such work with the least inconvenience to Tenant as is reasonably practicable, but in no event shall Tenant be permitted to withhold or reduce Basic Rental or other charges due hereunder as a result of same, make any claim for constructive eviction or otherwise make any claim against Landlord for interruption or interference with Tenant's business and/or operations.

(c) Rooftop. If Tenant desires to use the rooftop of the Project for any purpose, including the installation of communication equipment to be used from the Premises, such rights will be granted in Landlord's sole discretion and Tenant must negotiate the terms of any rooftop access with Landlord or the rooftop management company or lessee holding rights to the rooftop from time to time. Any rooftop access granted to Tenant will be at prevailing rates and will be governed by the terms of a separate written agreement or an amendment to this Lease.

ARTICLE 13

INDEMNITY; EXEMPTION OF LANDLORD FROM LIABILITY

(a) Indemnity. Tenant shall indemnify, defend and hold Landlord, Arden Realty, Inc., Arden Realty Limited Partnership, their subsidiaries, partners, affiliates and their respective officers, directors, employees and contractors (collectively, "Landlord Parties") harmless from any and all claims arising from Tenant's use of the Premises or the Project or from the conduct of its business or from any activity, work or thing which may be permitted or suffered by Tenant in or about the Premises or the Project and shall further indemnify, defend and hold Landlord and the Landlord Parties harmless from and against any and all claims arising from any breach or default in the performance of any obligation on Tenant's part to be performed under this Lease or arising from any negligence or willful misconduct of Tenant or any of its agents, contractors, employees or invitees, patrons, customers or members in or about the Project and from any and all costs, attorneys' fees and costs, expenses and liabilities incurred in the defense of any claim or any action or proceeding brought thereon, including negotiations in connection therewith. Tenant hereby assumes all risk of damage to property or injury to persons in or about the Premises from any cause, and Tenant hereby waives all claims in respect thereof against Landlord and the Landlord Parties, excepting where the damage is caused solely by the gross negligence or willful misconduct of Landlord or the Landlord Parties.

(b) Exemption of Landlord from Liability. Landlord and the Landlord Parties shall not be liable for injury to Tenant's business, or loss of income therefrom, however occurring (including, without limitation, from any failure or interruption of services or utilities or as a result of Landlord's negligence), or, except in connection with damage or injury resulting from the gross negligence or willful misconduct of Landlord or the Landlord Parties, for damage that may be sustained by the person, goods, wares, merchandise or property of Tenant, its employees, invitees, customers, agents, or contractors, or any other person in, on or about the Premises directly or indirectly caused by or resulting from any cause whatsoever, including, but not limited to, fire, steam, electricity, gas, water, or rain which may leak or flow from or into any part of the Premises, or from the breakage, leakage, obstruction or other defects of the pipes, sprinklers, wires, appliances, plumbing, air conditioning, light fixtures, or mechanical or electrical systems, or from intrabuilding cabling or wiring, whether such damage or injury results from conditions arising upon the Premises or upon other portions of the Project or from other sources or places and regardless of whether the cause of such damage or injury or the means of repairing the same is inaccessible to Tenant. Landlord and the Landlord Parties shall not be liable to Tenant for any damages arising from any willful or negligent action or inaction of any other tenant of the Project.

(c) Security. Tenant acknowledges that Landlord's election whether or not to provide any type of mechanical surveillance or security personnel whatsoever in the Project is solely within Landlord's discretion; Landlord and the Landlord Parties shall have no liability in connection with the provision, or lack, of such services, and Tenant hereby agrees to hold Landlord and the Landlord Parties harmless with regard to any such potential claim. Landlord and the Landlord Parties shall not be liable for losses due to theft, vandalism, or like causes. Tenant shall defend, indemnify, and hold Landlord and the Landlord Parties harmless from any such claims made by any employee, licensee, invitee, contractor, agent or other person whose presence in, on or about the Premises or the Project is attendant to the business of Tenant.

ARTICLE 14

INSURANCE

(a) Tenant's Insurance. Tenant, shall at all times during the Term of this Lease, and at its own cost and expense, procure and continue in force the following insurance coverage: (i) Commercial General Liability Insurance, written on an occurrence basis, with a combined single limit for bodily injury and property damages of not less than Two Million Dollars (\$2,000,000) per occurrence and Three Million Dollars (\$3,000,000) in the annual aggregate, including products liability coverage if applicable, blanket contractual coverage including written contracts, and personal injury coverage, covering the performance of Tenant of the indemnity and exemption of Landlord from liability agreements set forth in Article 13 hereof; (ii) a policy of standard fire, extended coverage and special extended coverage insurance (all risks), including a vandalism and malicious mischief endorsement and sprinkler leakage coverage where sprinklers are provided in an amount equal to the full replacement value new without deduction for depreciation of all (A) Tenant Improvements, Alterations, fixtures and other improvements in the Premises, including but not limited to all mechanical, plumbing, heating, ventilating, air conditioning, electrical, telecommunication and other equipment, systems and facilities, and (B) trade fixtures, furniture, equipment and other personal property installed by or at the expense of Tenant; (iii) Worker's Compensation coverage as required by law; and (iv) business interruption, loss of income and extra expense insurance covering any failure or interruption of Tenant's business equipment (including, without limitation, telecommunications equipment) and covering all other perils, failures or interruptions in an amount of not less than Five Hundred Thousand Dollars (\$500,000.00). Tenant shall carry and maintain during the entire Term (including any option periods, if applicable), at Tenant's sole cost and expense, increased amounts of the insurance required to be carried by Tenant pursuant to this Article 14 and such other reasonable types of insurance coverage and in such reasonable amounts covering the Premises and Tenant's operations therein, as may be reasonably required by Landlord, but Landlord shall only be entitled to require such increased amounts and/or other coverages if they are then generally required by owners of comparable office buildings in the San Diego, California area.

(b) Form of Policies. The aforementioned minimum limits of policies and Tenant's procurement and maintenance thereof shall in no event limit the liability of Tenant hereunder. The Commercial General Liability Insurance policy shall name Landlord, the Landlord Parties, Landlord's property manager, Landlord's lender(s) and such other persons or firms as Landlord specifies from time to time, as additional insureds with an appropriate endorsement to the policy(s). All such insurance policies carried by Tenant shall be with companies having a rating of not less than A-VIII in Best's Insurance Guide. Tenant shall furnish to Landlord, from the insurance companies, or cause the insurance companies to furnish, certificates of coverage. No such policy shall be cancelable or subject to reduction of coverage or other modification or cancellation except after thirty (30) days prior written notice to Landlord by the insurer. All such policies shall be endorsed to agree that Tenant's policy is primary as to claims arising within the Premises and that any insurance carried by Landlord is excess and not contributing with any Tenant insurance

requirement hereunder. Tenant shall, at least twenty (20) days prior to the expiration of such policies, furnish Landlord with renewals or binders. Tenant agrees that if Tenant does not take out and maintain such insurance or furnish Landlord with renewals or binders in a timely manner, upon notice to Tenant and the expiration of a three (3) business day cure period, Landlord may (but shall not be required to) procure said insurance on Tenant's behalf and charge Tenant the cost thereof, which amount shall be payable by Tenant upon demand with interest (at the rate set forth in Section 20(e) below) from the date such sums are expended. Tenant shall have the right to provide such insurance coverage pursuant to blanket policies obtained by Tenant, provided such blanket policies expressly afford coverage to the Premises and to Tenant as required by this Lease.

(c) Landlord's Insurance. Landlord may, as a cost to be included in Operating Costs, procure and maintain at all times during the Term of this Lease, a policy or policies of insurance covering loss or damage to the Project in the amount of the full replacement costs without deduction for depreciation thereof, providing protection against all perils included within the classification of fire and extended coverage, vandalism coverage and malicious mischief, sprinkler leakage, water damage, and special extended coverage on the building. Additionally, Landlord may carry: (i) Bodily Injury and Property Damage Liability Insurance and/or Excess Liability Coverage Insurance; and (ii) Earthquake and/or Flood Damage Insurance; and (iii) Rental Income Insurance; and (iv) any other forms of insurance Landlord may deem appropriate or any lender may require. However, notwithstanding the foregoing, Landlord shall either carry, or shall be deemed to have elected to self-insure, the Bodily Injury and Property Damage Liability Insurance coverage described in subsection (i) of the immediately preceding sentence, and if Landlord elects to self-insure any or all of such coverage, Tenant shall be deemed to be in the same position it would have been in had Landlord actually purchased such insurance from a third party carrier. The costs of all insurance carried by Landlord shall be included in Operating Costs.

(d) Waiver of Subrogation. Landlord and Tenant each agree to require their respective insurers issuing the insurance described in Sections 14(a)(ii), 14(a)(iv) and the first sentence of Section 14(c), waive any rights of subrogation that such companies may have against the other party. Tenant hereby waives any right that Tenant may have against Landlord and Landlord hereby waives any right that Landlord may have against Tenant as a result of any loss or damage to the extent such loss or damage is insurable under such policies.

(e) Compliance with Law. Tenant agrees that it will not, at any time, during the Term of this Lease, carry any stock of goods or do anything in or about the Premises that will in any way tend to increase the insurance rates upon the Project. Tenant agrees to pay Landlord forthwith upon demand the amount of any increase in premiums for insurance that may be carried during the Term of this Lease, or the amount of insurance to be carried by Landlord on the Project resulting from the foregoing, or from Tenant doing any act in or about the Premises that does so increase the insurance rates, whether or not Landlord shall have consented to such act on the part of Tenant. If Tenant installs upon the Premises any electrical equipment which causes an overload of electrical lines of the Premises, Tenant shall at its own cost and expense, in accordance with all other Lease provisions (specifically including, but not limited to, the provisions of Article 9, 10 and 11 hereof), make whatever changes are necessary to comply with requirements of the insurance underwriters and any governmental authority having jurisdiction thereover, but nothing herein contained shall be deemed to constitute Landlord's consent to such overloading. Tenant shall, at its own expense, comply with all insurance requirements applicable to the Premises including, without limitation, the installation of fire extinguishers or an automatic dry chemical extinguishing system.

ARTICLE 15

ASSIGNMENT AND SUBLETTING

Tenant shall have no power to, either voluntarily, involuntarily, by operation of law or otherwise, sell, assign, transfer or hypothecate this Lease, or sublet the Premises or any part thereof, or permit the Premises or any part thereof to be used or occupied by anyone other than Tenant or Tenant's employees without the prior written consent of Landlord, which consent shall not be unreasonably withheld. If Tenant is a corporation, unincorporated association, partnership or limited liability company, the sale, assignment, transfer or hypothecation of any class of stock or other ownership interest in such corporation, association, partnership or limited liability company in excess of twenty-five percent (25%) in the aggregate shall be deemed a "Transfer" within the meaning and provisions of this Article 15. Tenant may transfer its interest pursuant to this Lease only upon the following express conditions, which conditions are agreed by Landlord and Tenant to be reasonable:

(a) That the proposed Transferee (as hereafter defined) shall be subject to the prior written consent of Landlord, which consent will not be unreasonably withheld but, without limiting the generality of the foregoing, it shall be reasonable for Landlord to deny such consent if:

(i) The use to be made of the Premises by the proposed Transferee is (a) not generally consistent with the character and nature of all other tenancies in the Project, or (b) a use which conflicts with any so-called "exclusive" then in favor of, or for any use which might reasonably be expected to diminish the rent payable pursuant to any percentage rent lease with another tenant of the Project or any other buildings which are in the same complex as the Project, or (c) a use which would be prohibited by any other portion of this Lease (including but not limited to any Rules and Regulations then in effect);

(ii) The financial responsibility of the proposed Transferee is not reasonably satisfactory to Landlord or in any event not at least equal to those which were possessed by Tenant as of the date of execution of this Lease;

(iii) The proposed Transferee is either a governmental agency or instrumentality thereof; or

(iv) Either the proposed Transferee or any person or entity which directly or indirectly controls, is controlled by or is under common control with the proposed Transferee (A) occupies space in the Project at the time of the request for consent, or (B) is negotiating with Landlord or has negotiated with Landlord during the six (6) month period immediately preceding the date of the proposed Transfer, to lease space in the Project.



(b) Upon Tenant's submission of a request for Landlord's consent to any such Transfer, Tenant shall pay to Landlord Landlord's then standard processing fee and reasonable attorneys' fees and costs incurred in connection with the proposed Transfer, which the parties hereby stipulate to be \$1,000,00, unless Landlord provides to Tenant evidence that Landlord has incurred greater costs in connection with the proposed Transfer;

(c) That the proposed Transferee shall execute an agreement pursuant to which it shall agree to perform faithfully and be bound by all of the terms, covenants, conditions, provisions and agreements of this Lease applicable to that portion of the Premises so transferred; and

(d) That an executed duplicate original of said assignment and assumption agreement or other transfer on a form reasonably approved by Landlord, shall be delivered to Landlord within five (5) days after the execution thereof, and that such transfer shall not be binding upon Landlord until the delivery thereof to Landlord and the execution and delivery of Landlord's consent thereto. It shall be a condition to Landlord's consent to any subleasing, assignment or other transfer of part or all of Tenant's interest in the Premises ("Transfer") that (i) upon Landlord's consent to any Transfer, Tenant shall pay and continue to pay fifty percent (50%) of any "Transfer Premium" (defined below), received by Tenant from the transferee; (ii) any sublessee of part or all of Tenant's interest in the Premises shall agree that in the event Landlord gives such sublessee notice that Tenant is in default under this Lease, such sublessee shall thereafter make all sublease or other payments directly to Landlord, which will be received by Landlord without any liability whether to honor the sublease or otherwise (except to credit such payments against sums due under this Lease), and any sublessee shall agree to attorn to Landlord or its successors and assigns at their request should this Lease be terminated for any reason, except that in no event shall Landlord or its successors or assigns be obligated to accept such attornment; (iii) any such Transfer and consent shall be effected on forms supplied by Landlord and/or its legal counsel; (iv) Landlord may require that Tenant not then be in default hereunder in any respect; and (v) Tenant or the proposed subtenant or assignee (collectively, "Transferee") shall agree to pay Landlord, upon demand, as Additional Rent, a sum equal to the additional costs, if any, incurred by Landlord for maintenance and repair as a result of any change in the nature of occupancy caused by such subletting or assignment "Transfer Premium" shall mean all rent, Additional Rent or other consideration payable by a Transferee in connection with a Transfer in excess of the Basic Rental and Direct Costs payable by Tenant under this Lease during the term of the Transfer and if such Transfer is for less than all of the Premises, the Transfer Premium shall be calculated on a rentable square foot basis. "Transfer Premium" shall also include, but not be limited to, key money, bonus money or other cash consideration paid by a Transferee to Tenant in connection with such Transfer, and any payment in excess of fair market value for services rendered by Tenant to the Transferee and any payment in excess of fair market value for assets, fixtures, inventory, equipment, or furniture transferred by Tenant to the Transferee in connection with such Transfer. Any Transfer of this Lease which is not in compliance with the provisions of this Article 15 shall be voidable. by written notice from Landlord and shall, at the option of Landlord, terminate this Lease. In no event shall the consent by Landlord to any Transfer be construed as relieving Tenant or any Transferee from obtaining the express written consent of Landlord to any further Transfer, or as releasing Tenant from any liability or obligation hereunder whether or not then accrued and Tenant

shall continue to be fully liable therefor. No collection or acceptance of rent by Landlord from any person other than Tenant shall be deemed a waiver of any provision of this Article 15 or the acceptance of any Transferee hereunder, or a release of Tenant (or of any Transferee of Tenant). Notwithstanding anything to the contrary in this Lease, if Tenant or any proposed Transferee claims that Landlord has unreasonably withheld or delayed its consent under this Article 15 or otherwise has breached or acted unreasonably under this Article 15, their sole remedies shall be a declaratory judgment and an -injunction for the relief sought without any monetary damages, and Tenant hereby waives all other remedies, including, without limitation, any right at law or equity to terminate this Lease, on its own behalf and, to the extent permitted under all applicable laws, on behalf of the proposed Transferee.

Notwithstanding anything to the contrary contained in this Article 15, if Tenant contemplates a Transfer, then Tenant shall give Landlord notice (the "Intention to Transfer Notice") of such contemplated Transfer (whether or not the contemplated Transferee or the terms of such contemplated Transfer have been determined). The Intention to Transfer Notice shall specify the portion of and number of rentable square feet of the Premises which Tenant intends to Transfer (the "Contemplated Transfer Space") and the contemplated date of commencement of the contemplated Transfer (the "Contemplated Effective Date"). Thereafter, Landlord shall have the option, by giving written notice to Tenant within ten (10) business days after Landlord's receipt of the Intention to Transfer Notice, to terminate this Lease as to the Contemplated Transfer Space effective as of the Contemplated Effective Date. If this Lease shall be so terminated with respect to less than the entire Premises, the monthly Basic Rental reserved herein shall be prorated on the basis of the number of rentable square feet retained by Tenant in proportion to the number of rentable square feet contained in the entire Premises, and this Lease as so amended shall continue thereafter in full force and effect, and upon request of either party, the parties shall execute written confirmation of the same. If Landlord declines, or fails to elect in a timely manner to terminate this Lease as to the Contemplated Transfer Space under this Article 15 within such ten (10) business day period, then, provided Landlord has consented to the proposed Transfer, Tenant shall be entitled to proceed to transfer the Contemplated Transfer Space to a proposed Transferee and Landlord shall not have any right to recapture such Contemplated Transfer Space with respect to any Transfer thereof consummated within a period of six (6) months (the "Six Month Period") commencing on the expiration of such ten (10) business day period; provided, however, that any such Transfer shall be subject to other terms of this Article 15. If such a Transfer is not so consummated within the Six Month Period (or if a Transfer is so consummated, then upon the expiration of the term of any Transfer of such Contemplated Transfer Space consummated within such Six Month Period), Tenant shall again be required to submit a new Intention to Transfer Notice to Landlord with respect to any contemplated Transfer, as provided above in this Article 15.

Notwithstanding anything to the contrary contained in this Article 15, an assignment or subletting of all or a portion of the Premises to an affiliate ("Affiliate") of Tenant (an entity which is controlled by, controls, or is under common control with, Tenant), shall not be deemed a Transfer under this Article 15, provided that Tenant notifies Landlord of any such assignment or sublease and promptly supplies Landlord with any documents or information requested by Landlord regarding such assignment or sublease or such affiliate, and further provided that such assignment or sublease is not a subterfuge by Tenant to avoid its obligations under this Lease. An assignee of Tenant's entire interest in this Lease pursuant to the immediately preceding sentence may be referred to herein as an "Affiliated Assignee." "Control," as used in this Article 15, shall mean the ownership, directly or indirectly, of greater than fifty percent (50%) of the voting securities of, or possession of the right to vote, in the ordinary direction of its affairs, of greater than fifty percent (50%) of the voting interest in, an entity.

ARTICLE 16

DAMAGE OR DESTRUCTION

If the Project is damaged by fire or other insured casualty and the insurance proceeds have been made available therefor by the holder or holders of any mortgages or deeds of trust covering the Premises or the Project, the damage shall be repaired by Landlord to the extent such insurance proceeds are available therefor and provided such repairs can, in Landlord's sole opinion, be completed within two hundred seventy (270) days after the necessity for repairs as a result of such damage becomes known to Landlord, without the payment of overtime or other premiums, and until such repairs are completed rent shall be abated in proportion to the part of the Premises which is unusable by Tenant in the conduct of its business (but there shall be no abatement of rent by reason of any portion of the Premises or Project parking facility being unusable for a period equal to one (1) day or less). Furthermore, if the Project parking facility is damaged by fire or other casualty and if Landlord is unable to make arrangements for substitute parking for Tenant's employees and to the extent, as a result, Tenant does not utilize all or a portion of the Premises for the conduct of Tenant's business, Tenant's rent shall be abated in proportion to the part of the Premises which is not so used by Tenant in the conduct of its business. However, if any damage is due to the fault or neglect of Tenant, its employees, agents, contractors, guests, invitees and the like, there shall be no abatement of rent, unless and to the extent Landlord receives rental income insurance proceeds. Within sixty (60) days after the date Landlord learns of the necessity for repairs as a result of damage, Landlord shall notify Tenant ("Damage Repair Estimate") of Landlord's estimated assessment of the period of time in which the repairs will be completed. Upon the occurrence of any damage to the Premises, Tenant shall assign to Landlord (or to any party designated by Landlord) all insurance proceeds payable to Tenant under Section 14(a)(ii)(A) above; provided, however, that if the cost of repair of improvements within the Premises by Landlord exceeds the amount of insurance proceeds received by Landlord from Tenant's insurance carrier, as so assigned by Tenant, such excess costs shall be paid by Tenant to Landlord prior to Landlord's repair of such damage. If repairs cannot, in Landlord's opinion, be completed within two hundred seventy (270) days after the necessity for repairs as a result of such damage becomes known to Landlord without the payment of overtime or other premiums, Landlord may, at its option, either (i) make such repairs in a reasonable time and in such event this Lease shall continue in effect and the rent shall be abated, if at all, in the manner provided in this Article 16, or (ii) elect not to effect such repairs and instead terminate this Lease, by notifying Tenant in writing of such termination within sixty (60) days after Landlord learns of the necessity for repairs as a result of damage, such notice to include a termination date giving Tenant sixty (60) days to vacate the Premises. In addition, Landlord may elect to terminate this Lease if the Project shall be damaged by fire or other casualty or cause, whether or not the Premises are affected, if the damage is not fully covered, except for deductible amounts, by Landlord's insurance policies. However, if Landlord does not elect to terminate this Lease pursuant to Landlord's termination rights as provided

above, and if the Damage Repair Estimate indicates that repairs cannot be completed within two hundred seventy (270) days after being commenced and if such damage is not the result of the negligence or willful misconduct of Tenant or Tenant's employees, agents or contractors, Tenant may elect, not later than thirty (30) days after Tenant's receipt of the Damage Repair Estimate, to terminate this Lease by written notice to Landlord effective as of the date specified in Tenant's notice. Finally, if the Premises or the Project is damaged to any substantial extent during the last twelve (12) months of the Term, then notwithstanding anything contained in this Article 16 to the contrary, Landlord shall have the option to terminate this Lease by giving written notice to Tenant of the exercise of such option within sixty (60) days after Landlord learns of the necessity for repairs as the result of such damage. A total destruction of the Project shall automatically terminate this Lease. Except as provided in this Article 16, there shall be no abatement of rent and no liability of Landlord by reason of any injury to or interference with Tenant's business or property arising from such damage or destruction or the making of any repairs, alterations or improvements in or to any portion of the Project or the Premises or in or to fixtures, appurtenances and equipment therein. Tenant understands that Landlord will not carry insurance of any kind on Tenant's furniture, furnishings, trade fixtures or equipment, and that Landlord shall not be obligated to repair any damage thereto or replace the same. Tenant acknowledges that Tenant shall have no right to any proceeds of insurance carried by Landlord relating to property damage. With respect to any damage which Landlord is obligated to repair or elects to repair, Tenant, as a material inducement to Landlord entering into this Lease, irrevocably waives and releases its rights under the provisions of Sections 1932 and 1933 of the California Civil Code.

#### ARTICLE 17

#### SUBORDINATION

This Lease is subject and subordinate to all ground or underlying leases, mortgages and deeds of trust which affect the property or the Project, including all renewals, modifications, consolidations, replacements and extensions thereof; provided, however, if the lessor under any such lease or the holder or holders of any such mortgage or deed of trust shall advise Landlord that they desire or require this Lease to be prior and superior thereto, upon written request of Landlord to Tenant, Tenant agrees to promptly execute, acknowledge and deliver any and all documents or instruments which Landlord or such lessor, holder or holders deem necessary or desirable for purposes thereof. Landlord shall have the right to cause this Lease to be and become and remain subject and subordinate to any and all ground or underlying leases, mortgages or deeds of trust which may hereafter be executed covering the Premises, the Project or the property or any renewals, modifications, consolidations, replacements or extensions thereof, for the full amount of all advances made or to be made thereunder and without regard to the time or character of such advances, together with interest thereon and subject to all the terms and provisions thereof; provided, however, that a condition precedent to such subordination shall be that Landlord obtains from the lender or other party in question a commercially reasonable non-disturbance agreement in favor of Tenant. Subject to the foregoing, Tenant agrees, within ten (10) days after Landlord's written request therefor, to execute, acknowledge and deliver upon request any and all

documents or instruments requested by Landlord or necessary or proper to assure the subordination of this Lease to any such mortgages, deed of trust, or leasehold estates. Tenant agrees that in the event any proceedings are brought for the foreclosure of any mortgage or deed of trust or any deed in lieu thereof, to attorn to the purchaser or any successors thereto upon any such foreclosure sale or deed in lieu thereof as so requested to do so by such purchaser and to recognize such purchaser as the lessor under this Lease; Tenant shall, within five (5) days after request execute such further instruments or assurances as such purchaser may reasonably deem necessary to evidence or confirm such attornment. Tenant agrees to provide copies of any notices of Landlord's default under this Lease to any mortgagee or deed of trust beneficiary whose address has been provided to Tenant and Tenant shall provide such mortgagee or deed of trust beneficiary a commercially reasonable time after receipt of such notice within which to cure any such default. Tenant waives the provisions of any current or future statute, rule or law which may give or purport to give Tenant any right or election to terminate or otherwise adversely affect this Lease and the obligations of the Tenant hereunder in the event of any foreclosure proceeding or sale.

#### ARTICLE 18

##### EMINENT DOMAIN

If the whole of the Premises or the Project or so much of the Premises or Project parking facility as to render the Premises (or the balance thereof) unusable by Tenant shall be taken under power of eminent domain, or is sold, transferred or conveyed in lieu thereof, this Lease shall automatically terminate as of the date of such condemnation, or as of the date possession is taken by the condemning authority, at Landlord's option. No award for any partial or entire taking shall be apportioned, and Tenant hereby assigns to Landlord any award which may be made in such taking or condemnation, together with any and all rights of Tenant now or hereafter arising in or to the same or any part thereof; provided, however, that nothing contained herein shall be deemed to give Landlord any interest in or to require Tenant to assign to Landlord any award made to Tenant for the taking of personal property and trade fixtures belonging to Tenant and removable by Tenant at the expiration of the Term hereof as provided hereunder or for the interruption of, or damage to, Tenant's business. In the event of a partial taking described in this Article 18, or a sale, transfer or conveyance in lieu thereof, which does not result in a termination of this Lease, the rent shall be apportioned according to the ratio that the part of the Premises remaining useable by Tenant bears to the total area of the Premises. Tenant hereby waives any and all rights it might otherwise have pursuant to Section 1265.130 of the California Code of Civil Procedure.

#### ARTICLE 19

##### DEFAULT

Each of the following acts or omissions of Tenant or of any guarantor of Tenant's performance hereunder, or occurrences, shall constitute an "Event of Default":

(a) Failure or refusal to pay Basic Rental, Additional Rent or any other amount to be paid by Tenant to Landlord hereunder within three (3) calendar days after notice that the same is due or payable hereunder; said three (3) day period shall be in lieu of, and not in addition to, the notice requirements of Section 1161 of the California Code of Civil Procedure or any similar or successor law;

(b) Except as set forth in items (a) above and (c) through and including (f) below, failure to perform or observe any other covenant or condition of this Lease to be performed or observed within thirty (30) days following written notice to Tenant of such failure; provided, however, if the nature of such default is such that the same cannot be reasonably cured within a thirty (30) day period, Tenant shall not be deemed to be in default if Tenant diligently commences such cure within such period and thereafter diligently proceeds to rectify and cure said default. Such thirty (30) day notice shall be in lieu of, and not in addition to, any required under Section 1161 of the California Code of Civil Procedure or any similar or successor law;

(c) The taking in execution or by similar process or law (other than by eminent domain) of the estate hereby created;

(d) The filing by Tenant or any guarantor hereunder in any court pursuant to any statute of a petition in bankruptcy or insolvency or for reorganization or arrangement for the appointment of a receiver of all or a portion of Tenant's property; the filing against Tenant or any guarantor hereunder of any such petition, or the commencement of a proceeding for the appointment of a trustee, receiver or liquidator for Tenant, or for any guarantor hereunder, or of any of the property of either, or a proceeding by any governmental authority for the dissolution or liquidation of Tenant or any guarantor hereunder, if such proceeding shall not be dismissed or trusteeship discontinued within thirty (30) days after commencement of such proceeding or the appointment of such trustee or receiver; or the making by Tenant or any guarantor hereunder of an assignment for the benefit of creditors. Tenant hereby stipulates to the lifting of the automatic stay in effect and relief from such stay for Landlord in the event Tenant files a petition under the United States Bankruptcy laws, for the purpose of Landlord pursuing its rights and remedies against Tenant and/or a guarantor of this Lease;

(e) Tenant's failure to cause to be released any mechanics liens filed against the Premises or the Project within twenty (20) days after the date the same shall have been filed or recorded; or

(f) Tenant's failure to observe or perform according to the provisions of Articles 7, 14, 17 or 25 within seven (7) business days after notice from Landlord.

All defaults by Tenant of any covenant or condition of this Lease shall be deemed by the parties hereto to be material.

## ARTICLE 20

### REMEDIES

(a) Upon the occurrence of an Event of Default under this Lease as provided in Article 19 hereof, Landlord may exercise all of its remedies as may be permitted by law, including but not limited to the remedy provided by Section 1951.4 of the California Civil Code, and including without limitation, terminating this Lease, reentering the Premises and removing all persons and property therefrom, which property may be stored by Landlord at a warehouse or elsewhere at the risk, expense and for the account of Tenant. If Landlord elects to terminate this Lease, Landlord shall be entitled to recover from Tenant the

aggregate of all amounts permitted by law, including but not limited to (i) the worth at the time of award of the amount of any unpaid rent which had been earned at the time of such termination; plus (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus (iv) any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom; and (v) at Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law. The term "rent" as used in this Section 20(a) shall be deemed to be and to mean all sums of every nature required to be paid by Tenant pursuant to the terms of this Lease, whether to Landlord or to others. As used in items (i) and (ii), above, the "worth at the time of award" shall be computed by allowing interest at the rate set forth in item (e), below, but in no case greater than the maximum amount of such interest permitted by law. As used in item (iii), above, the "worth at the time of award" shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1 %).

(b) Nothing in this Article 20 shall be deemed to affect Landlord's right to indemnification for liability or liabilities arising prior to the termination of this Lease for personal injuries or property damage under the indemnification clause or clauses contained in this Lease.

(c) Notwithstanding anything to the contrary set forth herein, Landlord's re-entry to perform acts of maintenance or preservation of or in connection with efforts to relet the Premises or any portion thereof, or the appointment of a receiver upon Landlord's initiative to protect Landlord's interest under this Lease shall not terminate Tenant's right to possession of the Premises or any portion thereof and, until Landlord does elect to terminate this Lease, this Lease shall continue in full force and effect and Landlord may enforce all of Landlord's rights and remedies hereunder including, without limitation, the remedy described in California Civil Code Section 1951.4 (lessor may continue lease in effect after lessee's breach and abandonment and recover rent as it becomes due, if lessee has the right to sublet or assign, subject only to reasonable limitations). Accordingly, if Landlord does not elect to terminate this Lease on account of any default by Tenant, Landlord may, from time to time, without terminating this Lease, enforce all of its rights and remedies under this Lease, including the right to recover all rent as it becomes due.

(d) All rights, powers and remedies of Landlord hereunder and under any other agreement now or hereafter in force between Landlord and Tenant shall be cumulative and not alternative and shall be in addition to all rights, powers and remedies given to Landlord by law, and the exercise of one or more rights or remedies shall not impair Landlord's right to exercise any other right or remedy.

(e) Any amount due from Tenant to Landlord hereunder which is not paid when due shall bear interest at the lower of eighteen percent (18%) per annum or the maximum lawful rate of interest from the due date until paid, unless otherwise specifically provided herein, but the payment of such interest shall not excuse or cure any default by Tenant under this Lease. In addition to such interest: (i) if Basic Rental is not paid on or before the fifth (5th) day of

the calendar month for which the same is due, a late charge equal to ten percent (10%) of the amount overdue or \$100, whichever is greater, shall be immediately due and owing and shall accrue for each calendar month or part thereof until such rental, including the late charge, is paid in full, which late charge Tenant hereby agrees is a reasonable estimate of the damages Landlord shall suffer as a result of Tenant's late payment and (ii) an additional charge of \$25 shall be assessed for any check given to Landlord by or on behalf of Tenant which is not honored by the drawee thereof; which damages include Landlord's additional administrative and other costs associated with such late payment and unsatisfied checks and the parties agree that it would be impracticable or extremely difficult to fix Landlord's actual damage in such event. Such charges for interest and late payments and unsatisfied checks are separate and cumulative and are in addition to and shall not diminish or represent a substitute for any or all of Landlord's rights or remedies under any other provision of this Lease.

#### ARTICLE 21

##### TRANSFER OF LANDLORD'S INTEREST

In the event of any transfer or termination of Landlord's interest in the Premises or the Project by sale, assignment, transfer, foreclosure, deed-in-lieu of foreclosure or otherwise whether voluntary or involuntary, Landlord shall be automatically relieved of any and all obligations and liabilities on the part of Landlord from and after the date of such transfer or termination to the extent such obligations are assumed by the transferee by operation of law or otherwise, including without limitation, the obligation of Landlord under Article 4 and California Civil Code 1950.7 above to return the security deposit, provided said security deposit is transferred to said transferee. Tenant agrees to attorn to the transferee upon any such transfer and to recognize such transferee as the lessor under this Lease and Tenant shall, within five (5) days after request, execute such further instruments or assurances as such transferee may reasonably deem necessary to evidence or confirm such attornment.

#### ARTICLE 22

##### BROKER

In connection with this Lease, Landlord and Tenant warrant and represent that they have had dealings only with firm(s) set forth in Article 1.H. of the Basic Lease Provisions (who shall be compensated by Landlord pursuant to a separate agreement) and that they know of no other person or entity who is or might be entitled to a commission, finder's fee or other like payment in connection herewith. Each party does hereby indemnify and agree to hold the other and their agents, members, partners, representatives, officers, affiliates, shareholders, employees, successors and assigns harmless from and against any and all loss, liability and expenses that may be incurred should such warranty and representation prove incorrect, inaccurate or false.



ARTICLE 23

PARKING

Tenant shall rent from Landlord, commencing on the Commencement Date, the number of parking passes set forth in Article 1.I. of the Basic Lease Provisions, which parking passes shall pertain to the Project parking facility. Tenant may elect to have up to five (5) of such parking passes designated for Tenant's use as reserved parking at locations mutually agreed upon in good faith by Landlord and Tenant and the remainder of such parking passes shall be for unreserved parking. Unreserved parking shall be free of charge throughout the initial Lease Term and for Tenant's reserved parking, Tenant shall pay to Landlord the prevailing rate charged from time to time at the location of such parking passes for reserved parking, which rate is currently \$100.00 per reserved parking pass per month. In addition, Tenant shall be responsible for the full amount of any taxes imposed by any governmental authority in connection with the renting of such parking passes by Tenant or the use of the parking facility by Tenant. Tenant's continued right to use the parking passes is conditioned upon Tenant abiding by all rules and regulations which are prescribed from time to time for the orderly operation and use of the parking facility where the parking passes are located, including any sticker or other identification system established by Landlord, Tenant's cooperation in seeing that Tenant's employees and visitors also comply with such rules and regulations, and Tenant not being in default under this Lease. Provided that Tenant continues to have the parking to which it is entitled under this Lease, Landlord specifically reserves the right to change the size, configuration, design, layout and all other aspects of the Project parking facility at any time and Tenant acknowledges and agrees that Landlord may, without incurring any liability to Tenant and without any abatement of rent under this Lease, from time to time, close-off or restrict access to the Project parking facility for purposes of permitting or facilitating any such construction, alteration or improvements. Landlord may, from time to time, relocate any reserved parking spaces (if any) rented by Tenant to another location in the Project parking facility. Landlord may delegate its responsibilities hereunder to a parking operator or a lessee of the parking facility in which case such parking operator or lessee shall have all the rights of control attributed hereby to the Landlord. The parking passes rented by Tenant pursuant to this Article 23 are provided to Tenant solely for use by Tenant's own personnel and such passes may not be transferred, assigned, subleased or otherwise alienated by Tenant without Landlord's prior approval. Tenant may validate visitor parking by such method or methods as the Landlord may establish, at the validation rate from time to time generally applicable to visitor parking.

ARTICLE 24

WAIVER

No waiver by Landlord of any provision of this Lease shall be deemed to be a waiver of any other provision hereof or of any subsequent breach by Tenant of the same or any other provision. No provision of this Lease may be waived by Landlord, except by an instrument in writing executed by Landlord. Landlord's consent to or approval of any act by Tenant requiring Landlord's consent or approval shall not be deemed to render unnecessary the obtaining of Landlord's consent to or approval of any subsequent act of Tenant, whether or not similar to the act so consented to or approved. No act or thing done by Landlord or Landlord's agents during the Term of this Lease shall be deemed an acceptance of

a surrender of the Premises, and no agreement to accept such surrender shall be valid unless in writing and signed by Landlord. The subsequent acceptance of rent hereunder by Landlord shall not be deemed to be a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, other than the failure of Tenant to pay the particular rent so accepted, regardless of Landlord's knowledge of such preceding breach at the time of acceptance of such rent. Any payment by Tenant or receipt by Landlord of an amount less than the total amount then due hereunder shall be deemed to be in partial payment only thereof and not a waiver of the balance due or an accord and satisfaction, notwithstanding any statement or endorsement to the contrary on any check or any other instrument delivered concurrently therewith or in reference thereto. Accordingly, Landlord may accept any such amount and negotiate any such check without prejudice to Landlord's right to recover all balances due and owing and to pursue its other rights against Tenant under this Lease, regardless of whether Landlord makes any notation on such instrument of payment or otherwise notifies Tenant that such acceptance or negotiation is without prejudice to Landlord's rights.

#### ARTICLE 25

##### ESTOPPEL CERTIFICATE

Tenant shall, at any time and from time to time, upon not less than ten (10) days' prior written notice from Landlord, execute, acknowledge and deliver to Landlord a statement in writing certifying the following information, (but not limited to the following information in the event further information is requested by Landlord): (i) that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of such modification and certifying that this Lease, as modified, is in full force and effect); (ii) the dates to which the rental and other charges are paid in advance, if any; (iii) the amount of Tenant's security deposit, if any; and (iv) acknowledging that there are not, to Tenant's knowledge, any uncured defaults on the part of Landlord hereunder, and no events or conditions then in existence which, with the passage of time or notice or both, would constitute a default on the part of Landlord hereunder, or specifying such defaults, events or conditions, if any are claimed. It is expressly understood and agreed that any such statement may be relied upon by any prospective purchaser or encumbrancer of all or any portion of the Real Property. Tenant's failure to deliver such statement within such time shall constitute an admission by Tenant that all statements contained therein are true and correct. Tenant hereby irrevocably appoints Landlord as Tenant's attorney-in-fact and in Tenant's name, place and stead to execute any and all documents described in this Article 25 if Tenant fails to do so within the specified time period.

#### ARTICLE 26

##### LIABILITY OF LANDLORD

Notwithstanding anything in this Lease to the contrary, any remedy of Tenant for the collection of a judgment (or other judicial process) requiring the payment of money by Landlord in the event of any default by Landlord hereunder or any claim, cause of action or obligation, contractual, statutory or otherwise by Tenant against Landlord or the Landlord Parties concerning, arising out of or relating to any matter relating to this Lease and all of the covenants and conditions or any obligations, contractual, statutory, or otherwise set forth herein, shall be limited solely and exclusively to an amount which is

equal to the lesser of (i) the interest of Landlord in and to the Project, and (ii) the interest Landlord would have in the Project if the Project were encumbered by third party debt in an amount equal to eighty percent (80%) of the then current value of the Project. No other property or assets of Landlord or any Landlord Party shall be subject to levy, execution or other enforcement procedure for the satisfaction of Tenant's remedies under or with respect to this Lease, Landlord's obligations to Tenant, whether contractual, statutory or otherwise, the relationship of Landlord and Tenant hereunder, or Tenant's use or occupancy of the Premises.

#### ARTICLE 27

##### INABILITY TO PERFORM

This Lease and the obligations of Tenant hereunder shall not be affected or impaired because Landlord is unable to fulfill any of its obligations hereunder or is delayed in doing so, if such inability or delay is caused by reason of any prevention, delay, stoppage due to strikes, lockouts, acts of God, or any other cause previously, or at such time, beyond the reasonable control or anticipation of Landlord (collectively, a "Force Majeure") and Landlord's obligations under this Lease shall be forgiven and suspended by any such Force Majeure.

#### ARTICLE 28

##### HAZARDOUS WASTE

(a) Tenant shall not cause or permit any Hazardous Material (as defined in Section 28(c) below) to be brought, kept or used in or about the Project by Tenant, its agents, employees, contractors, or invitees. Tenant indemnifies Landlord and the Landlord Parties from and against any breach by Tenant of the obligations stated in the preceding sentence, and agrees to defend and hold Landlord and the Landlord Parties harmless from and against any and all claims, judgments, damages, penalties, fines, costs, liabilities, or losses (including, without limitation, diminution in value of the Project, damages for the loss or restriction or use of rentable or usable space or of any amenity of the Project, damages arising from any adverse impact or marketing of space in the Project, and sums paid in settlement of claims, attorneys' fees and costs, consultant fees, and expert fees) which arise during or after the Term of this Lease as a result of such breach. This indemnification of Landlord and the Landlord Parties by Tenant includes, without limitation, costs incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state, or local governmental agency or political subdivision because of Hazardous Material present in the soil or ground water on or under the Project. Without limiting the foregoing, if the presence of any Hazardous Material on the Project caused or permitted by Tenant results in any contamination of the Project, then subject to the provisions of Articles 9, 10 and 11 hereof, Tenant shall promptly take all actions at its sole expense as are necessary to return the Project to the condition existing prior to the introduction of any such Hazardous Material and the contractors to be used by Tenant for such work must be approved by Landlord, which approval shall not be unreasonably withheld so long as such actions would not potentially have any material adverse long-term or short-term effect on the Project and so long as such actions do not materially interfere with the use and enjoyment of the Project by the other tenants thereof; provided however, Landlord shall also have the right, by written notice to Tenant, to directly undertake any such mitigation efforts with regard to Hazardous Materials in or about the Project due to Tenant's breach of its obligations pursuant to this Section 28(a), and to charge Tenant, as Additional Rent, for the costs thereof.

(b) It shall not be unreasonable for Landlord to withhold its consent to any proposed Transfer if (i) the proposed transferee's anticipated use of the Premises involves the generation, storage, use, treatment, or disposal of Hazardous Material; (ii) the proposed Transferee has been required by any prior landlord, lender, or governmental authority to take remedial action in connection with Hazardous Material contaminating a property if the contamination resulted from such Transferee's actions or use of the property in question; or (iii) the proposed Transferee is subject to an enforcement order issued by any governmental authority in connection with the use, disposal, or storage of a Hazardous Material.

(c) As used herein, the term "Hazardous Material" means any hazardous or toxic substance, material, or waste which is or becomes regulated by any local governmental authority, the State of California or the United States Government. The term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as "Hazardous Waste," "Extremely Hazardous Waste," or "Restricted Hazardous Waste" under Sections 25115, 25117 or 25122.7, or listed pursuant to Section 25140, of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "Hazardous Substance" under Section 25316 of the California Health and Safety Code, Division 20, Chapter 6.8 (Carpenter-Presley-Tanner Hazardous Substance Account Act), (iii) defined as a "Hazardous Material," "Hazardous Substance," or "Hazardous Waste" under Section 25501 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Materials Release Response Plans and Inventory), (iv) defined as a "Hazardous Substance" under Section 25281 of the California Health and Safety Code, Division 20, Chapter 6.7 (Underground Storage of Hazardous Substances), (v) petroleum, (vi) asbestos, (vii) listed under Article 9 or defined as Hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (viii) designated as a "Hazardous Substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. ss. 1317), (ix) defined as a "Hazardous Waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. ss. 6901 et seq. (42 U.S.C. ss. 6903), or (x) defined as a "Hazardous Substance" pursuant to Section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. ss. 9601 et seq. (42 U.S.C. ss. 9601).

(d) As used herein, the term "Laws" means any applicable federal, state or local law, ordinance, or regulation relating to any Hazardous Material affecting the Project, including, without limitation, the laws, ordinances, and regulations referred to in Section 28(c) above.

#### ARTICLE 29

##### SURRENDER OF PREMISES; REMOVAL OF PROPERTY

(a) The voluntary or other surrender of this Lease by Tenant to Landlord, or a mutual termination hereof, shall not work a merger, and shall at the option of Landlord, operate as an assignment to it of any or all subleases or subtenancies affecting the Premises.

(b) Upon the expiration of the Term of this Lease, or upon any earlier termination of this Lease, Tenant shall quit and surrender possession of the Premises to Landlord in good order and condition, reasonable wear and tear and repairs which are Landlord's obligation excepted, and shall, without expense to Landlord, remove or cause to be removed from the Premises all debris and rubbish, all furniture, equipment, business and trade fixtures, tree-standing cabinet work, moveable partitioning, telephone and data cabling and other articles of personal property owned by Tenant or installed or placed by Tenant at its own expense in the Premises, and all similar articles of any other persons claiming under Tenant (unless Landlord exercises its option to have any subleases or subtenancies assigned to it), and Tenant shall repair all damage to the Premises resulting from the removal of such items from the Premises.

(c) Whenever Landlord shall reenter the Premises as provided in Article 20 hereof, or as otherwise provided in this Lease, any property of Tenant not removed by Tenant upon the expiration of the Term of this Lease (or within forty-eight (48) hours after a termination by reason of Tenant's default), as provided in this Lease, shall be considered abandoned and Landlord may remove any or all of such items and dispose of the same in any manner or store the same in a public warehouse or elsewhere for the account and at the expense and risk of Tenant, and if Tenant shall fail to pay the cost of storing any such property after it has been stored for a period of thirty (30) days or more, Landlord may sell any or all of such property at public or private sale, in such manner and at such times and places as Landlord, in its sole discretion, may deem proper, without notice to or demand upon Tenant, for the payment of all or any part of such charges or the removal of any such property, and shall apply the proceeds of such sale as follows: first, to the cost and expense of such sale, including reasonable attorneys' fees and costs for services rendered; second, to the payment of the cost of or charges for storing any such property; third, to the payment of any other sums of money which may then or thereafter be due to Landlord from Tenant under any of the terms hereof; and fourth, the balance, if any, to Tenant.

(d) All fixtures, equipment, leasehold improvements, Alterations and/or appurtenances attached to or built into the Premises prior to or during the Term, whether by Landlord or Tenant and whether at the expense of Landlord or Tenant, or of both, shall be and remain part of the Premises and shall not be removed by Tenant at the end of the Term unless otherwise expressly provided for in this Lease or unless such removal is required by Landlord. Such fixtures, equipment, leasehold improvements, Alterations, additions, improvements and/or appurtenances shall include but not be limited to: all floor coverings, drapes, paneling, built-in cabinetry, molding, doors, vaults (including vault doors), plumbing systems, security systems, electrical systems, lighting systems, silencing equipment, communication systems, all fixtures and outlets for the systems mentioned above and for all telephone, radio, telegraph and television purposes, and any special flooring or ceiling installations.

#### ARTICLE 30

#### MISCELLANEOUS

(a) SEVERABILITY; ENTIRE AGREEMENT. ANY PROVISION OF THIS LEASE WHICH SHALL PROVE TO BE INVALID, VOID, OR ILLEGAL SHALL IN NO WAY AFFECT, IMPAIR OR INVALIDATE ANY OTHER PROVISION HEREOF AND SUCH OTHER PROVISIONS SHALL REMAIN IN FULL FORCE AND EFFECT. THIS LEASE AND THE EXHIBITS AND ANY ADDENDUM ATTACHED

HERETO CONSTITUTE THE ENTIRE AGREEMENT BETWEEN THE PARTIES HERETO WITH REGARD TO TENANT'S OCCUPANCY OR USE OF ALL OR ANY PORTION OF THE PROJECT, AND NO PRIOR AGREEMENT OR UNDERSTANDING PERTAINING TO ANY SUCH MATTER SHALL BE EFFECTIVE FOR ANY PURPOSE. NO PROVISION OF THIS LEASE MAY BE AMENDED OR SUPPLEMENTED EXCEPT BY AN AGREEMENT IN WRITING SIGNED BY THE PARTIES HERETO OR THEIR SUCCESSOR IN INTEREST. THE PARTIES AGREE THAT ANY DELETION OF LANGUAGE FROM THIS LEASE PRIOR TO ITS MUTUAL EXECUTION BY LANDLORD AND TENANT SHALL NOT BE CONSTRUED TO HAVE ANY PARTICULAR MEANING OR TO RAISE ANY PRESUMPTION, CANON OF CONSTRUCTION OR IMPLICATION INCLUDING, WITHOUT LIMITATION, ANY IMPLICATION THAT THE PARTIES INTENDED THEREBY TO STATE THE CONVERSE, OBVERSE OR OPPOSITE OF THE DELETED LANGUAGE.

(b) Attorneys' Fees; Waiver of Jury Trial.

(i) In any action to enforce the terms of this Lease, including any suit by Landlord for the recovery of rent or possession of the Premises, the losing party shall pay the successful party a reasonable sum for attorneys' fees and costs in such suit and such attorneys' fees and costs shall be deemed to have accrued prior to the commencement of such action and shall be paid whether or not such action is prosecuted to judgment.

(ii) Should Landlord, without fault on Landlord's part, be made a party to any litigation instituted by Tenant or by any third party against Tenant, or by or against any person holding under or using the Premises by license of Tenant, or for the foreclosure of any lien for labor or material furnished to or for Tenant or any such other person or otherwise arising out of or resulting from any act or transaction of Tenant or of any such other person, Tenant covenants to save and hold Landlord harmless from any judgment rendered against Landlord or the Premises or any part thereof and from all costs and expenses, including reasonable attorneys' fees and costs incurred by Landlord in connection with such litigation.

(iii) When legal services are rendered by an attorney at law who is an employee of a party, attorneys' fees and costs incurred by that party shall be deemed to include an amount based upon the number of hours spent by such employee on such matters multiplied by an appropriate billing rate determined by taking into consideration the same factors, including but not limited by, the importance of the matter, time applied, difficulty and results, as are considered when an attorney not in the employ of a party is engaged to render such service.

(iv) EACH PARTY HEREBY WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION SEEKING SPECIFIC PERFORMANCE OF ANY PROVISION OF THIS LEASE, FOR DAMAGES FOR ANY BREACH UNDER THIS LEASE, OR OTHERWISE FOR ENFORCEMENT OF ANY RIGHT OR REMEDY HEREUNDER.

(c) Time of Essence. Each of Tenant's covenants herein is a condition and time is of the essence with respect to the performance of every provision of this Lease.

(d) Headings; Joint and Several. The article headings contained in this Lease are for convenience only and do not in any way limit or amplify any term or provision hereof. The terms "Landlord" and "Tenant" as used herein shall include the plural as well as the singular, the neuter shall include the masculine and feminine genders and the obligations herein imposed upon Tenant shall be joint and several as to each of the persons, firms or corporations of which Tenant may be composed.

(e) Reserved Area. Tenant hereby acknowledges and agrees that the exterior walls of the Premises and the area between the finished ceiling of the Premises and the slab of the floor of the Project thereabove have not been demised hereby and the use thereof together with the right to install, maintain, use, repair and replace pipes, ducts, conduits, wiring and cabling leading through, under or above the Premises or throughout the Project in locations which will not materially interfere with Tenant's use of the Premises and serving other parts of the Project are hereby excepted and reserved unto Landlord.

(f) NO OPTION. THE SUBMISSION OF THIS LEASE BY LANDLORD, ITS AGENT OR REPRESENTATIVE FOR EXAMINATION OR EXECUTION BY TENANT DOES NOT CONSTITUTE AN OPTION OR OFFER TO LEASE THE PREMISES UPON THE TERMS AND CONDITIONS CONTAINED HEREIN OR A RESERVATION OF THE PREMISES IN FAVOR OF TENANT, IT BEING INTENDED HEREBY THAT THIS LEASE SHALL ONLY BECOME EFFECTIVE UPON THE EXECUTION HEREOF BY LANDLORD AND TENANT AND DELIVERY OF A FULLY EXECUTED LEASE TO TENANT.

(g) Use of Project Name; Improvements. Tenant shall not be allowed to use the name, picture or representation of the Project, or words to that effect, in connection with any business carried on in the Premises or otherwise (except as Tenant's address) without the prior written consent of Landlord. In the event that Landlord undertakes any additional improvements on the Real Property including but not limited to new construction or renovation or additions to the existing improvements, Landlord shall use commercially reasonable efforts to avoid material interference with Tenant's business operations; however, Landlord shall not be liable to Tenant for any noise, dust, vibration or interference with access to the Premises or disruption in Tenant's business caused thereby.

(h) Rules and Regulations. Tenant shall observe faithfully and comply strictly with the Rules and Regulations attached to this Lease as Exhibit "B" and made a part hereof, and such other Rules and Regulations as Landlord may from time to time reasonably adopt for the safety, care and cleanliness of the Project, the facilities thereof, or the preservation of good order therein. Landlord shall not be liable to Tenant for violation of any such Rules and Regulations, or for the breach of any covenant or condition in any lease by any other tenant in the Project. A waiver by Landlord of any Rule or Regulation for any other tenant shall not constitute nor be deemed a waiver of the Rule or Regulation for this Tenant.

(i) Quiet Possession. Upon Tenant's paying the Basic Rental, Additional Rent and other sums provided hereunder and observing and performing all of the covenants, conditions and provisions on Tenant's part to be observed and performed hereunder, Tenant shall have quiet possession of the Premises for the entire Term hereof, subject to all of the provisions of this Lease.

(j) Rent. All payments required to be made hereunder to Landlord shall be deemed to be rent, whether or not described as such.

(k) Successors and Assigns. Subject to the provisions of Article 15 hereof, all of the covenants, conditions and provisions of this Lease shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, personal representatives, successors and assigns.

(l) Notices. Any notice required or permitted to be given hereunder shall be in writing and may be given by personal service evidenced by a signed receipt or sent by registered or certified mail, return receipt requested, or via overnight courier, and shall be effective upon proof of delivery, addressed to Tenant at the Premises (Attention: CEO/CF0) or to Landlord at the management office for the Project, with a copy to Landlord, c/o Arden Realty, Inc., 11601 Wilshire Boulevard, Fourth Floor, Los Angeles, California 90025, Attn: Legal Department. Either party may by notice to the other specify a different address for notice purposes except that, upon Tenant's taking possession of the Premises, the Premises shall constitute Tenant's address for notice purposes. A copy of all notices to be given to Landlord hereunder shall be concurrently transmitted by Tenant to such party hereafter designated by notice from Landlord to Tenant. Any notices sent by Landlord regarding or relating to eviction procedures, including without limitation three day notices, may be sent by regular mail.

(m) Persistent Delinquencies. In the event that Tenant shall be delinquent by more than fifteen (15) days in the payment of rent on three (3) separate occasions in any twelve (12) month period, Landlord shall have the right to terminate this Lease by thirty (30) days written notice given by Landlord to Tenant within thirty (30) days of the last such delinquency.

(n) Right of Landlord to Perform. All covenants and agreements to be performed by Tenant under any of the terms of this Lease shall be performed by Tenant at Tenant's sole cost and expense and without any abatement of rent. If Tenant shall fail to pay any sum of money, other than rent, required to be paid by it hereunder or shall fail to perform any other act on its part to be performed hereunder, and such failure shall continue beyond any applicable cure period set forth in this Lease, Landlord may, but shall not be obligated to, without waiving or releasing Tenant from any obligations of Tenant, make any such payment or perform any such other act on Tenant's part to be made or performed as is in this Lease provided. All sums so paid by Landlord and all reasonable incidental costs, together with interest thereon at the rate of ten percent (10%) per annum from the date of such payment by Landlord, shall be payable to Landlord on demand and Tenant covenants to pay any such sums, and Landlord shall have (in addition to any other right or remedy of Landlord) the same rights and remedies in the event of the nonpayment thereof by Tenant as in the case of default by Tenant in the payment of the rent.

(o) Access, Changes in Project, Facilities, Name.



(i) Every part of the Project except the inside surfaces of all walls, windows and doors bounding the Premises (including exterior building walls, the rooftop, core corridor walls and doors and any core corridor entrance), and any space in or adjacent to the Premises or within the Project used for shafts, stacks, pipes, conduits, fan rooms, ducts, electric or other utilities, sinks or other building facilities, and the use thereof, as well as access thereto through the Premises for the purposes of operation, maintenance, decoration and repair, are reserved to Landlord.

(ii) Tenant shall permit Landlord to install, use and maintain pipes, ducts and conduits within the walls, columns and ceilings of the Premises and throughout the Project.

(iii) Landlord reserves the right, without incurring any liability to Tenant therefor, to make such changes in or to the Project and the fixtures and equipment thereof, as well as in or to the street entrances, halls, passages, elevators, stairways and other improvements thereof, as it may deem necessary or desirable; provided, however, that no such changes shall preclude Tenant from accessing the Premises and Landlord shall use commercially reasonable efforts to avoid material interference with Tenant's business operations.

(iv) Landlord may adopt any name for the Project and Landlord reserves the right, from time to time, to change the name and/or address of the Project at any time.

(p) Signing Authority. If Tenant is a corporation, partnership or limited liability company, each individual executing this Lease on behalf of said entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of said entity in accordance with: (i) if Tenant is a corporation, a duly adopted resolution of the Board of Directors of said corporation or in accordance with the By-laws of said corporation, (ii) if Tenant is a partnership, the terms of the partnership agreement, and (iii) if Tenant is a limited liability company, the terms of its operating agreement, and that this Lease is binding upon said entity in accordance with its terms. Concurrently with Tenant's execution of this Lease, Tenant shall provide to Landlord a copy of: (i) if Tenant is a corporation, such resolution of the Board of Directors authorizing the execution of this Lease on behalf of such corporation, which copy of resolution shall be duly certified by the secretary or an assistant secretary of the corporation to be a true copy of a resolution duly adopted by the Board of Directors of said corporation and shall be in a form reasonably acceptable to Landlord, (ii) if Tenant is a partnership, a copy of the provisions of the partnership agreement granting the requisite authority to each individual executing this Lease on behalf of said partnership, and (iii) if Tenant is a limited liability company, a copy of the provisions of its operating agreement granting the requisite authority to each individual executing this Lease on behalf of said limited liability company. In the event Tenant fails to comply with the requirements set forth in this subparagraph (p), then each individual executing this Lease shall be personally liable, jointly and severally along with Tenant, for all of Tenant's obligations in this Lease.

(q) Identification of Tenant.

(i) If Tenant constitutes more than one person or entity, (A) each of them shall be jointly and severally liable for the keeping, observing and

performing of all of the terms, covenants, conditions and provisions of this Lease to be kept, observed and performed by Tenant, (B) the term "Tenant" as used in this Lease shall mean and include each of them jointly and severally, and (C) the act of or notice from, or notice or refund to, or the signature of, any one or more of them, with respect to the tenancy of this Lease, including, but not limited to, any renewal, extension, expiration, termination or modification of this Lease, shall be binding upon each and all of the persons or entities executing this Lease as Tenant with the same force and effect as if each and all of them had so acted or so given or received such notice or refund or so signed.

(ii) If Tenant is a partnership (or is comprised of two or more persons, individually and as co-partners of a partnership) or if Tenant's interest in this Lease shall be assigned to a partnership (or to two or more persons, individually and as co-partners of a partnership) pursuant to Article 15 hereof (any such partnership and such persons hereinafter referred to in this Section 30(q)(ii) as "Partnership Tenant"), the following provisions of this Lease shall apply to such Partnership Tenant:

(A) The liability of each of the parties comprising Partnership Tenant shall be joint and several.

(B) Each of the parties comprising Partnership Tenant hereby consents in advance to, and agrees to be bound by, any written instrument which may hereafter be executed, changing, modifying or discharging this Lease, in whole or in part, or surrendering all or any part of the Premises to the Landlord, and by notices, demands, requests or other communication which may hereafter be given, by the individual or individuals authorized to execute this Lease on behalf of Partnership Tenant under Subparagraph (p) above.

(C) Any bills, statements, notices, demands, requests or other communications given or rendered to Partnership Tenant or to any of the parties comprising Partnership Tenant shall be deemed given or rendered to Partnership Tenant and to all such parties and shall be binding upon Partnership Tenant and all such parties.

(D) If partnership Tenant admits new partners, all of such new partners shall, by their admission to Partnership Tenant, be deemed to have assumed performance of all of the terms, covenants and conditions of this Lease on Tenant's part to be observed and performed.

(E) Partnership Tenant shall give prompt notice to Landlord of the admission of any such new partners, and, upon demand of Landlord, shall cause each such new partner to execute and deliver to Landlord an agreement in form satisfactory to Landlord, wherein each such new partner shall assume performance of all of the terms, covenants and conditions of this Lease on Partnership Tenant's part to be observed and performed (but neither Landlord's failure to request any such agreement nor the failure of any such new partner to execute or deliver any such agreement to Landlord shall terminate the provisions of clause (D) of this Section 30(q)(ii) or relieve any such new partner of its obligations thereunder).

(r) Intentionally Deleted.

(s) Survival of Obligations. Any obligations of Tenant occurring prior to the expiration or earlier termination of this Lease shall survive such expiration or earlier termination.

(t) Confidentiality. Tenant acknowledges that the content of this Lease and any related documents are confidential information. Tenant shall keep such confidential information strictly confidential and shall not disclose such confidential information to any person or entity other than Tenant's financial, legal and space planning consultants and any proposed Transferees.

(u) Governing Law. This Lease shall be governed by and construed in accordance with the laws of the State of California. No conflicts of law rules of any state or country (including, without limitation, California conflicts of law rules) shall be applied to result in the application of any substantive or procedural laws of any state or country other than California. All controversies, claims, actions or causes of action arising between the parties hereto and/or their respective successors and assigns, shall be brought, heard and adjudicated by the courts of the State of California, with venue in the County of San Diego. Each of the parties hereto hereby consents to personal jurisdiction by the courts of the State of California in connection with any such controversy, claim, action or cause of action, and each of the parties hereto consents to service of process by any means authorized by California law and consent to the enforcement of any judgment so obtained in the courts of the State of California on the same terms and conditions as if such controversy, claim, action or cause of action had been originally heard and adjudicated to a final judgment in such courts. Each of the parties hereto further acknowledges that the laws and courts of California were freely and voluntarily chosen to govern this Lease and to adjudicate any claims or disputes hereunder.

(v) Office of Foreign Assets Control. Tenant certifies to Landlord that Tenant is not entering into this Lease, nor acting, for or on behalf of any person or entity named as a terrorist or other banned or blocked person or entity pursuant to any law, order, rule or regulation of the United States Treasury Department or the Office of Foreign Assets Control. Tenant hereby agrees to indemnify, defend and hold Landlord and the Landlord Parties harmless from any and all Claims arising from or related to any breach of the foregoing certification.

(w) Financial Statements. If Tenant is not then publicly traded on NASDAQ or a nationally recognized securities exchange, within ten (10) days after Tenant's receipt of Landlord's written request, Tenant shall provide Landlord with current financial statements of Tenant and financial statements for the two (2) calendar or fiscal years (if Tenant's fiscal year is other than a calendar year) prior to the current financial statement year. Any such statements shall be prepared in accordance with generally accepted accounting principles and, if the normal practice of Tenant, shall be audited by an independent certified public accountant.

(x) Exhibits. The Exhibits attached hereto are incorporated herein by this reference as if fully set forth herein.

(y) Independent Covenants. This Lease shall be construed as though the covenants herein between Landlord and Tenant are independent (and not dependent) and Tenant hereby expressly waives the benefit of any statute to the contrary and agrees that if Landlord fails to perform its obligations set forth herein, Tenant shall not be entitled to make any repairs or perform any acts hereunder at Landlord's expense or to set off of any of the rent or other amounts owing hereunder against Landlord.

(z) Counterparts. This Lease may be executed in counterparts, each of which shall be deemed an original, but such counterparts, when taken together, shall constitute one agreement.

#### ARTICLE 31

##### OPTION TO EXTEND

(a) Option Right. Landlord hereby grants the Tenant named in this Lease (the "Original Tenant") one (1) option ("Option") to extend the Term for the entire Premises for a period of five (5) years ("Option Term"), which Option shall be exercisable only by written notice delivered by Tenant to Landlord as set forth below. The right contained in this Article 31 shall be personal to the Original Tenant or an Affiliated Assignee and may only be exercised by the Original Tenant or an Affiliated Assignee (and not any other transferee) if the Original Tenant or Affiliated Assignee occupies the entire Premises as of the date of Tenant's Acceptance (as defined in Section 31(c) below).

(b) Option Rent. The rent payable by Tenant during the Option Term ("Option Rent") shall be equal to the "Market Rent" (defined below). "Market Rent" shall mean the applicable Monthly Basic Rental, including all escalations, Direct Costs, additional rent and other charges at which tenants, as of the time of Landlord's "Option Rent Notice" (as defined below), are entering into leases for non-sublease, non-encumbered, space comparable in size, location and quality to the Premises in renewal transactions for a term comparable to the Option Term, which comparable space is located in office buildings comparable to the Project in the immediate vicinity of the Project, in San Diego, California, taking into consideration the value of the existing improvements in the Premises to Tenant, as compared to the value of the existing improvements in such comparable space, with such value to be based upon the age, quality and layout of the improvements and the extent to which the same could be utilized by Tenant with consideration given to the fact that the improvements existing in the Premises are specifically suitable to Tenant.

(c) Exercise of Option. The Option shall be exercised by Tenant only in the following manner: (i) Tenant shall not be in default on the delivery date of the Interest Notice and Tenant's Acceptance; (ii) Tenant shall deliver written notice ("Interest Notice") to Landlord not more than twelve (12) months nor less than nine (9) months prior to the expiration of the Term, stating that Tenant is interested in exercising the Option, (iii) within fifteen (15) business days of Landlord's receipt of Tenant's written notice, Landlord shall deliver notice ("Option Rent Notice") to Tenant setting forth the Option Rent; and (iv) if Tenant desires to exercise such Option, Tenant shall provide Landlord written notice within fifteen (15) business days after receipt of the Option Rent Notice ("Tenant's Acceptance"). Tenant's failure to deliver the Interest Notice or Tenant's Acceptance on or before the dates specified above shall be deemed to constitute Tenant's election not to exercise the Option. If Tenant timely and properly exercises its Option, the Term shall be extended for the Option Term upon all of the terms and conditions set forth in this Lease, except that the rent for the Option Term shall be as indicated in "the Option Rent Notice."

ARTICLE 32

SIGNAGE

Provided Tenant is not in default hereunder, Tenant, at Tenant's sole cost and expense, shall have the non-exclusive right to install a strip at a location designated by Landlord on the Project's existing "monument" sign ("Tenant's Signage"). Tenant's Signage shall be subject to Landlord's approval as to size, design, graphics, materials, colors and similar specifications and shall be consistent with the exterior design, materials and appearance of the Project and the Project's signage program and shall be further subject to all applicable local governmental laws, rules, regulations, codes and Tenant's receipt of all permits and other governmental approvals and any applicable covenants, conditions and restrictions. Tenant's Signage rights may not be assigned or transferred by Tenant to any other person or entity except that in connection with any assignment of Tenant's interest under this Lease to an Affiliated Assignee, Tenant's Signage may be assigned to the assignee with Landlord's prior consent, which consent shall not be unreasonably withheld by Landlord so long as the name of the assignee is not an "Objectionable Name," as that term is defined below. In addition, should the name of the Original Tenant change, Tenant shall be entitled to modify, at Tenant's sole cost and expense, Tenant's Signage to reflect Tenant's new name, but only if Tenant's new name is not an "Objectionable Name." The term "Objectionable Name" shall mean any name that (i) relates to an entity that is of a character or reputation, or is associated with a political orientation or faction that is materially inconsistent with the quality of the Project, or which would otherwise reasonably offend a landlord of a building comparable to the Project, taking into consideration the level and visibility of Tenant's Signage, or (ii) conflicts with any covenants in other leases of space in the Project. Landlord shall have the right, but not the obligation, to oversee the installation of Tenant's Signage. The cost to maintain and operate, if any, Tenant's Signage shall be paid for by Tenant. Upon the expiration of the Term, or other earlier termination of this Lease, Tenant shall be responsible for any and all costs associated with the removal of Tenant's Signage, including, but not limited to, the cost to repair and restore the monument to its original condition, normal wear and tear excepted.

ARTICLE 33

TERMINATION OPTION

Provided Tenant fully and completely satisfies each of the conditions set forth in this Article 33, Tenant shall have the on-going option ("Termination Option") to terminate this Lease as of a date specified by Tenant, which date (the "Termination Date") must be during the initial Lease Term and after expiration of the fourth (4th) Lease Year. In order to exercise the Termination Option, Tenant must fully and completely satisfy each and everyone of the following conditions: (a) Tenant must give Landlord written notice ("Termination Notice") of its exercise of the Termination Option, which Termination Notice shall specify the Termination Date (which date shall be within the parameters described in the immediately preceding sentence) and which Termination Notice must be delivered to Landlord at least nine (9) months prior to such Termination Date, (b) at the time of the Termination Notice Tenant shall not be in default under this Lease after expiration of applicable cure periods, and (c)

concurrently with Tenant's delivery of the Termination Notice to Landlord, Tenant shall pay to Landlord a termination fee ("Termination Fee") equal to the sum of (i) the unamortized balance, as of the Termination Date, of the (A) amount expended by Landlord in connection with the design and construction of the Improvements pursuant to the Tenant Work Letter, and (B) brokerage commissions paid by Landlord in connection with this Lease, plus (ii) Fifty-Five Thousand Seven Hundred Forty-Four and 50/100 Dollars (\$55,744.50). Amortization pursuant to subsection (i), above, shall be calculated on a seven (7) year amortization schedule commencing as of the Commencement Date based upon equal monthly payments of principal and interest, with interest imputed on the outstanding principal balance at the rate of ten percent (10%) per annum. Upon written inquiry from Tenant, Landlord shall provide Tenant with Landlord's calculation of the Termination Fee.

#### ARTICLE 34

##### COMMUNICATION EQUIPMENT

Subject to all governmental laws, rules and regulations, Tenant and Tenant's contractors (which shall first be reasonably approved by Landlord) shall have the right and access to install, repair, replace, remove, operate and maintain one (1) so-called "satellite dish" or other similar device, such as antennae (collectively, "Communication Equipment") no greater than one (1) meter in diameter, together with aesthetic screening designated by Landlord and all cable, wiring, conduits and related equipment, for the purpose of receiving and sending radio, television, computer, telephone or other communication signals, at a location on the roof of the Project designated by Landlord. Landlord shall have the right to require Tenant to relocate the Communication Equipment, at Landlord's expense, at any time to another location on the roof of the Project reasonably approved by Tenant. Tenant shall retain Landlord's designated roofing contractor to make any necessary penetrations and associated repairs to the roof in order to preserve Landlord's roof warranty. Tenant's installation and operation of the Communication Equipment shall be governed by the following terms and conditions:

(a) Tenant's right to install, replace, repair, remove, operate and maintain the Communication Equipment shall be subject to all governmental laws, rules and regulations and Landlord makes no representation that such laws, rules and regulations permit such installation and operation.

(b) All plans and specifications for the Communication Equipment shall be subject to Landlord's reasonable approval.

(c) All costs of installation, operation and maintenance of the Communication Equipment and any necessary related equipment (including, without limitation, costs of obtaining any necessary permits and connections to the Project's electrical system) shall be borne by Tenant.

(d) It is expressly understood that Landlord retains the right to use the roof of the Project for any purpose whatsoever provided that Landlord shall not unduly interfere with Tenant's use of the Communication Equipment.

(e) Tenant shall use the Communication Equipment so as not to cause any interference to other tenants in the Project or with any other tenant's Communication Equipment, and not to damage the Project or interfere with the normal operation of the Project.

(f) Landlord shall not have any obligations with respect to the Communication Equipment. Landlord makes no representation that the Communication Equipment will be able to receive or transmit communication signals without interference or disturbance (whether or not by reason of the installation or use of similar equipment by others on the roof of the Project) and Tenant agrees that Landlord shall not be liable to Tenant therefor. Tenant shall not lease or otherwise make the Communication Equipment available to any third party and the Communication Equipment shall be only for Tenant's use in connection with the conduct of Tenant's business in the Premises.

(g) Tenant shall (i) be solely responsible for any damage caused as a result of the Communication Equipment, (ii) promptly pay any tax, license or permit fees charged pursuant to any laws or regulations in connection with the installation, maintenance or use of the Communication Equipment and comply with all precautions and safeguards recommended by all governmental authorities, and (iii) pay for all necessary repairs, replacements to or maintenance of the Communication Equipment.

(h) The Communication Equipment shall remain the sole property of Tenant. Tenant shall remove the Communication Equipment and related equipment at Tenant's sole cost and expense upon the expiration or sooner termination of this Lease or upon the imposition of any governmental law or regulation which may require removal, and shall repair the Project upon such removal to the extent required by such work of removal. If Tenant fails to remove the Communication Equipment and repair the Project within fifteen (15) days after the expiration or earlier termination of this Lease, Landlord may do so at Tenant's expense. The provisions of this Section 34(h) shall survive the expiration or earlier termination of this Lease.

(i) The Communication Equipment shall be deemed to constitute a portion of the Premises for purposes of Articles 13 and 14 of this Lease.

(j) Tenant agrees to execute a license agreement with Landlord's rooftop management company regarding Tenant's installation, use and operation of the Communication Equipment, which license agreement should be in commercially reasonable form and shall incorporate the terms and conditions of this Article 34. Tenant acknowledges that such license agreement will require Tenant to pay a one-time initial oversight fee to the rooftop management company in connection with the installation of the Communication Equipment.

(k) Prior to Tenant's installation of the Communication Equipment, Tenant shall pay to Landlord or Landlord's rooftop management company, a one-time initial oversight fee in the amount of Five Hundred Dollars (\$500.00). Furthermore, Tenant shall be responsible for the cost of any utilities provided to the Communication Equipment, which costs shall be billed to Tenant and payable by Tenant monthly, as Additional Rent.

IN WITNESS WHEREOF, the parties have executed this Lease, consisting of the foregoing provisions and Articles, including all exhibits and other attachments referenced therein, as of the date first above written.

"LANDLORD"

ARDEN REALTY FINANCE V, L.L.C.,  
a Delaware limited liability company

By: \_\_\_\_\_  
Its: \_\_\_\_\_

"TENANT"

MITEK SYSTEMS, INC.,  
a Delaware corporation

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_



EXHIBIT "A"

PREMISES

[GRAPHIC]

This Exhibit "A" is provided for informational purposes only and is intended to be only an approximation of the layout of the Premises and shall not be deemed to constitute any representation by Landlord as to the exact layout or configuration of the Premises.

EXHIBIT "A"

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EXHIBIT "B"

RULES AND REGULATIONS

1. No sign, advertisement or notice shall be displayed, printed or affixed on or to the Premises or to the outside or inside of the Project or so as to be visible from outside the Premises or Project without Landlord's prior written consent. Landlord shall have the right to remove any non-approved sign, advertisement or notice, without notice to and at the expense of Tenant, and Landlord shall not be liable in damages for such removal. All approved signs or lettering on doors and walls shall be printed, painted, affixed or inscribed at the expense of Tenant by Landlord or by a person selected by Landlord and in a manner and style acceptable to Landlord.

2. Tenant shall not obtain for use on the Premises ice, waxing, cleaning, interior glass polishing, rubbish removal, towel or other similar services, or accept barbering or bootblackening, or coffee cart services, milk, soft drinks or other like services on the Premises, except from persons authorized by Landlord and at the hours and under regulations fixed by Landlord. Except for snack and soft drink vending machines for use by Tenant's employees in the kitchen area of the Premises, no vending machines or machines of any description shall be installed, maintained or operated upon the Premises without Landlord's prior written consent.

3. The sidewalks, halls, passages, exits, entrances, elevators and stairways shall not be obstructed by Tenant or used for any purpose other than for ingress and egress from Tenant's Premises. Under no circumstances is trash to be stored in the corridors. Notice must be given to Landlord for any large deliveries. Furniture, freight and other large or heavy articles, and all other deliveries may be brought into the Project only at times and in the manner designated by Landlord, and always at Tenant's sole responsibility and risk. Landlord may impose reasonable charges for use of freight elevators after or before normal business hours. All damage done to the Project by moving or maintaining such furniture, freight or articles shall be repaired by Landlord at Tenant's expense. Tenant shall not take or permit to be taken in or out of entrances or passenger elevators of the Project, any item normally taken, or which Landlord otherwise reasonably requires to be taken, in or out through service doors or on freight elevators. Tenant shall move all supplies, furniture and equipment as soon as received directly to the Premises, and shall move all waste that is at any time being taken from the Premises directly to the areas designated for disposal.

4. Toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used for any purpose other than for which they were constructed and no foreign substance of any kind whatsoever shall be thrown therein.

5. Tenant shall not overload the floor of the Premises or mark, drive nails, screw or drill into the partitions, ceilings or floor or in any way deface the Premises other than in connection with hanging normal artwork within the Premises. Tenant shall not place typed, handwritten or computer generated signs in the corridors or any other common areas. Should there be a need for signage additional to the Project standard tenant placard, a written request shall be made to Landlord to obtain approval prior to any installation. All costs for said signage shall be Tenant's responsibility.

6. In no event shall Tenant place a load upon any floor of the Premises or portion of any such flooring exceeding the floor load per square foot of area for which such floor is designed to carry and which is allowed by law, or any machinery or equipment which shall cause excessive vibration to the Premises or noticeable vibration to any other part of the Project. Prior to bringing any heavy safes, vaults, or similarly heavy equipment into the Project, Tenant shall inform Landlord in writing of the dimensions and weights thereof and shall obtain Landlord's reasonable consent thereto. Such consent shall not constitute a representation or warranty by Landlord that the safe, vault or other equipment complies, with regard to distribution of weight and/or vibration, with the provisions of this Rule 6 nor relieve Tenant from responsibility for the consequences of such noncompliance, and any such safe, vault or other equipment which Landlord determines to constitute a danger of damage to the Project or a nuisance to other tenants, either alone or in combination with other heavy and/or vibrating objects and equipment, shall be promptly removed by Tenant, at Tenant's cost, upon Landlord's written notice of such determination and demand for removal thereof

7. Tenant shall not use or keep in the Premises or Project any kerosene, gasoline or inflammable, explosive or combustible fluid or material, or use any method of heating or air-conditioning other than that supplied by Landlord.

8. Tenant shall not lay linoleum, tile, carpet or other similar floor covering so that the same shall be affixed to the floor of the Premises in any manner except as approved by Landlord.

9. Tenant shall not install or use any blinds, shades, awnings or screens in connection with any window or door of the Premises and shall not use any drape or window covering facing any exterior glass surface other than the standard drapes, blinds or other window covering established by Landlord.

10. Tenant shall cooperate with Landlord in obtaining maximum effectiveness of the cooling system by closing window coverings when the sun's rays fall directly on windows of the Premises. Tenant shall not obstruct, alter, or in any way impair the efficient operation of Landlord's heating, ventilating and air-conditioning system. Tenant shall not tamper with or change the setting of any thermostats or control valves.

11. The Premises shall not be used for manufacturing or for the storage of merchandise except as such storage may be incidental to the permitted use of the Premises. Tenant shall not, without Landlord's prior written consent, occupy or permit any portion of the Premises to be occupied or used for the manufacture or sale of liquor or tobacco in any form, or a barber or manicure shop, or as an employment bureau. The Premises shall not be used for lodging or sleeping or for any improper, objectionable or immoral purpose. No auction shall be conducted on the Premises.

12. Tenant shall not make, or permit to be made, any unseemly or disturbing noises, or disturb or interfere with occupants of Project or neighboring buildings or premises or those having business with it by the use of any musical instrument, radio, phonographs or unusual noise, or in any other way.

EXHIBIT "B"

- 2 -

13. No bicycles, vehicles or animals of any kind shall be brought into or kept in or about the Premises, and no cooking shall be done or permitted by any tenant in the Premises, except that the preparation of coffee, tea, hot chocolate and similar items for tenants, their employees and visitors shall be permitted. No tenant shall cause or permit any unusual or objectionable odors to be produced in or permeate from or throughout the Premises. The foregoing notwithstanding, Tenant shall have the right to use a microwave and to heat microwavable items typically heated in an office. No hot plates, toaster ovens or similar open element cooking apparatus shall be permitted in the Premises.

14. The sashes, sash doors, skylights, windows and doors that reflect or admit light and air into the halls, passageways or other public places in the Project shall not be covered or obstructed by any tenant, nor shall any bottles, parcels or other articles be placed on the window sills.

15. No additional locks or bolts of any kind shall be placed upon any of the doors or windows by any tenant, nor shall any changes be made in existing locks or the mechanisms thereof unless Landlord is first notified thereof, gives written approval, and is furnished a key therefor. Each tenant must, upon the termination of his tenancy, give to Landlord all keys and key cards of stores, offices, or toilets or toilet rooms, either furnished to, or otherwise procured by, such tenant, and in the event of the loss of any keys so furnished, such tenant shall pay Landlord the cost of replacing the same or of changing the lock or locks opened by such lost key if Landlord shall deem it necessary to make such change. If more than two keys for one lock are desired, Landlord will provide them upon payment therefor by Tenant. Tenant shall not key or re-key any locks. All locks shall be keyed by Landlord's locksmith only.

16. Landlord shall have the right to prohibit any advertising by any tenant which, in Landlord's opinion, tends to impair the reputation of the Project or its desirability as an office building and upon written notice from Landlord any tenant shall refrain from and discontinue such advertising.

17. Landlord reserves the right to control access to the Project by all persons after reasonable hours of generally recognized business days and at all hours on Sundays and legal holidays and may at all times control access to the equipment areas of the Project outside the Premises. Each tenant shall be responsible for all persons for whom it requests after hours access and shall be liable to Landlord for all acts of such persons. Landlord shall have the right from time to time to establish reasonable rules and charges pertaining to freight elevator usage, including the allocation and reservation of such usage for tenants' initial move-in to their premises, and final departure therefrom. Landlord may also establish from time to time reasonable rules and charges for accessing the equipment areas of the Project, including the risers, rooftops and telephone closets.

18. Any person employed by any tenant to do janitorial work shall, while in the Project and outside of the Premises, be subject to and under the control and direction of the Office of the Project or its designated representative such as security personnel (but not as an agent or servant of Landlord, and the Tenant shall be responsible for all acts of such persons).

EXHIBIT "B"

- 3 -

19. All doors opening on to public corridors shall be kept closed, except when being used for ingress and egress. Tenant shall cooperate and comply with any reasonable safety or security programs, including fire drills and air raid drills, and the appointment of "fire wardens" developed by Landlord for the Project, or required by law. Before leaving the Premises unattended, Tenant shall close and securely lock all doors or other means of entry to the Premises and shut off all lights and water faucets in the Premises.

20. The requirements of tenants will be attended to only upon application to the Office of the Project.

21. Canvassing, soliciting and peddling in the Project are prohibited and each tenant shall cooperate to prevent the same.

22. All office equipment of any electrical or mechanical nature shall be placed by tenants in the Premises in settings approved by Landlord, to absorb or prevent any vibration, noise or annoyance.

23. No air-conditioning unit or other similar apparatus shall be installed or used by any tenant without the prior written consent of Landlord. Tenant shall pay the cost of all electricity used for air-conditioning in the Premises if such electrical consumption exceeds normal office requirements, regardless of whether additional apparatus is installed pursuant to the preceding sentence.

24. There shall not be used in any space, or in the public halls of the Project, either by any tenant or others, any hand trucks except those equipped with rubber tires and side guards.

25. All electrical ceiling fixtures hung in offices or spaces along the perimeter of the Project must be fluorescent and/or of a quality, type, design and bulb color approved by Landlord. Tenant shall not permit the consumption in the Premises of more than 2 1/2 watts per net usable square foot in the Premises in respect of office lighting nor shall Tenant permit the consumption in the Premises of more than 1 1/2 watts per net usable square foot of space in the Premises in respect of the power outlets therein, at anyone time. In the event that such limits are exceeded, Landlord shall have the right to require Tenant to remove lighting fixtures and equipment and/or to charge Tenant for the cost of the additional electricity consumed.

26. Parking.

(a) Project parking facility hours shall be 7:00 a.m. to 7:00 p.m., Monday through Friday, and closed on weekends, state and federal holidays excepted, as such hours may be revised from time to time by Landlord; however, subject to casualty and repairs and maintenance, Tenant's employees shall have access to the Project parking facility twenty-four (24) hours per day, seven (7) days per week.

(b) Automobiles must be parked entirely within the stall lines on the floor.

(c) All directional signs and arrows must be observed.

(d) The speed limit shall be 5 miles per hour.

EXHIBIT "B"

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(e) Parking is prohibited in areas not striped for parking.

(f) Parking cards or any other device or form of identification supplied by Landlord (or its operator) shall remain the property of Landlord (or its operator). Such parking identification device must be displayed as requested and may not be mutilated in any manner. The serial number of the parking identification device may not be obliterated. Devices are not transferable or assignable and any device in the possession of an unauthorized holder will be void. There will be a replacement charge to the Tenant or person designated by Tenant of \$25.00 for loss of any parking card. There shall be a security deposit of \$25.00 due at issuance for each card key issued to Tenant.

(g) The monthly rate for parking is payable one (1) month in advance and must be paid by the third business day of each month. Failure to do so will automatically cancel parking privileges and a charge at the prevailing daily rate will be due. No deductions or allowances from the monthly rate will be made for days parker does not use the parking facilities.

(h) Tenant may validate visitor parking by such method or methods as the Landlord may approve, at the validation rate from time to time generally applicable to visitor parking.

(i) Landlord (and its operator) may refuse to permit any person who violates the within rules to park in the Project parking facility, and any violation of the rules shall subject the automobile to removal from the Project parking facility at the parker's expense. In either of said events, Landlord (or its operator) shall refund a prorata portion of the current monthly parking rate and the sticker or any other form of identification supplied by Landlord (or its operator) will be returned to Landlord (or its operator).

(j) Project parking facility managers or attendants are not authorized to make or allow any exceptions to these Rules and Regulations.

(k) All responsibility for any loss or damage to automobiles or any personal property therein is assumed by the parker.

(l) Loss or theft of parking identification devices from automobiles must be reported to the Project parking facility manager immediately, and a lost or stolen report must be filed by the parker at that time.

(m) The parking facilities are for the sole purpose of parking one automobile per space. Washing, waxing, cleaning or servicing of any vehicles by the parker or his agents is prohibited.

(n) Landlord (and its operator) reserves the right to refuse the issuance of monthly stickers or other parking identification devices to any Tenant and/or its employees who refuse to comply with the above Rules and Regulations and all City, State or Federal ordinances, laws or agreements.

(o) Tenant agrees to acquaint all employees with these Rules and Regulations.

EXHIBIT "B"

- 5 -

(p) No vehicle shall be stored in the Project parking facility for a period of more than one (1) week.

27. The Project is a non-smoking Project. Smoking or carrying lighted cigars or cigarettes in the Premises or the Project, including the elevators in the Project, is prohibited.

28. Tenant shall not, without Landlord's prior written consent (which consent may be granted or withheld in Landlord's absolute discretion), allow any employee or agent to carry any type of gun or other firearm in or about any of the Premises, Building or Project.

EXHIBIT "B"

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EXHIBIT "C"

NOTICE OF TERM DATES  
AND TENANT'S PROPORTIONATE SHARE

TO: \_\_\_\_\_ DATE: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

RE: Lease dated \_\_\_\_\_, 20\_\_\_\_, between  
\_\_\_\_\_  
("Landlord"), and \_\_\_\_\_  
\_\_\_\_\_ ("Tenant"), concerning Suite \_\_\_\_\_,  
located at \_\_\_\_\_.

Ladies and Gentlemen:

In accordance with the Lease, Landlord wishes to advise and/or confirm the following:

1. That the Premises have been accepted herewith by the Tenant as being substantially complete in accordance with the Lease and that there is no deficiency in construction.
2. That the Tenant has taken possession of the Premises and acknowledges that under the provisions of the Lease the Term of said Lease shall commence as of \_\_\_\_\_ for a term of \_\_\_\_\_ ending on \_\_\_\_\_.
3. That in accordance with the Lease, Basic Rental commenced to accrue on \_\_\_\_\_.
4. If the Commencement Date of the Lease is other than the first day of the month, the first billing will contain a prorata adjustment. Each billing thereafter shall be for the full amount of the monthly installment as provided for in said Lease.
5. Rent is due and payable in advance on the first day of each and every month during the Term of said Lease. Your rent checks should be made payable to \_\_\_\_\_ at \_\_\_\_\_.
6. The exact number of rentable square feet within the Premises is \_\_\_\_\_ square feet.

EXHIBIT "C"



7. Tenant's Proportionate Share, as adjusted based upon the exact number of rentable square feet within the Premises is \_\_\_\_%.

AGREED AND ACCEPTED:

TENANT:

\_\_\_\_\_ /

a \_\_\_\_\_

By: \_\_\_\_\_

Its: \_\_\_\_\_

EXHIBIT "C"

- 2 -

EXHIBIT "D"

TENANT WORK LETTER

[MITEK SYSTEMS, INC.]

This Tenant Work Letter shall set forth the terms and conditions relating to the renovation of the tenant improvements in the Premises. This Tenant Work Letter is essentially organized chronologically and addresses the issues of the construction of the Premises, in sequence, as such issues will arise.

SECTION 1

CONSTRUCTION DRAWINGS FOR THE PREMISES

Landlord shall construct the improvements in the Premises (the "Improvements") pursuant to that certain plan prepared by "Hurkes Harris Design Associates dated July 15, 2005 as modified by the bulletins which are attached hereto as Schedule 1 and made a part hereof (collectively, the "Plans"). Unless specifically noted to the contrary on the Plans, the Improvements shall be constructed using Project-standard quantities, specifications and materials as determined by Landlord. Based upon the Plans, Landlord shall cause the Architect to prepare detailed plans and specifications for the Improvements ("Working Drawings"). Landlord shall then forward the Working Drawings to Tenant for Tenant's approval. Tenant shall approve or reasonably disapprove any draft of the Working Drawings within three (3) business days after Tenant's receipt thereof; provided, however, that (i) Tenant shall not be entitled to disapprove any portion, component or aspect of the Working Drawings which are consistent with the Plans unless Tenant agrees to pay for the additional cost resulting from such change in the Plans as part of the Over-Allowance Amount pursuant to Section 2 below, and (ii) any disapproval of the Working Drawings by Tenant shall be accompanied by a detailed written explanation of the reasons for Tenant's disapproval. Failure of Tenant to reasonably disapprove any draft of the Working Drawings within said three (3) business day period shall be deemed to constitute Tenant's approval thereof. The Working Drawings, as approved by Landlord and Tenant, may be referred to herein as the "Approved Working Drawings." Tenant shall make no changes or modifications to the Plans or the Approved Working Drawings without the prior written consent of Landlord, which consent may be withheld in Landlord's sole discretion if such change or modification would directly or indirectly delay the "Substantial Completion," as that term is defined in Section 5.1 of this Tenant Work Letter, of the Improvements in the Premises or increase the cost of designing or constructing the Improvements.

SECTION 2

OVER-ALLOWANCE AMOUNT

In the event any revisions, changes, or substitutions are made with Tenant's consent to the Plans or the Approved Working Drawings or the Improvements, any additional costs which arise in connection with such revisions, changes or substitutions shall be considered to be an "Over-Allowance Amount." The Over-Allowance Amount shall be paid by Tenant to Landlord, as Additional Rent, within ten (10) days after Tenant's receipt of invoice therefor. The Over-Allowance Amount shall be disbursed by Landlord prior to the disbursement of any portion of Landlord's contribution to the construction of the Improvements.

EXHIBIT "D"

SECTION 3

RETENTION OF CONTRACTOR;  
WARRANTIES AND GUARANTIES

Landlord hereby assigns to Tenant all warranties and guaranties by the contractor who constructs the Improvements (the "Contractor") relating to the Improvements, and Tenant hereby waives all claims against Landlord relating to, or arising out of the construction of, the Improvements. The Contractor shall be designated and retained by Landlord to construct the Improvements.

SECTION 4

TENANT'S COVENANTS

Tenant shall, at no cost to Tenant, cooperate with Landlord and the space planner or architect retained by Landlord ("Architect") to cause a Notice of Completion to be recorded in the office of the Recorder of the County of San Diego in accordance with Section 3093 of the Civil Code of the State of California or any successor statute upon completion of construction of the Improvements.

SECTION 5

COMPLETION OF THE IMPROVEMENTS

5.1 Substantial Completion. For purposes of this Lease, "Substantial Completion" of the Improvements in the Premises shall occur upon the completion of construction of the Improvements in the Premises pursuant to the Approved Working Drawings, with the exception of any punch list items and any tenant fixtures, work-stations, built-in furniture, or equipment to be installed by Tenant.

5.2 Delay of the Substantial Completion of the Premises. Except as provided in this Section 5.2, the Commencement Date shall occur as set forth in the Lease. If there shall be a delay or there are delays in the Substantial Completion of the Improvements in the Premises as a result of the following (collectively, "Tenant Delays"):

5.2.1 Tenant's failure to timely approve any matter requiring Tenant's approval;

5.2.2 A breach by Tenant of the terms of this Tenant Work Letter or the Lease;

5.2.3 Tenant's request for changes in the Plans, Working Drawings or Approved Working Drawings;

5.2.4 Changes in any of the Plans, Working Drawings or Approved Working Drawings because the same do not comply with applicable laws;

EXHIBIT "D"

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5.2.5 Tenant's requirement for materials, components, finishes or improvements which are not available in a commercially reasonable time given the anticipated date of Substantial Completion of the Improvements in the Premises, or which are different from, or not included in, Landlord's standard improvement package items for the Project;

5.2.6 Changes to the base, shell and core work of the Project required by the Approved Working Drawings or any changes thereto; or

5.2.7 Any other acts or omissions of Tenant, or its agents, or employees;

then, notwithstanding anything to the contrary set forth in the Lease or this Tenant Work Letter and regardless of the actual date of the Substantial Completion of the Improvements in the Premises, the date of Substantial Completion thereof shall be deemed to be the date that Substantial Completion would have occurred if no Tenant Delay or Delays, as set forth above, had occurred.

5.3 Outside Date. In the event that the Substantial Completion of the Improvements in the Premises has not occurred by the "Outside Date," which shall be January 15, 2006, as such January 15, 2006 date may be extended by the number of days of Tenant Delays and by the number of days of "Force Majeure Delays" (as defined below), then the sole remedy of Tenant shall be the right to deliver a notice to Landlord (the "Outside Date Termination Notice") electing to terminate this Lease effective upon receipt of the Outside Date Termination Notice by Landlord (the "Effective Date"). Except as provided hereinbelow, the Outside Date Termination Notice must be delivered by Tenant to Landlord, if at all, not earlier than the Outside Date and not later than five (5) business days after the Outside Date. If Tenant delivers the Outside Date Termination Notice to Landlord, then Landlord shall have the right to suspend the Effective Date for a period ending thirty (30) days after the original Effective Date. In order to suspend the Effective Date, Landlord must deliver to Tenant, within five (5) business days after receipt of the Outside Date Termination Notice, a certificate of the Contractor certifying that it is such Contractor's best good faith judgment that Substantial Completion of the Improvements in the Premises will occur within thirty (30) days after the original Effective Date. If Substantial Completion of the Improvements in the Premises occurs within said thirty (30) day suspension period, then the Outside Date Termination Notice shall be of no further force and effect; if, however, Substantial Completion of the Improvements in the Premises does not occur within said thirty (30) day suspension period, then this Lease shall terminate as of the date of expiration of such thirty (30) day period. If prior to the Outside Date Landlord determines that Substantial Completion of the Improvements in the Premises will not occur by the Outside Date, Landlord shall have the right to deliver a written notice to Tenant stating Landlord's opinion as to the date by which Substantial Completion of the Improvements in the Premises shall occur and Tenant shall be required, within five (5) business days after receipt of such notice, to either deliver the Outside Date Termination Notice (which will mean that this Lease shall thereupon terminate and shall be of no further force and effect) or agree to extend the Outside Date to that date which is set by Landlord. Failure of Tenant to so respond in writing within said five (5) business day period shall be deemed to constitute Tenant's agreement to extend the Outside Date to that date which is set by Landlord. If the Outside Date is so extended, Landlord's

EXHIBIT "D"

- 3 -

right to request Tenant to elect to either terminate or further extend the Outside Date shall remain and shall continue to remain, with each of the notice periods and response periods set forth above, until the Substantial Completion of the Improvements in the Premises or until this Lease is terminated. For purposes of this Section 5.3, "Force Majeure Delays" shall mean and refer to a period of delay or delays encountered by Landlord affecting the work of construction of the Improvements because of delays due to excess time in obtaining governmental permits or approvals beyond the time period normally required to obtain such permits or approvals for similar space, similarly improved, in comparable office buildings in the Clairemont area of San Diego, California; fire, earthquake or other acts of God; acts of the public enemy; riot; public unrest; insurrection; governmental regulations of the sales of materials or supplies or the transportation thereof; strikes or boycotts; shortages of material or labor or any other cause beyond the reasonable control of Landlord.

## SECTION 6

### MISCELLANEOUS

6.1 Tenant's Representative. Tenant has designated Tesfaye Hailemichael as its sole representative with respect to the matters set forth in this Tenant Work Letter, who, until further notice to Landlord, shall have full authority and responsibility to act on behalf of the Tenant as required in this Tenant Work Letter.

6.2 Landlord's Representative. Prior to commencement of construction of the Improvements, Landlord shall designate a representative with respect to the matters set forth in this Tenant Work Letter, who, until further notice to Tenant, shall have full authority and responsibility to act on behalf of the Landlord as required in this Tenant Work Letter.

6.3 Time of the Essence in This Tenant Work Letter. Unless otherwise indicated, all references herein to a "number of days" shall mean and refer to calendar days.

6.4 Punch List. Concurrently with Landlord's delivery of the Premises to Tenant, a representative of Landlord and a representative of Tenant shall perform a walk-through inspection of the Premises to identify any "punchlist" items in the Improvements (i.e., minor defects or conditions in such Improvements that do not impair Tenant's ability to utilize the Premises for the purposes permitted hereunder) and any "punchlist" items regarding the systems of the Project serving the Premises pursuant to Landlord's obligations under the first sentence of Article 8 of the Lease, which items Landlord shall repair or correct no later than thirty (30) days after the date of such walk-through (unless the nature of such repair or correction is such that more than thirty (30) days are required for completion, in which case Landlord shall commence such repair or correction work within such thirty (30) day period and diligently prosecute the same to completion).

EXHIBIT "D"

**EXHIBIT 23**

**INDEPENDENT AUDITORS' CONSENT**

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in Registration Statement Nos. 33-3888, 333-23707, 333-80567, 333-58032 and 333-106843 of Mitek Systems, Inc. on Form S-8 of our report dated November 21, 2005, appearing in this Annual Report on Form 10-KSB of Mitek Systems, Inc. for the years ended September 30, 2005 and 2004.

*/s/ Stonefield Josephson, Inc.*

Stonefield Josephson, Inc.

Santa Monica, California

November 29, 2005

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**CERTIFICATION OF  
CHIEF EXECUTIVE OFFICER**

I, James B. DeBello, certify that:

1. I have reviewed this annual report on Form 10-KSB of Mitek Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 28, 2005

By: /s/ James B. DeBello

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James B. DeBello  
Chief Executive Officer

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**CERTIFICATION OF  
CHIEF FINANCIAL OFFICER**

I, John M. Thornton, certify that:

1. I have reviewed this annual report on Form 10-KSB of Mitek Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 28, 2005

By: /s/ Tesfaye Hailemichael

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Tesfaye Hailemichael  
Chief Financial Officer

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, James B. DeBello, Chief Executive Officer of Mitek Systems, Inc. (the "Registrant"), do hereby certify pursuant to Rule 13a of the Securities and Exchange Act of 1934, as amended, and Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of Chapter 63 of Title 18 of the United States Code that:

- (1) the Registrant's Annual Report on Form 10-KSB of the Registrant for the year ended September 30, 2005 (the "Report"), to which this statement is filed as an exhibit, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: November 28, 2005

By: /s/ James B. DeBello

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James B. DeBello  
Chief Executive Officer

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Tesfaye Hailemichael, Chief Financial Officer of Mitek Systems, Inc. (the "Registrant"), do hereby certify pursuant to Rule 13a of the Securities and Exchange Act of 1934, as amended, and Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of Chapter 63 of Title 18 of the United States Code that:

- (1) the Registrant's Annual Report on Form 10-KSB of the Registrant for the year ended September 30, 2005 (the "Report"), to which this statement is filed as an exhibit, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: November 28, 2005

By: /s/ Tesfaye Hailemichael

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Tesfaye Hailemichael  
Chief Financial Officer

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