ELECTRONIC CLEARING HOUSE INC
Form 10-K
December 29, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

# FORM 10-K

X Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended Sept. 30, 2004

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

Commission File Number 0-15245

ELECTRONIC CLEARING HOUSE, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| NEVADA | 93-0946274 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| 730 PASEO CAMARILLO, CAMARILLO, CALIFORNIA | 93010 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (805) 419-8700, fax number: (805) 419-8689

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

| TITLE OF EACH CLASS | Name of each exchange ON WHICH REGISTERED |
|---|---|
| None | None |

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.01 par value
(Title of class)

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on March 31, 2004 as reported on the NASDAQ SmallCap Market, was approximately $60,535,000. Shares of Common Stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of December 13, 2004, Registrant had outstanding 6,472,331 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE - NONE

ELECTRONIC CLEARING HOUSE, INC.
2004 FORM 10-K ANNUAL REPORT

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# PART 1

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This 2004 Annual Report on Form 10-K contains statements which constitute 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. Those statements include statements regarding our intent, belief or current expectations. Examples of forward-looking statements include statements regarding our strategy, financial performance and revenue sources. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors, including, but not limited to, those set forth elsewhere in this Annual Report. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Factors."

## ITEM 1. BUSINESS

### OVERVIEW

Electronic Clearing House, Inc. is an electronic payment processor that provides for the payment processing needs of merchants, banks and collection agencies. We derive the majority of our revenues from two main business segments, bankcard and transaction processing services ("bankcard services"), whereby we provide solutions to merchants and banks to allow them to accept credit and debit card payments from consumers, and check-related products ("check services"), whereby we provide various services to merchants and banks to allow them to accept and process check payments from consumers. The principal services we offer within these two segments include, with respect to our bankcard services, debit and credit card processing, and with respect to our check services, check guarantee (where, if we approve a check transaction and a check is subsequently dishonored by the check writer's bank, the merchant is reimbursed by us), check verification (where, prior to approving a check, we search our negative and positive check writer database to determine whether the check writer has a positive record or delinquent check-related debts), electronic check conversion (the conversion of a paper check at the point of sale to a direct bank debit which is processed for settlement through the Federal Reserve System's Automated Clearing House ("ACH") network; the ACH is the electronic banking network through which a majority of electronic funds transfers are made in the United States), check re-presentment (where we attempt to clear a check on multiple occasions via the ACH network prior to returning the check to the merchant so as to increase the number of cleared check transactions), and check collection (where we provide national scale collection services for a merchant or bank). We operate our services under the following brands:

- MerchantAmerica, our retail provider of all payment processing services to both the merchant and bank markets;
- National Check Network ("NCN"), our proprietary database of negative

and positive check writer accounts (i.e., accounts that show delinquent history in the form of non-sufficient funds and other negative transactions), for back-end check verification, check authorization and check capture services, and for membership to collection agencies; and

- XPRESSCHEX, Inc. for retail check verification, check conversion, Automated Clearing House services (which we describe in greater detail below), check collection and check guarantee services.
- ECHO, for wholesale check processing services offered to Visa banks under the Visa POS Check Service program.

We discuss our services in greater detail below. Overall, our ability to program and oversee the management of a merchant's point-of-sale system, provide credit card and debit card processing, provide multiple check services for the processing of checks, provide both electronic and traditional collection services, and fully integrate all of these services into a single Internet-based reporting capability allows us to provide for the majority of the payment processing needs of our customers.

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We were incorporated in Nevada in December 1981. Our executive offices are located at 730 Paseo Camarillo, Camarillo, California 93010, and our telephone number is (805) 419-8700. Our common stock is traded on the NASDAQ SmallCap Market under the ticker symbol "ECHO." Information on our website, www.echo-inc.com, does not constitute part of this annual report.

HISTORY OF THE COMPANY

ECHO has been offering bankcard and check services for over 18 years. We were incorporated in Nevada in 1981 under the name Bio Recovery Technology, Inc. and changed our name to Electronic Clearing House, Inc. with the acquisition of a credit card processing company, Electronic Financial Systems, Inc. in January 1986. In 1986, ECHO developed the capability, utilizing the Federal Reserve System's Automated Clearing House ("ACH"), a network which serves as a nationwide, wholesale electronic payment and collection system by way of transferring funds between banks via the Federal Reserve System, to deposit funds into any U.S. bank of the merchant's choice. This development made it possible for remote banks and processors to provide the same processing services previously available only through the merchant's local bank.

In 1999, ECHO acquired Magic Software Development, Inc., a check processing company located in Albuquerque, New Mexico, that serviced National Check Network ("NCN"), an association of approximately 60 affiliated collection agencies across the nation. At the time, we provided a check guarantee service that only served California merchants, but with the addition of Magic's check processing capabilities, our check guarantee services have been offered on a national basis since 1999. In fiscal 2000, Magic's corporate name was changed to XPRESSCHEX and all XPRESSCHEX activity was moved to our XPRESSCHEX subsidiary. XPRESSCHEX provides and promotes its check and ACH services to other processors and sales organizations in addition to ECHO.

In November 1999, we acquired Peak Collection Services, a collection agency in Albuquerque, New Mexico, and incorporated Peak into our XPRESSCHEX operations as our Collection Division in December of 1999. Through filings and individual testing, the XPRESSCHEX Collection Division has completed registration as a collection agency in 48 of 50 states to date. Having a fully integrated, nationally approved collection service allows XPRESSCHEX to operate as a central check clearing facility for NCN's 260 collection agencies without each agency having to authorize such activity.

In January 2000, we acquired Rocky Mountain Retail Systems ("RMRS") located in Boulder, Colorado, which provided a national check verification service to over 200 collection agencies across the nation. RMRS maintained a national check database of negative and positive check writer records.

In December 2000, we signed an agreement with Visa U.S.A. to participate in a point-of-sale check processing pilot program as both an "Acquirer Processor" (a role that accepts transactions from a merchant's point-of-sale terminal and reformats them for submission to the Visa network) and as a "Third-Party Processor" (a role that approves or declines checks written on accounts of banks not yet participating in the Visa POS Check Service program and deposits approved funds utilizing the Federal Reserve System's Automated Clearing House). Under the program, any one of over 14,000 Visa member banks can offer various check processing services to their merchants and utilize Visa's dedicated communications network and banking relationships to clear check activity using direct debits from the check writer's account. In July 2001, several major financial institutions began participating in the pilot program. The program was released from pilot in December of 2002 and, as of September 2004, nine financial institutions were using ECHO as their Acquirer Processor and sixteen financial institutions were using ECHO as their Third-Party Processor.

In May 2001, we acquired the assets of National Check Network ("NCN") and combined the NCN positive and negative check writer records with the RMRS database, resulting in a combined database of over 120 million check writer records which identify the positive and negative check writing activities occurring with individual check writers (including information related to accepted checks, bounced checks, and the frequency of delinquent transactions). This database is ever-growing with additional contributions daily.



Also in May 2001, ECHO launched MerchantAmerica.com, a web-based source of financial information whereby an ECHO merchant can access its transactional history, bank information, significant business and office-related services and even build an online store and accept payment in the form of credit cards or checks. The site also contains a national Merchant Directory that is free to any merchant in the United States. It also provides any merchant in the United States with the ability to edit and enhance their directory listing. While we believe that MerchantAmerica.com is a valuable and cost-effective resource for merchants, it also provides us with a low-cost method of keeping our merchants informed and involved with us.

## OUR SERVICES

### BANKCARD AND TRANSACTION PROCESSING SERVICES

#### Services

With our bankcard and transaction processing services, we provide payment solutions to merchants and banks to allow them to accept credit and debit card payments from consumers. Our bankcard and transaction processing services include the following:

Debit and Credit Card Payment Processing
MerchantAmerica, our retail provider of payment processing services to both the merchant and bank markets, currently provides 24-hour daily payment processing, "800" number access to customer service personnel and, as needed, various field support services. Utilizing one of several methods of access to us, the merchants' systems dial our host computers and receive credit card and debit

card authorizations, which have been electronically verified. Electronic files are then transmitted daily by MerchantAmerica to the major credit card organizations or to the ACH, which subsequently transfer funds from the banks to MerchantAmerica's processing bank, which then deposits the funds into the bank of the merchant's choice. On average, ECHO deposits funds to over 600 banks across the nation on behalf of its merchant base each day.

Our software programs capture the transactions, retain data and enable merchants to review, reconcile and edit transactions. MerchantAmerica's customer service efforts include a terminal loaner program to minimize downtime, frequent sales and activity reports, and sophisticated security services utilizing the merchant's terminal, our host computers and assistance in the field. Additionally, MerchantAmerica utilizes several advanced telecommunications capabilities to provide consistent and reliable services to its merchants.

Other Payment Processing Services

We also provide various services related to our debit and credit card payment processing, including:

- Internet Processing - ECHO allows merchants to process payment transactions online with immediate processing, online reporting and security services that protect the cardholder, merchant and Internet Service Provider ("ISP") from fraud.
- Batch File Processing - ECHO allows mail order, telephone order or direct marketing merchants to process and transmit hundreds of thousands of payments at a time by using Microsoft Excel(R), Access(R) or any other program that can create a "flat file" of data. In this process, the merchant can visit the ECHO Merchant Center, log on with its PIN and merchant number, and then upload the file to ECHO's processing center. The transactions are processed immediately, with reporting available almost immediately to provide response data on each transaction.

Deriving Revenues
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Bankcard and transaction processing services provide for the majority of our revenues. For the year ended September 30, 2004, bankcard and transaction processing accounted for approximately 76% of our revenues. Bankcard and transaction processing volume rose 9.5% in fiscal 2004, from $961,248,000 in fiscal 2003 to $1,052,588,000 in fiscal 2004, and revenue increased approximately 11.5%, from $32,444,000 in fiscal 2003 to $36,161,000 in fiscal 2004.

In a typical transaction, ECHO receives a percentage-based fee on the dollar amount processed and a transaction fee on the number of transactions processed. ECHO's revenue for debit/credit card processing is derived primarily

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from three sources: the merchant's discount rate, the merchant's transaction fee and set monthly fees. The discount rate is expressed as a percentage of the amount being processed and is deducted from the amount of each transaction submitted by the merchant, while the net amount is deposited into the merchant's bank account.

Discount rates range between 1.5% and 4.5%, and our average discount rate is 2.4%, which is consistent with our rates for the year ended September 30, 2003. Depending upon the discount rate and the cost of clearing interchange, about 75% to 90%, and about 85% on average, of the discount rate revenue is paid to card-issuing banks and organizations and the sponsoring bank.

A transaction fee is charged for each transaction processed and ECHO's average transaction fee in fiscal 2004 was $0.20 per transaction, compared to $0.19 in fiscal 2003. We charge our bankcard merchants a range from $0.15 up to $0.32 per transaction, depending on the type of transaction and merchant. Larger customers tend to pay lower transaction fees given the volume of business they provide. Both Visa and MasterCard have instituted $0.05 to $0.10 transaction fees on each transaction processed that ECHO is required to pay. On average, ECHO pays approximately $0.012 per transaction for communication costs, depending upon the duration and method of transmission.

The market size for credit card processing is approximately 19 billion transactions per year, and this number is growing annually. ECHO has a very small percentage of this market, but we are one of the top 50 credit card processors according to The Nilson Report, a monthly financial subscription-based newsletter. Our competitors include First Data Corporation, the biggest credit card processor in the United States, Certegy, NPC, Global Payments, and many other smaller payment processors. The credit card processing market has undergone rapid consolidation, which has raised unique challenges, including supporting and integrating numerous processing methodologies, initiating quality customer support and field support services and maintaining merchant relationships. While merchant portfolios can be purchased by a processor or a credit card agent bank, merchants are generally under no contractual obligation to utilize the services of the new owner so many of the most active consolidators have been experiencing difficulty in maintaining their number of active merchants.

In an effort to enhance the bankcard transaction processing business segment's processing infrastructure and control processing costs, we licensed several payment processing systems from Oasis Technologies in 2002 and a full integration of this system is currently projected for 2005. While we believe that our data center is reliable and the costs to operate the MerchantAmerica program are currently reasonable, no assurance can be made that such favorable conditions will continue.

In order to engage in Visa and MasterCard processing, a cooperative relationship is required with a bank that sponsors the Visa and MasterCard transactions. ECHO's primary processing bank relationship is with First Regional Bank of Los Angeles, California. As a result of its relationship, ECHO is a registered Independent Sales Organization and Merchant Service Provider with Visa and MasterCard, respectively, which allows us to solicit and support merchants utilizing our services. We have an agreement with First Regional Bank, which continues our relationship through 2005. Pursuant to the terms of the agreement, among other matters, we market and sell merchant services and the bank provides various support services in connection with individual transactions, in exchange for our payment to the bank, on a monthly basis, of either a payment of $0.02 per transaction, or 10 basis points of the bankcard processing volume, depending on the merchant and/or processing volume requirements. The agreement does not allow either party to terminate other than for cause (as defined in the agreement) without incurring liability for breach of the agreement.

CHECK-RELATED PRODUCTS (OR "CHECK SERVICES")

Overview
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ECHO has invested significant resources and management focus in its check services business. Check services revenue increased approximately 39.4% in fiscal 2004, from $8,192,000 for fiscal 2003 to $11,423,000 for fiscal 2004. Revenues from ACH and check conversion are all increasing significantly. Visa officially released its POS Check Service as of December 2002 and several national banks have since approved the program to be offered to their merchants.

Therefore, ECHO anticipates continued growth in check services as the marketing efforts of participating banks in the Visa Program become more widely implemented. (See also the discussion of the Visa POS Check Service program below.)

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Services
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With our check services, we provide various services to merchants and banks to allow them to accept and process check payments from consumers. Our check services include the following:

Check Verification
For a fee, we will search NCN, our proprietary database of negative and positive check writer accounts, attempting to match a specific piece of information, such as a driver's license number or Magnetic Ink Character Recognition ("MICR") number (the numeric data along the bottom of a check), provided by a merchant. A match may identify whether the check writer has a positive record or delinquent check-related debts. Upon notification of this match (via a coded response from the provider), the merchant decides whether to accept or decline the check. Verification reduces the risk of accepting a bad check for the merchant, however, in providing this program alone, we typically offer no guarantee that the check will be honored by the check writer's bank and make no promise of reimbursement if the check is dishonored by the bank. Revenue from check verification is derived from fees collected from the merchants when a check is verified against our positive and negative check database. This revenue is recognized when the transaction is processed, since we have no further performance obligations.

Check Guarantee
With this service, if we approve a check transaction and a check is subsequently dishonored by the check writer's bank, the merchant is reimbursed by us and we acquire rights to collect the delinquent amount from the check writer.

The principal risk of providing this service is the risk of ever collecting the amount we guarantee from a delinquent check writer whose check transaction was dishonored by his or her own bank. If we are unable to collect the amount, we lose that amount. On average, we usually collect on 50-60% of the amounts we guarantee that have become delinquent. Given the risks associated with check guarantee, especially for large volume merchants, we exercise strict risk parameters with the merchants to which this service is offered. We typically apply several risk management approaches with this service, which include searching NCN's database against the data provided by the merchant, and "scoring" each transaction according to several factors such as velocity (the number of times a check writer has been searched in a certain period of time), prior activity (historic negative or positive transactions with the check writer), check writer's presence in other databases (these national databases are selectively searched based upon the size of the check and the prior activity with the check writer), size of the check, and historic bad check activity by geographic and/or merchant specific locations, to name a few. If our scoring system concludes that the risk is too high, we issue a coded response instructing the merchant that we will not guarantee the check. If our scoring system results in a positive result, a coded response advises the merchant that we have guaranteed payment on that item.

Electronic Check Conversion ("ECC")
Check conversion is the ability to convert a paper check to an electronic item at the point of sale. ECC is a relatively new system of check settlement that is quickly gaining merchant acceptance. Under the program, the merchant slips a

customer's check either through a check reader that reads the MICR line on the check or a check imager that records the total image of the face of the check and the merchant enters the amount of the check into the system. The merchant has the customer sign a receipt, much the same as in a credit card transaction, and gives a copy of the signed receipt along with the check to the customer. The electronic image, captured by the reader, is sent to our processing center and we settle the check transaction electronically. Merchants' customers like this new system because they get their check back immediately and still have a hard copy receipt of the transaction. Banks like ECC because no paper has to be handled by the bank to settle the transaction. While large national merchants already have check-reading equipment, small merchants will adopt the system only if their check volume justifies the capital investment in equipment, ranging from $150 to $600 per reader.

Check Re-Presentment

The Federal Reserve System's Automated Clearing House ("ACH") provides the tools to electronically present, re-present and settle funds between banks. Our check re-presentment program allows a merchant to advise its bank that a returned check should be sent to the XPRESSCHEX data processing center in Albuquerque, New Mexico, rather than returned to the merchant. Upon receipt, XPRESSCHEX converts the check to an electronic ACH

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transaction for resubmission through the ACH network and marks the check for possible collection activity, should it become necessary. One feature a merchant may choose is to time the re-presentment so as to coincide with a check writer's typical payday to better the odds of collection. Generally, the full face value of the check is returned to the merchant upon collection and a collection fee charged to the check writer, usually in the range of $15 to $25, is retained by XPRESSCHEX as payment for its services.

Internet Check, Batch Check and Virtual Terminal

A check can be presented as a form of payment over the Internet and we support the multiple types of ACH entry classes. XPRESSCHEX allows an e-commerce site to accept a check as payment, allows a batch of check data to be sent electronically for processing (this is commonly used by mail order or phone order businesses) and allows both verification-only and ACH transactions to be submitted by merchants via a secure logon and passcode connection over the Internet.

Visa POS Check Service Program ("Visa Program")
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The Visa Program represents a major new initiative by Visa to enable merchants to receive direct online authorization for checks written against consumer checking accounts, similar to the authorizations provided for credit and debit card transactions. The Visa Program was offered as a pilot program by Visa to its member banks from December of 2000 to December of 2002 over which time several banks electronically connected their check writer data to the Visa network, making verification of the check writer's bank account balance possible when checks drawn on these select banks were processed. In December of 2002, the program was officially released out of pilot. As of November 2004, approximately 12% of checking accounts in the United States are electronically connected to the Visa network through the banks that are now participating in the Visa Program. This number is expected to increase to 30% or higher over the coming year as more banks connect their check writer data with Visa. ECHO has invested significant resources and management focus in its check services business, particularly with respect to the Visa Program, and anticipates continued growth in check services as the marketing efforts of participating banks in the Visa Program become more widely implemented.

As described above, "check conversion" is the ability to convert a paper check to an electronic item at the point of sale. The Visa Program provides Visa member banks with a check conversion service that they can sell to their bank merchants. The Visa check conversion service allows the merchant to get an immediate authorization or decline on a check while the check writer is at the checkout counter. If the check is approved, the service allows the merchant to immediately return the paper check to the check writer since the funds will be electronically withdrawn from the check writer's account and deposited into the merchant's account.

Being able to approve or decline a check in real time at the point of sale requires some method to verify the check writer has either an adequate balance in the bank to cover the check or, if that is not possible, to verify if the check written has a match in a negative check account database. In order to provide this check service on 100% of the checks received by a merchant, Visa needed a solution to approve or decline (and for those approved, electronically deposit) the checks that processed through the program on a bank that had not yet connected its check writer data to the Visa network. We are currently one of two companies that provide this service to Visa as a Third-Party Processor. When a Visa member bank signs up to offer the Visa Program to its merchants, it chooses a Third-Party Processor from the certified providers and, to date, ECHO serves as a Third-Party Processor for sixteen financial institutions actively participating in the program.

When Visa receives electronic check data from a merchant and the bank upon which the check is drawn has not connected its check writer data to the Visa network, Visa routes that check to the Third-Party Processor that was chosen by the merchant's bank when they set up the program. The Third-Party Processor authorizes or declines a check based upon the negative and positive data contained in several national check account databases that are commercially available and, for those transactions that are approved, the Third-Party Processor will electronically move the funds from the check writer's account to either the merchant bank's master clearing account or directly to the merchant's banking account (depending on the bank's desired settlement method) utilizing the Automated Clearing House ("ACH"), a funds settlement service offered through the Federal Reserve Bank.

In addition to being a Third-Party Processor, we are one of only five companies that are currently certified as an Acquirer Processor with Visa, a role that accepts transactions from the merchant's point-of-sale terminal/systems and reformats them for submission to the Visa network. We are chosen by nine banks currently in the program to serve as their Acquirer Processor. Most banks presently in the Visa Program are large national or regional banks



and already had terminal management service providers that could act as Acquirer Processor for the Visa Program. In the future, as smaller banks make the decision to enter the Visa Program, it is expected that many will have no prior relationship with a terminal management provider and therefore, may potentially choose us as their Acquirer Processor.

We derive transaction revenue in our role as a Third-Party Processor and/or Acquirer Processor by negotiating a transaction fee with Visa and/or the bank that chose us as its Third-Party Processor and/or Acquirer Processor. This transaction fee averages $0.09 per transaction. The party that sells the service to the merchant (usually the bank) enjoys the largest mark-up on the product, offering the service in the range of $0.30 to $0.60 per check, with external cost in the $0.12 to $0.20 range, depending on what the bank negotiates with Visa and any third-party provider.

We entered into a sponsorship agreement with our primary credit card processing bank, First Regional Bank, to enable us to sell the Visa Program directly to merchants with an obligation to pay a small transaction fee per check to the bank. This allows the bank to realize added revenue, allows us to realize higher revenues in a marked-up pricing model, and a portion of the mark-up to be used to compensate and motivate resellers of our products and services to offer the Visa Program to merchants in the marketplace. The balance of the mark-up after paying the bank and the sales organization would be additional revenue to us. This will also enable us to use our direct sales channels to provide the Visa Program to ECHO's current and potential merchant base.

The Visa infrastructure requires ECHO to coordinate and integrate its services with several parties and systems. As part of the Visa Program, we have written, tested and installed special merchant terminal software that meets specified Visa Program requirements and certified our terminal and host response code with Vital Processing Services, a major provider of terminal services to many major banks. ECHO has also developed special add-on services and reporting for specific banks or select merchants that desired to participate in the Visa Program. Additionally, ECHO has designed and is implementing several risk management tools that contribute to the significant reduction in net bad debt seen by a retailer, making the Visa Program a true competitive alternative to guarantee services.

## Deriving Revenues

For the past several years, we have invested significant resources and management focus in our check services business which provides various services to merchants and banks to allow them to accept and process check payments from consumers. This business segment comprised approximately 24% of our total revenues for the fiscal year ended September 30, 2004. As an individual segment, check-related revenue increased by 39.4% to $11,423,000 in fiscal 2004 from $8,192,000 for fiscal 2003.

ECHO's revenue in check services can come from several sources. Typically, the merchant pays either a fixed fee for each transaction (verification, conversion, etc.) or a fee based on the face amount of the check (check guarantee) or both (check guarantee). In the Visa model, ECHO can receive transaction fees for providing "third-party" services to Visa banks, whereby ECHO assists them in processing checks from banks not participating in the Visa Program. In addition, ECHO may serve a Visa bank by being a collector of the transaction data for the merchant and submitting it to VisaNet, a process referred to as an "Acquiring Processor". Finally, ECHO can also participate in the mark-up that is charged on the sales price to a merchant, although this is only earned by ECHO if its primary sales channels secured the relationship. Additional revenue is earned if the merchant utilizes ECHO's collection services and it is primarily derived from the collection fee associated with successful collection of an item. If ECHO refers a collection item to an NCN member, a small participation in the collection fee is returned to ECHO through agreement with the NCN member. Finally, when ECHO provides a guarantee service to a merchant or a bank, it earns a percentage of every check processed from the merchant or bank and ECHO's earnings related thereto are directly tied to its success in collection and its risk management capability.

The NCN database includes over 20 million negative check account records and 100 million positive records. Over 260 affiliated collection agencies continually contribute to the database to enrich its depth and value. Through its network of NCN members, ECHO can offer regional collection services and distribute collection items to one or more of a select group of NCN's member agencies to maximize a merchant's or bank's ability to collect amounts on a local level. NCN provides an ongoing revenue stream for ECHO as collection agencies, major national merchants, banks, other transaction processors, and thousands of small merchants access the NCN database daily to verify the status of a check writer in real time. Check verification has been recognized as one of the lowest



cost and most effective ways for retailers to lower the risks and losses experienced in accepting checks as a form of payment. Our NCN database is one of only four major databases in the nation that can serve this market need on a national scale, and we are currently the fifth largest check verification processor in the United States according to the July 2004 issue of The Nilson Report, a monthly financial subscription-based newsletter. In addition to operating NCN, we provide a common platform where a business can also access other major negative check writer databases that are currently available in the nation.

XPRESSCHEX revenues are growing due to the increased use of our check conversion services, which include the capture (through digital imaging, or the retention of specified personal information) of the necessary check data at the point of sale and submission of the transaction electronically to the Federal Reserve System's Automated Clearing House for settlement of funds. XPRESSCHEX also maintains an active collection agency, registered in 48 states, that serves primarily as a referral agent to select NCN members that are collection agencies and are located in various regions of the country.

OTHER SERVICES

ECHO had historically generated a small percentage of its revenue from its terminal business whereby we deployed proprietary software and terminal hardware in a comprehensive system for real-time credit card authorization, capture and compilation of compensation data, and in some cases, active management of rental equipment information. However, we are currently not pursuing the sale of our proprietary terminal system but rather focusing on our core bankcard and check services business segments. In fact, in fiscal 2003, we gradually shut down our terminal deployment operations.

STRATEGY

Overview
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ECHO's strategy is to provide merchants, banks and industry-specific resellers with electronic connectivity to various payment services in the credit card, debit card and check-related markets. Our platform of services is very flexible, enabling merchant customization and scalability to meet the requirements of high transaction volumes, as well as access to the Visa Program. ECHO's services enable merchants to maximize revenues by offering a wide variety of payment options, reducing the costs associated with processing and handling checks, improving collections and managing risk more effectively. Additionally, ECHO is committed to customer service and a recent internal survey of customer satisfaction rates showed an improvement to 4.43 out of a possible 5.0, from approximately 4.15 in a similar survey taken three years prior.

We have targeted several areas as significant opportunities for growth, including focusing on retail accounts for check services and developing a scalable infrastructure to support widespread implementation of the Visa Program. We also seek to increase profitability of our principal merchant services by enhancing our back-end technology and identifying and targeting new low-cost, incremental revenue opportunities, such as active promotion of our payment services to non-profit organizations.

## Promote Check Services for Middle Market Retail Accounts

While ECHO focuses its credit card services to the middle market of retail and non-face-to-face merchants, our check services business, through various sales channels like direct sales and sales through authorized resellers, has the ability to target the full scope of merchants in the marketplace, from the small merchant that may only require check verification to the national retailers that require check conversion and national collection services.

With approximately four million merchants in the U.S. and over 95% currently accepting credit cards as payment, ECHO estimates that approximately 60% of merchants, or about 2.3 million merchants, that accept credit cards also accept checks as a form of payment. Furthermore, of the group that accepts checks as a form of payment, we estimate that only 17% of them have an electronic method to accept checks and the other 83% accept a paper check and process it in the traditional manner by taking the check to the bank.

ECHO's estimated market potential for check services is:



- Approximately 1.7 million merchants currently accept credit cards, but do not currently accept checks as a form of payment;
- Approximately 1.9 million merchants currently accept paper checks and may consider an electronic form of payment;
- Approximately 400,000 merchants currently converting paper checks to electronic format at the point of sale may consider changing to a better service and/or lower-cost provider.

While we have the ability to approach all sizes of merchants, efforts will be focused on working with our sales channels, like direct sales and sales through authorized resellers, to approach mid-size retail chains that can benefit most from automating check processing and verification or participation in the Visa Program. These mid-size accounts typically offer higher margins than larger accounts and provide a less competitive marketplace. ECHO has recently signed agreements with several middle market retailers and believes that the pipeline for prospective customers is growing.

## Promote Visa POS Check Service Program

The Visa Program represents a major initiative by Visa to enable merchants to receive direct online authorization for checks written against consumer checking accounts, similar to the authorizations provided for credit and debit card transactions. Given ECHO's role in the early stages of the program and our investment of significant resources and management focus in our check services business as a whole, and specifically with respect to the Visa Program, we anticipate continued growth in check services as the marketing efforts of participating banks in the Visa Program become more widely implemented.

Overall, as the market gains acceptance of the Visa Program, our opportunities to market our check collection services, our stand-alone verification services (not currently part of the Visa Program) and any other check services that we are able to provide will further solidify our relationships with the various financial institutions that have chosen us as their Acquirer Processor and/or Third-Party Processor under the Visa Program. We intend to utilize these opportunities to expand our check services business.

As of September 2004, sixteen financial institutions actively participating in the program were using ECHO's services as a Third-Party Processor and are beginning to actively sell check services to their merchants. One of the current participating banks sold the Visa Program to a national specialty-clothing retailer that became active in the Visa Program in June 2003 and now constitutes the largest single user of the Visa Program to date. This national merchant participates in the Visa Program by submitting the MICR data in real time and then returning the paper check to the check writer at the point of sale. All deposit and collection activity on approved checks is derived from the use of the numeric check data and, to date, we have been successful in lowering the retailer's return check percentage to, or below, a competitive level with rates normally charged by national check guarantee services. Significant savings to the retailer are therefore derived (1) from the elimination of having to handle and process paper checks and (2) from the net financial benefit seen from the bad check write-off percentage falling below the rates charged by the national guarantee services.

Altogether, ECHO has grown in its knowledge and capability of facilitating the integration and implementation of the Visa Program for new banks and developing a standardized, but customizable platform of options based upon its experience with the banks participating in the Visa Program. The number of project implementation staff dedicated to the Visa Program has been increased to assist current and future banks in making the fastest and easiest conversion to the Visa Program. However, implementation of new banks, at least in the near term, will rely on the bank's ability to coordinate the integration of its internal deposit account management system to the Visa Program and this process is outside of ECHO's realm of responsibilities.

While ECHO believes that the Visa Program has the potential to generate significant revenues for us in the future, the market potential of this service is still unproven and its success is dependent on the continuing marketing support of Visa and its member banks.



## Promote Merchant Payment Processing for Regional and Community Banks

ECHO has identified an under-served, niche market of smaller regional and community banks for credit card and check payment programs. These banks are characterized by having an asset base in the $500 million range or less, and/or equity capital in the $10 to $50 million range. ECHO has developed a service that allows smaller banks to offer credit card and check processing services on a private-label basis using our back-end infrastructure with little or no technical involvement by the bank. Much of the reporting to the merchant utilizes the Internet as a delivery channel, an environment in which we have significant experience and knowledge. We estimate that approximately 80% of merchants are familiar with or connected to the Internet, many from their personal residences. Due to the high costs and the perceived high risk, most small banks are either unable or unwilling to compete with national banks in providing online transaction processing and Internet-based reporting tools to their merchants. We have designed the program to be adopted by a bank at little or no cost while it allows the bank to generate revenues and earnings in competition to those earned by much larger banks that have had to make major investments in the technology.

This merchant payment processing service, which is marketed under the MerchantAmerica name, incorporates all of ECHO's web-based features and functionalities and our full set of services and payment options for the retail channel. We believe that our fully integrated payment and reporting system allows smaller banks to enjoy competitive equality with much bigger banks without making significant investments in technology. It enables banks to compete feature by feature with the offering of the major banks with no set-up fee or annual charge to participate. We, in turn, benefit from the increased processing and transaction revenues. Additional benefits of the MerchantAmerica program to regional and community banks include the:

- Ability for banks to set processing fees for each merchant;
- Assurance that the bank controls the merchant relationship and maintains any financial asset value related to ownership; and
- Reduction of fraud risk.

In addition to the benefits that the bank receives from the MerchantAmerica program, the bank's merchants also receive numerous benefits, including a retail merchant account for credit cards, debit cards and checks; an online shopping cart and check-out payment system; sales tracking and online transaction history; automatic referral to collection agencies; and dedicated customer service available 24 hours a day, seven days a week.

The program was launched in August 2002 and at the end of fiscal 2004 had 19 participating banks. ECHO estimates that there are 10,000 community banks in the United States. and no one provider of services has over 10% of the market. Based on third-party research, we estimate that approximately 6,000 of these banks do not directly offer bankcard services and the approximately 4,000 that are affiliated with a service may be responsive to the MerchantAmerica value proposition.

SALES AND MARKETING

ECHO sells its merchant and check services through several marketing channels, including independent sales organizations (i.e, authorized resellers of our products and services), its own internal sales force and direct merchant referrals by existing merchants. We also offer Merchant Services through a direct online sales channel, MerchantAmerica. Approximately 20% of our new accounts have historically been generated through the authorized resellers of our products and services. In fiscal 2002, ECHO restructured its sales force by hiring more sales people for its Check Services National Sales Group, which focuses on selling to major accounts and mid-sized retail chains, and implementing an incentive-based commission structure with the goal of targeting specific accounts and shortening the sales cycle. Due to the growing interest in the Visa Program and being the Third-Party Processor of a national clothing retailer, we have redirected much of our marketing and sales resources to aggressively promote the Visa Program.

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ECHO offers its payment services through several sales channels, including:

- MerchantAmerica - Payment services offered directly to merchants and to regional and community banks to offer to their local merchants. MerchantAmerica combines the ECHO credit card services with a full set of check and collection services.

- Primary Sales Channels - These channels, which include First Regional Bank sponsored Visa Program, direct merchant sales, Check Services National Sales, group sales and MerchantAmerica direct merchant sales, provide the highest margin opportunities.

- Secondary Sales Channels - Banks in the Visa Program, authorized resellers, NCN Collection Agency Members and MerchantAmerica Agent Banks are part of the secondary sales channel. These channels offer lower margins due to the added participation in the overall revenue such channels require. Currently ECHO has 150 authorized resellers registered to sell ECHO's check products. NCN has over 260 member collection agencies that serve over 85,000 merchants and many agencies are acting as sales agents for ECHO's check services.

Management believes that we are distinctive in the number of payment methods that we allow, the combination of transaction types that we manage directly, our ability to integrate additional services and our ability to support each merchant through one vertically integrated source.

Our marketing strategy is to maximize cross-selling opportunities to our existing base of retail merchants and financial institutions, including those merchants and financial institutions in the Visa Program; sell integrated suites of check, credit and debit card processing services through small banks and industry-specific resellers; enhance and market MerchantAmerica.com; and develop the private label check service program that allows appropriate identification between the customer and the vendor. ECHO intends to:

- Market the MerchantAmerica service to regional and community banks, through direct sales to merchants and to not-for-profit organizations;

- Promote the Visa Program by working with Visa-referred banks to assist them in initiating the service and also, selling the Visa service directly to merchants through the sponsorship of ECHO's primary bank, First Regional Bank.

- Educate national merchants, processors, banks and industry-specific resellers on the benefits associated with our NCN services, including check conversion, verification, ACH payments, collection and our positive and negative database capability and enlist their active sales thereof.

COMPETITION

Bankcard processing and check processing services are highly competitive industries and are characterized by consolidation, rapid technological change, rapid rates of product obsolescence and introductions of competitive products often at lower prices and/or with greater functionality than those currently on the market. Credit card and debit card processors have similar direct costs and therefore their products are becoming somewhat of a commodity product where a natural advantage accrues to the highest volume processors. To offset this fact, we have focused on marketing to niche markets where we can maintain the margins we deem necessary to operate profitably but no assurance can be given that this strategy will be successful in the future.

There are a number of competitors in the check services industry, the largest of which are TeleCheck (the leading provider of conversion and guarantee services and a subsidiary of First Data Corporation), SCAN/eFunds (the largest verification provider in the nation), Certegy (a spin-off of Equifax), and Global Payments. While all four have major national accounts, the last two are now actively moving into the smaller merchant and middle market where ECHO has historically positioned itself. ECHO believes that it can effectively compete due to its ownership of the NCN database, its integrated set of check and collection services and the technological advantage of having certified as both a Third-Party Processor and Acquirer Processor in the early stages of the Visa Program.

ECHO is not currently a major player in the credit card processing market but we do believe we are among the top 50 in the nation. We believe we hold a significant competitive position in the check services market due largely to our investment to date in the Visa POS Check program and the integration of our check and collection capabilities. Despite this fact, many of our competitors have greater financial and marketing resources than us. As a result, they may be better able to respond more quickly to new or emerging technologies and changes in customer requirements. Competitors also may enjoy per transaction cost advantages due to their high processing volumes that may make it difficult for ECHO to compete. In addition, major players in the check services industry have developed sophisticated risk assessment technology that may provide a competitive advantage in providing check guarantee services. We believe that our success will depend upon our ability to continuously develop new products and services and to enhance our current products and to introduce them promptly into the market.

## EMPLOYEES

As of September 30, 2004, we employed 210 individuals, 182 of whom were full time employees.

## REPORTABLE SEGMENTS

Refer to Note 14 "Segment Information" in the accompanying Notes to Consolidated Financial Statements for reportable segment information.

## ITEM 2. PROPERTIES

In March 2004, we sold a building in Agoura Hills, California which was previously our corporate headquarters, for $2,382,000, and paid off the two notes collateralized by this building. As a result of this sale, we recognized a gain of $1,319,000 on a pre-tax basis.

In October 2003, we leased 21,500 square feet of a 40,000 square foot building in Camarillo, California with an option to purchase the building in two years. Our principal executive offices, including customer support, data center and other operational departments were moved to this Camarillo location. We signed an addendum to the October 2003 lease in July 2004 and added 11,100 square feet to the lease. We currently occupy 32,669 square feet of this Camarillo building. The lease payment for this facility as of September 2004 was $23,700 per month. The lease payment will increase to $35,936 per month effective January 2005 pursuant to the provisions of the lease governing the property, which permitted a lower rent during the period commencing July 2004 and ending December 2004.

We have additional real property leases in Agoura Hills, California; Albuquerque, New Mexico; Boulder, Colorado; and Lawrence, Kansas for sales, data center and other operations, under various agreements, which expire at various times over the next year. The total of these lease payments are approximately $40,000 per month.

## ITEM 3. LEGAL PROCEEDINGS

We are involved in various lawsuits arising in the ordinary course of business. Based upon current information, management, after consultation with legal counsel, believes the ultimate disposition of these lawsuits will have no material effect upon either our results of operations, financial position, or cash flows.

In July 2004, LML Patent Corporation, a wholly-owned subsidiary of LML Payment Systems, Inc. ("LML"), filed a patent infringement claim against us, our subsidiary, XPRESSCHEX, Inc. and others, relating with respect to us and our subsidiary, to the alleged infringement by our check conversion processes of three patents held by LML. The suit was filed in the U.S. District Court for the District of Delaware. LML seeks an undisclosed amount of damages in connection with the alleged infringement. We do not believe that any of our check conversion processes infringe upon any valid or enforceable patent rights of LML and intend to vigorously defend our position against the claims made. Ultimately, we expect that we will not be held liable for any of the alleged infringement. Despite this belief, the costs associated with our defense will be significant in both 2005 and 2006. We estimate these costs to be approximately $400,000 or higher each year. The case is scheduled to go to trial in April of 2006. Should we be held liable for any alleged infringement, which is not expected, the ultimate liability we may sustain may include a royalty payment primarily calculated on activity commencing in the middle of calendar 2003 for only select conversion activity, as that was the time period in which we actively began utilizing the check conversion



processes alleged to infringe the LML patents. In view of the relatively short time period involved and the relatively small overall transaction volume arising from the alleged infringing check conversion services in comparison to ECHO's total transaction volume, while having to make any payment relating to these claims would be disappointing, we believe that any such alleged damages award should have a relatively minor impact on our results of operations, financial position, or cash flows.

In August 2003, one of our independent sales organizations ("ISO") filed a breach of contract arbitration claim against us in Los Angeles, California. The dispute involved a disagreement related to the manner in which commissions were to be calculated under the agreement. The agreement with the ISO required binding arbitration of all disputes arising under the agreement. The arbitration proceedings occurred in December 2004. The arbitration award is expected between the end of calendar 2004 and the beginning of 2005. The claim arose in the ordinary course of business and we have accrued $300,000 as a litigation accrual related to the dispute. The accrual represents our management's good faith evaluation of the dispute after consultation with legal counsel, however, there can be no assurance that the actual award will not exceed the amount accrued. In the event the arbitration award exceeds the amount accrued, such excess amount would impact our results of operations, financial position or cash flows. Our management does not believe any such impact would be material.

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

No matters were submitted to a vote of ECHO's shareholders in the quarter ended September 30, 2004.



# PART II

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

Since January 17, 1986, we have been trading on the over-the-counter market under the name Electronic Clearing House, Inc. On October 2, 1989, we were accepted for listing on the National Association of Securities Dealers Automated Quotation System ("NASDAQ") and trade under the symbol of "ECHO" on the NASDAQ SmallCap Market. The following table sets forth the range of high and low prices for our common stock during the fiscal periods indicated, as reported on the NASDAQ SmallCap Market.

| FISCAL YEAR ENDED SEPTEMBER 30 | High | Low |
|---|---|---|
| 2004 | | |
| First Quarter | $11.33 | $6.15 |
| Second Quarter | $13.06 | $8.23 |
| Third Quarter | $11.47 | $8.75 |
| Fourth Quarter | $ 9.99 | $6.45 |
| 2003 | | |
| First Quarter | $ 2.85 | $1.09 |
| Second Quarter | $ 2.75 | $1.72 |
| Third Quarter | $ 4.40 | $2.47 |
| Fourth Quarter | $ 9.59 | $3.20 |

The prices set forth above are not necessarily indicative of liquidity of the trading market. Trading in our common stock is limited and sporadic, as indicated by the average monthly trading volume of 829,849 shares for the period from October 2003 to September 2004. On December 13, 2004, the closing representative price per share of our common stock, as reported on the NASDAQ SmallCap Market, was $8.00.

HOLDERS OF COMMON STOCK

As of December 13, 2004, there were 839 record holders and 3,374 beneficial holders of our common stock, with 6,472,331 shares outstanding. The number of holders of record is based on the actual number of holders registered on the books of our transfer agent and does not reflect holders of shares in "street name" or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

DIVIDEND POLICY

We have not paid any dividends in the past and have no current plan to pay any dividends. We intend to devote all funds to the operation of our businesses.

EQUITY COMPENSATION PLAN INFORMATION

The Equity Compensation Plan Information identified in Item 11 of this Annual Report on Form 10-K is incorporated herein by this reference.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth certain selected consolidated financial data, which should be read in conjunction with the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Items 7 and 8 below. The following data, insofar as it relates to each of the five years ended September 30, has been derived from our annual financial statements, including the consolidated balance sheets at September 30, 2004 and 2003, and the related consolidated statements of operations and of cash flows for the three years ended September 30, 2004, 2003 and 2002, and notes thereto appearing elsewhere herein.

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| | YEAR ENDED SEPTEMBER 30 | | | |
|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 |
| | ( ---- AMOUNTS IN THOUSANDS, EXCEPT PER SHA | | | |
| STATEMENT OF OPERATIONS DATA: | | | | |
| Revenues | $ 47,584 | $ 40,636 | $ 33,291 | $ 29,943 |
| Costs and expenses | 44,127 | 38,211 | 36,960 | 29,380 |
| Income (loss) from operations | 3,457 | 2,425 | (3,669) | 563 |
| Interest income (expense), net | (104) | (172) | (74) | 106 |
| Other income (expense), net | 1,319 | -0- | -0- | 350 |
| Income (loss) before income tax (provision) benefit and cumulative effect of an accounting change | 4,672 | 2,253 | (3,743) | 1,019 |
| (Provision) benefit for income taxes | (1,823) | (925) | 1,367 | (585) |
| Income (loss) before cumulative effect of an accounting change | 2,849 | 1,328 | (2,376) | 434 |
| Cumulative effect of an accounting change to adopt SFAS 142[1] | -0- | (4,707) | -0- | -0- |
| Net income (loss) | $ 2,849 | $ (3,379) | $ (2,376) | $ 434 |
| Earnings (loss) per share-basic | $ 0.45 | $ (0.58) | $ (0.41) | $ 0.07 |
| Earnings (loss) per share-diluted | $ 0.41 | $ (0.56) | $ (0.41) | $ 0.07 |
| Weighted average number of common shares and equivalents outstanding-basic | 6,312 | 5,812 | 5,788 | 5,797 |
| Weighted average number of common shares and equivalents outstanding-diluted | 6,900 | 6,024 | 5,788 | 5,964 |
| BALANCE SHEET DATA: | | | | |
| Working capital | $ 8,004 | $ 3,201 | $ 3,234 | $ 5,821 |
| Current assets | 29,923 | 9,646 | 5,728 | 8,259 |
| Total assets | 39,428 | 18,775 | 18,191 | 18,921 |
| Current liabilities | 21,919 | 6,445 | 2,494 | 2,438 |
| Long-term debt, and payable to stockholders and related parties, less current portion | 704 | 1,961 | 2,159 | 744 |
| Total stockholders' equity | $ 16,240 | $ 10,369 | $ 13,538 | $ 15,739 |

[1] The Company completed the transitional impairment testing required by SFAS 142 in the first quarter of fiscal 2003 and determined that its goodwill was fully impaired and a $4.7 million goodwill write-off was recognized.

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

OVERVIEW

Electronic Clearing House, Inc. is an electronic payment processor that provides for the payment processing needs of merchants, banks and collection agencies. We derive the majority of our revenues from two main business segments, bankcard and transaction processing services ("bankcard services"), whereby we provide solutions to merchants and banks to allow them to accept credit and debit card payments from consumers, and check-related products ("check services"), whereby we provide various services to merchants and banks to allow them to accept and process check payments from consumers. The principal services we offer within these two segments include, with respect to our bankcard services, debit and credit card processing, and with respect to our check services, check guarantee, check verification, electronic check conversion, check re-presentment, and check collection.

We organize our service offerings under the following brand names:

- MerchantAmerica: ECHO's retail provider of payment processing services to both merchant and bank markets;
- National Check Network ("NCN"): for wholesale check verification, check authorization and capture services, and for referral to member collection agencies;
- XPRESSCHEX, Inc.: for retail check verification, check conversion, ACH services, check collection and check guarantee services.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, management evaluates its estimates, including those related to revenue recognition, deferred taxes, reserve for doubtful accounts, capitalization of software costs, contingencies and litigation. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Management applies the following critical accounting policies in the preparation of our consolidated financial statements:

- REVENUE RECOGNITION POLICY. We earn revenue from services which include the following: debit and credit card processing, check verification, ACH services, check conversion, check re-presentment, check collection, check guarantee, and inventory tracking. All of these services are performed pursuant to a contract with customers, which state the terms and fixed price for all contracted services. The price of a service may be a fixed fee for each transaction and/or a percentage of the transaction processed, depending on the service. We generally collect our fee at the time we process the transaction and accordingly, collectibility of the service fee is reasonably assured.

Revenue from debit and credit card (collectively called bankcards) and transaction processing revenue is based on a percentage of the transaction value, commonly referred to as a discount fee on a credit and debit card transaction processed by us. In addition, there is a per transaction fee associated with each bankcard transaction which is charged to the merchant. We recognize the processing and transaction revenue when the services are performed.

Revenue from check verification is derived from fees collected from the merchants when a check is verified against our own positive and negative check database and other check databases that we use. This revenue is recognized when the transaction is processed, since we have no further performance obligations.

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Revenue from check conversion is derived from fees collected from merchants to convert the paper check received by merchants into an ACH transaction, which allows us to settle the transaction electronically for the merchant. We recognize the revenue related to check conversion fees when the services are performed.

Revenue from check re-presentment is derived from fees charged to check writers. Check re-presentment is a service that allows merchants to collect a paper check through the ACH network after a check has previously been presented to the bank for collection unsuccessfully at least once. The fees earned from the check writer are recognized when collected, as collectibility is not reasonably assured until that point.

Revenue from check guarantee is derived from a percentage of the gross amount of the check and guarantees payment of the check to the merchant in the event the check is not honored by the check writer's bank. Merchants typically present customer checks for processing on a regular basis and, therefore, dishonored checks are generally identified within a few days of the date the checks are guaranteed by us. We recognize revenue when the checks are processed at the point of sale. At the time the guarantee revenue is recognized, we provide a reserve for estimated guarantee losses based upon our historical loss experience. In the event the check is dishonored, we have the right to collect the full amount of the check from the check writer but have historically recovered approximately 50-60% of the guaranteed checks. We establish a receivable from the delinquent check writer for the full amount of the guaranteed check. The check guarantee service also earns revenue based on fees collected from delinquent check writers, which collection fee is recognized when collected, as collectibility is not reasonably assured until that point.

Revenue from check collection is derived from collection activities performed on behalf of a merchant on uncollected checks. The merchants usually keep the face amount of the uncollected checks if the collection effort is successful. Our revenue is derived from the collection fee collected from the check writer. If we refer the collection item to another collection agency, we will receive a fee from the collection agency upon its successful efforts. Collection fee revenue is recognized when collected, as collectibility is not reasonably assured until that point.

Revenue from inventory tracking is derived from transaction fees for processing and tracking U-Haul's daily inventory activities. This revenue is recognized when the transaction is processed, since we have no further performance obligations.

- DEFERRED TAXES. Deferred taxes are determined based on the differences between the financial statement and tax basis of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. In assessing the need for a valuation allowance, management considers estimates of future taxable income and ongoing prudent and feasible tax planning strategies.

- CHARGEBACK LOSSES. Chargeback losses occur when a credit card holder presents a valid claim against one of our merchants and the merchant has insufficient funds or is no longer in business resulting in the charge being absorbed by us. We record a receivable for those chargebacks for which the merchant is liable but has not made payment. We record a provision for estimated chargeback losses at the time bankcard transactions are processed. A reserve is estimated based upon a historically-determined percentage of gross credit card processing volume and actual losses experienced.

- RESEARCH AND DEVELOPMENT EXPENSE. Expenditures for activities relating to product development and improvement are charged to expense as incurred. Such expenditures amounted to $1,465,000 in fiscal year 2004 and $1,464,000 in fiscal year 2003.

- CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE. Effective October 1, 2002, we adopted Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets". SFAS 142 requires that goodwill no longer be amortized, but instead be tested for impairment at least annually using a fair value-based approach. In the year of adoption, SFAS No. 142 also requires us to perform an initial assessment of its reporting units to determine whether there is any indication that the goodwill carrying value may be impaired. This transitional assessment is made by comparing the fair value of each reporting unit, as determined in accordance with the new standard, to its book value. To the extent the fair value of any reporting unit is less than



its book value, which would indicate that potential impairment of goodwill exists, a second transitional test is required to determine the amount of impairment. In 2003, we determined that all of our goodwill was impaired under SFAS No. 142 and accordingly took a charge to write down the amount of that impairment.

- CAPITALIZATION OF SOFTWARE COSTS. The costs of purchased and internally developed software used to provide services to customers or for the process of internal administration are capitalized and amortized on a straight-line basis over the lesser of three years or estimated useful life. Under the provisions of Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," we capitalize software costs when both the preliminary project stage is completed and management has authorized further funding for the completion of the project. Capitalization of costs ceases when the project is substantially complete and the software is ready for its intended use. Software developed or obtained for internal use is tested for impairment whenever events or changes in circumstance indicates that its carrying amount may not be recoverable.

RESULTS OF OPERATIONS

FISCAL YEARS 2004 AND 2003

Financial highlights for fiscal 2004 as compared to fiscal 2003 were as follows:

-- Total revenue increased 17.1% to $47.6 million

-- Gross margin from processing and transaction revenue improved to 37.4% from 33.9%

-- Operating income increased to $3.5 million from $2.4 million

- Diluted earnings per share before cumulative effect of accounting change were $0.41 as compared to $0.22 per share.
- Bankcard and transaction processing revenue increased by 11.5% to $36.2 million
- Bankcard processing volume increased 9.5% to $1.1 billion
- Check-related revenue increased by 39.4% to $11.4 million
- ACH processing volume increased 128.4% to 25.8 million transactions

REVENUE. Total revenue increased 17.1% to $47,584,000 for fiscal 2004, from $40,636,000 for fiscal 2003. The increase can be primarily attributable to 11.5% growth in bankcard and transaction processing revenue and 39.4% growth in check services revenue year-over-year. This growth has occurred organically from our existing merchants and from our marketing initiatives during the year, and as a result of increasing acceptance of our check services products and the continued growth in the Visa Program.

The bankcard and transaction processing revenue increase was mainly attributable to a 9.5% increase in bankcard processing volume as compared to last fiscal year. This increase was the result of our organic growth and the growth from our various marketing channels such as the Agent Bank Program and the MerchantAmerica marketing program. The increase was partially offset by the departure of several high volume merchants during the year.

The check-related processing revenue increase was attributable to a 10.6% increase in check verification revenue and a 101.3% increase in ACH services revenues. The high growth in the ACH revenue was due to the increasing market acceptance of this product and the continued growth in the Visa Program.

COST OF SALES. Bankcard processing expenses are directly related to the changes in processing revenue. A majority of our bankcard processing expenses are fixed costs and are reflected as a percentage of the total face amount of each bankcard transaction, and the remaining costs are based on a fixed rate applied to the number of transactions processed. Processing-related expenses, consisting of bankcard processing expense and transaction and check processing expense, increased 11.2% for the year, from $26,660,000 in fiscal 2003 to $29,634,000 in fiscal 2004. The increase reflects the 17.3% increase in processing and transaction revenues for the year.

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Gross margin from processing and transaction services improved from 33.9% in fiscal 2003 to 37.4% in fiscal 2004. This improvement in gross margin was mainly due to: 1) check-related revenue, which has a higher gross margin, made up 24.0% of the total revenue in fiscal 2004 as compared to 20.2% of the total revenue in fiscal 2003 and; 2) a rate adjustment was applied to a broad base of bankcard merchants during fiscal 2004 to offset increases in direct bankcard processing expenses.

EXPENSE. Other operating costs such as personnel costs, telephone, depreciation expenses and outside services increased 18.5%, from $4,373,000 in fiscal 2003 to $5,182,000 in fiscal 2004 primarily due to more staff hired in fiscal 2004 to support our growth. Research and development expenses remained constant, from $1,464,000 in fiscal 2003 to $1,465,000 in fiscal 2004. Almost all of our major development projects were in the coding and testing phases in fiscal 2004. Several major development projects should be completed during fiscal year 2005.

However, given the rapid change in technology occurring in our industry, we plan to continue to invest in product development in both the bankcard processing business segment and the check-related products segment in order to remain competitive in these financial services markets.

Selling, general and administrative (SG&A) expenses increased 37.3% from $5,714,000 in fiscal 2003 to $7,846,000 in fiscal 2004. This increase was primarily attributable to: 1) greater personnel costs due to cost of living adjustments and greater employee benefits costs, such as health insurance and worker's compensation insurance; 2) growth in sales and marketing expenses to implement our sales and marketing strategies; 3) increased legal and professional expenses to defend several lawsuits; 4) an increase in rent expense due to our new corporate relocation in October 2003; and 5) a $300,000 litigation accrual related to an ordinary course contract dispute with one of its independent sales organizations. The dispute is subject to binding arbitration, the award from which is expected between the end of calendar 2004 and the beginning of 2005. The accrual represents management's good faith evaluation of the dispute after consultation with its legal counsel. As a percentage of total revenue, SG&A expenses increased from 14.1% in fiscal 2003 to 16.5% in fiscal 2004.

OPERATING INCOME. Operating income increased from $2,425,000 in fiscal 2003 to $3,457,000 in fiscal 2004, an increase of 42.6%. The improvement in operating income was primarily attributable to the 17.1% increase in revenue and the 3.5% improvement in gross margin described above.

INTEREST EXPENSE. Interest expense decreased to $175,000 for fiscal 2004, from $200,000 for fiscal 2003. The decrease was due to the full repayment of two long-term notes. Interest income increased from $28,000 in fiscal 2003 to $71,000 in fiscal 2004 due to higher average cash balances on hand throughout fiscal year 2004.

GAIN ON SALE OF ASSETS. Fiscal 2004 results were favorably affected by a pre-tax gain on sale of $1,319,000 resulting from the sale of the building that formerly held the Company's principal executive offices. After the sale, the Company used a portion of the proceeds to pay off two loans totaling $1,524,000, which were collateralized by the building.

EFFECTIVE TAX RATE. The income tax provision was $1,823,000 for fiscal 2004 as compared to $925,000 for fiscal 2003. Our effective tax rate was 39.0% for fiscal 2004, as compared to 37.7% for fiscal 2003. See Notes to Consolidated Financial Statements included elsewhere herein for further explanation of the income tax expense and a reconciliation of reported income taxes to the amount utilizing the statutory rate.

NET INCOME. Net income for fiscal 2004 was $2,849,000, as compared to a net loss of $3,379,000 for fiscal 2003. Income before cumulative effect of an accounting change to adopt SFAS 142 was $1,328,000 in fiscal 2003 and $2,849,000 in fiscal 2004, an increase of 114.5%. This increase was primarily attributable to the 17.1% revenue growth year-over-year and the improvements in gross margin.

SEGMENT RESULTS

Bankcard and Transaction Processing. For the year ended September 30, 2004, bankcard processing and transaction revenue accounted for approximately 76.0% of our revenues, compared to 79.8% in fiscal 2003. Bankcard processing and transaction revenue increased 11.5%, from $32,444,000 in fiscal 2003 to $36,161,000 in fiscal 2004. This increase was mainly attributable to a 9.5% increase in bankcard processing volume as compared to last fiscal year. This increase was partially offset by the departure of several high volume merchants. To a lesser extent, the increase was positively impacted by a rate adjustment to our bankcard merchant base during fiscal 2004. We continue to grow our bankcard processing business primarily through organic growth and various sales and marketing programs.



In fiscal 2004, the bankcard and transaction processing segment generated operating income of $5,977,000, or 16.5% of the related revenues, as compared to $4,303,000, or 13.3% of the related revenues in fiscal 2003. This increase in operating income was reflective of the increase in revenue and the higher gross margin as a result of the broad base rate adjustment to merchants to offset higher operating costs.

In fiscal 2001, we purchased a fully integrated, multi-modular bankcard processing system from Oasis Technologies for approximately $1.3 million. We have incurred an additional $700,000 of internal development costs thus far in implementing this system. The implementation of this system will give us greater flexibility to price our credit card processing services, allowing us to attract and retain larger merchants as well as the small and mid-market merchants that have been our target market. This project has experienced numerous implementation delays, mainly as a result of vendor software delivery issues and the vigorous testing required prior to implementation. Management now anticipates that portions of the Oasis system will begin productive use in the second half of 2005.

Check Related Products. Check-related revenues increased from $8,192,000 for fiscal 2003 to $11,423,000 for fiscal 2004, an increase of 39.4%. Check verification revenue increased 10.6% to $3,425,000 for fiscal 2004, from $3,097,000 for fiscal 2003. Check conversion, ACH services and check re-presentment revenue increased 101.3% to $5,820,000 for fiscal 2004, from $2,892,000 for fiscal 2003. Additionally, check collection revenue increased 14.0%, from $1,791,000 in fiscal 2003 to $1,816,000 in fiscal 2004. The high growth in the check conversion and ACH revenue was due to the increasing market acceptance of this product and to the transaction revenue generated by the Visa Program. Total ACH transactions processed during fiscal 2004 were 25.8 million transactions, as compared to 11.3 million transactions processed in fiscal 2003, an increase of 128.4%. ACH transactions, like ACH revenues, increased primarily from the increasing market acceptance of the ACH services and the Visa Program.

Check services revenue made up 24.0% of the total processing and transaction revenues for fiscal 2004 as compared to 20.2% in fiscal 2003. Check-related operating income was $1,644,000 in fiscal 2004, as compared to operating income of $591,000 in fiscal 2003, an increase of 178.2%. The increase in operating income was mainly due to the 39.4% increase in check-related revenues.

The Visa Program is continuing to gain traction during 2004. We are currently working with 16 Visa member banks that have signed up to participate in this Visa Program. One of the Visa acquiring banks, using us as the Third-Party Processor, rolled out this Program to a national retailer in June 2003. This one merchant accounted for a significant percentage of revenue generated from the Visa Program in fiscal 2004 and an increased volume of transactions processed. Management continues to believe that the Visa Program will provide us with numerous opportunities to develop strategic relationships with the banks who have chosen us to be their Third-Party Processor and Acquirer Processor under the Visa Program. These relationships could play a major role in increasing our check services revenue in the coming years.

RESULTS OF OPERATIONS

FISCAL YEARS 2003 AND 2002
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Financial highlights for fiscal 2003 as compared to fiscal 2002 were as follows:

-- Total revenue increased 22.1% to $40.6 million

-- Gross margin from processing and transaction revenue improved to 33.9% from 30.1%

-- Operating income increased to $2.4 million from a loss of $3.7 million (which included $2.9 million of litigation related expenses).

-- Diluted earnings per share before cumulative effect of accounting change were $0.22 as compared to diluted loss per share before cumulative effect of accounting change of $0.41.

-- Bankcard and transaction processing revenue increased by 18.2% to $32.4 million

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-- Bankcard processing volume increased 26.4% to $961 million

-- Check-related revenue increased by 40.4% to $8.2 million

-- ACH processing volume increased 403.8% to 11.3 million transactions

REVENUE. In fiscal 2003, total revenue increased 22.1% to $40,636,000, from $33,291,000 for fiscal 2002. The increase was primarily attributable to the growth in the processing and transaction business. Total processing and transaction revenue for fiscal 2003 increased 22.6%, from $32,889,000 in fiscal 2002 to $40,313,000 in fiscal 2003. The increase was attributable to an 18.2% increase in bankcard and transaction processing revenue and a 40.4% increase in check-related revenue.

The bankcard and transaction processing revenue increase was mainly attributable to an approximate 26.4% increase in bankcard processing volume as compared to fiscal 2002. This increase was also affected by a rate adjustment to the bankcard merchant base during fiscal 2003 and the fact that we continued to grow our bankcard processing business organically through various sales and marketing programs.

The check-related processing revenue increase was attributable to a 9.8% increase in check verification revenue and a 246.0% increase in electronic check conversion and electronic check presentment revenue. The high growth in check conversion revenue was due to the increasing market acceptance of this product. Additionally, it was attributable to the transactions generated by the Visa Program.

Terminal sales decreased by 50.8%, from $252,000 in fiscal 2002 to $124,000 in fiscal 2003. During fiscal 2003, U-Haul stopped sending its terminals to us for repair. We gradually shut down our terminal deployment operations during fiscal 2003.

COST OF SALES. Bankcard processing expenses are directly related to the changes in processing revenue. A majority of our bankcard processing expenses are fixed costs and reflected as a percentage of the total face amount of each bankcard transaction, and the remaining costs are based on a fixed rate applied to the number of transactions processed. Processing-related expenses, consisting of bankcard processing expense and transaction and check processing expense, increased 16.0% in fiscal 2003, from $22,973,000 in fiscal 2002 to $26,660,000 in fiscal 2003. The increase reflected a 22.7% increase in processing and transaction revenues for the year. Gross margin from processing and transaction services improved from 30.1% in fiscal 2002 to 33.9% in fiscal 2003. This improvement in gross margin was mainly due to: 1) check-related revenue which has a higher gross margin made up 20.2% of the total revenue in fiscal 2003 as compared to 17.5% of the total revenue in fiscal 2002; 2) a rate adjustment was applied to a broad base of bankcard merchants during fiscal 2003 to offset increases in direct bankcard processing expenses; and 3) loss on chargeback decreased substantially, from $261,000 in fiscal 2002 to $44,000 in fiscal 2003.

EXPENSE. Other operating costs such as personnel costs, telephone and depreciation expenses increased 8.5%, from $4,032,000 in fiscal 2002 to $4,373,000 in fiscal 2003 primarily due to the 22.1% increase in revenue. Research and development expenses decreased 162% from $1,747,000 in fiscal 2002 to $1,464,000 in fiscal 2003, as most of our development projects entered into coding and testing phases.

Selling, general and administrative expenses increased 9.5% from $5,219,000 in fiscal 2002 to $5,714,000 in fiscal 2003. This increase was mainly due to the addition of management personnel to support our growth, the increase in employee benefits costs such as medical insurance, workers compensation insurance and the increase in cost of living adjustments. As a percentage of total revenue, selling, general and administrative expenses decreased from 15.7% in the fiscal 2002 to 14.1% in fiscal 2003.

Amortization of goodwill expense, which amounted to $489,000 in 2002, was eliminated in fiscal 2003 due to the implementation of SFAS No. 142.

INTEREST EXPENSE. Interest expense increased to $200,000 for fiscal 2003, from $129,000 in fiscal 2002. The increase was due to a $1.3 million long-term note from a legal settlement in fiscal 2002 and an increase in capitalized leases from equipment purchases. Interest income decreased from $55,000 in fiscal 2002 to $28,000 in fiscal 2003 due to a decline in interest rates and lower average cash balances.



EFFECTIVE TAX RATE. The income tax provision was $925,000 for fiscal 2003 as compared to an income tax benefit of $1,367,000 for fiscal 2002. Our effective tax benefit rate was 36.5% for fiscal 2002 and a tax provision rate was 37.7% for fiscal 2003.

NET LOSS. Net loss for fiscal 2003 was $3,379,000, as compared to a net loss of $2,376,000 for fiscal 2002. The higher net loss in fiscal 2003 was primarily due to a $4.7 million goodwill write-off on our adoption of SFAS 142 in October 2002. Income from operations improved substantially in fiscal 2003, from a $3,669,000 operating loss in fiscal 2002 to $2,425,000 in operating income for fiscal 2003. The improvement in income from operations between fiscal 2002 and fiscal 2003 comprised the following: 1) a 22.1% increase in revenue; 2) a 3.8% improvement in gross margin; 3) the elimination of $489,000 in goodwill amortization expense; and 4) a one-time $2.5 million legal settlement cost was incurred in fiscal 2002.

SEGMENT RESULTS

Bankcard and Transaction Processing. For the year ended September 30, 2003, MerchantAmerica, our primary generator of bankcard process and transaction revenue, accounted for approximately 80% of our revenues, compared to 82% in fiscal 2002. Bankcard processing and transaction revenue increased 18.2%, from $27,456,000 in fiscal 2002 to $32,444,000 in fiscal 2003. This increase was mainly attributable to an approximate 26.4% increase in bankcard processing volume as compared to fiscal 2002. This increase was also affected by a rate adjustment to our bankcard merchant base during fiscal 2003 and the fact that we continued to grow our bankcard processing business organically through various sales and marketing programs.

In fiscal 2003, the bankcard and transaction processing segment generated operating income of $4,303,000, or 13.3% of the related revenues, as compared to $1,996,000, or 7.3% of the related revenues in fiscal 2002. This increase in operating income was reflective of the increase in revenue and the higher gross margin as a result of the rate adjustment to merchants and the lower chargeback losses.

Check Related Products. Check-related revenues increased from $5,835,000 for fiscal 2002 to $8,192,000 for fiscal 2003, an increase of 40.4%. Check verification revenue increased 9.8% to $3,097,000 for fiscal 2003, from $2,821,000 for fiscal 2002. Check conversion and check re-presentment revenue increased 246.0% to $2,892,000 for fiscal 2003, from $836,000 for fiscal 2002. Additionally, check collection revenue increased 5.1%, from $1,453,000 in fiscal 2002 to $1,526,000 in fiscal 2003. The high growth in the check conversion revenue was due to the increasing market acceptance of this product and attributable to the transaction revenue generated by the Visa Program.

Check services revenue made up 20.2% of the total processing and transaction revenues for fiscal 2003 as compared to 17.5% in the prior year. Check-related operating income was $591,000 for fiscal 2003, as compared to operating loss of $872,000 in fiscal 2002. The increase in operating income was mainly due to the 40.4% increase in check-related revenues.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2004, we had available cash and cash equivalents of $7,576,000, restricted cash of $1,024,000 in reserve with our primary processing banks and working capital of $8,004,000.

Accounts receivable, net of allowance for doubtful accounts, increased slightly to $1,943,000 at September 30, 2004 from $1,939,000 at the end of fiscal 2003. Allowance for doubtful accounts, which reflects chargeback losses increased to $111,000 at the end of fiscal 2004 from $71,000 at September 30, 2003. This increase was due to the higher processing revenue generated in fiscal 2004.

Net cash provided by operating activities for the year ended September 30, 2004 was $5,325,000 as compared to net cash provided by operating activities of $4,549,000 for fiscal 2003. The increase in cash from operations was primarily attributable to the $1,032,000 increase in operating income between fiscal 2004 and 2003. Settlement receivable/payable results from timing differences in our settlement process with merchants. These timing differences account for the difference between the time that funds are received in our bank accounts and the time that settlement payments are made to merchants. Therefore, at any given time, settlement receivable/payable may vary and ultimately depends on the volume of transactions processed. The increase in settlement receivable/payable in fiscal 2004 is primarily attributable to the high volume of transactions experienced from our check services. As our business grows, settlement receivable/payable balances will likely increase.

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Net cash used in investing activities was $1,904,000 for the fiscal 2004 as compared to $3,271,000 for fiscal year 2003. During fiscal 2004, we used $4,278,000 for purchases of equipment and capitalized software costs as compared to $3,291,000 for fiscal 2003. We should be completing several major projects in fiscal 2005 related to infrastructure improvements and thereby decreasing the amount of investment required in fiscal 2005 as compared to fiscal 2004. In fiscal 2004, we also received $2,233,000 in proceeds from the sale of our former corporate headquarters building.

Net cash provided by financing activities was $1,247,000 for the current fiscal year as compared to net cash used by financing activities of $179,000 for fiscal year 2003. During fiscal 2004, we received net proceeds of $2,693,000 from a private placement. We paid off $1,916,000 in notes payable, and used $562,000 for the repayment of capitalized leases and received $221,000 from the exercise of employee stock options.

In November 2003, we negotiated a $1,000,000 equipment lease line and a $3,000,000 credit line with Bank of the West for working capital needs. As of September 30, 2004, we have drawn down $600,000 of the equipment lease line but have not used the $3,000,000 credit line.

At September, 2004, we had the following cash commitments:

| | Payment Due By Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 2-3 years | 4-5 years | After 5 years |
| Long-term debt including interest | $ 970,000 | $ 434,000 | $ 356,000 | $ 180,000 | $ -0- |
| Capital lease obligations | 757,000 | 528,000 | 196,000 | 33,000 | -0- |
| Operating leases | 1,929,000 | 565,000 | 909,000 | 455,000 | -0- |
| Total contractual cash obligations | $3,656,000 | $1,527,000 | $1,461,000 | $ 668,000 | $ -0- |

Our primary source of liquidity is expected to be cash flow generated from operations and cash and cash equivalents currently on hand. Management believes that our cash flow from operations together with cash on hand, our lease line, our established line of credit with Bank of the West, and cash previously received from our private placement financing will be sufficient to meet our working capital and other commitments.

NEW ACCOUNTING PRONOUNCEMENT

In December 2004, the FASB issued SFAS 123R, "Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95," that addresses the accounting for share-based payment transactions in which a Company receives employee services in exchange for either equity instruments of the Company or liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic method that the Company currently uses and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense in the consolidated statement of operations. SFAS 123R is effective for interim and annual periods beginning after June 15, 2005. Management is currently evaluating the impact of SFAS 123R and it is expected that it will have a significant impact on the consolidated statement of operations as the Company will be required to expense the fair value of stock option awards.

RISK FACTORS

Our business, and accordingly, your investment in our common stock, is subject to a number of risks. These risks could affect our operating results and liquidity. You should consider the following risk factors, among others, before investing in our common stock:

## RISKS RELATED TO OUR BUSINESS

WE RELY ON COOPERATIVE RELATIONSHIPS WITH, AND SPONSORSHIP BY, BANKS, THE ABSENCE OF WHICH MAY AFFECT OUR OPERATIONS.

We currently rely on cooperative relationships with, and sponsorship by, banks in order to process our Visa, MasterCard and other bankcard transactions. We also rely on several banks for access to the Automated Clearing House ("ACH") for submission of both credit card and check settlements. Our banking relationships are currently with smaller banks (with assets of less than $500,000,000). Even though smaller banks tend to be more susceptible to mergers or acquisitions and are therefore less stable, these banks find the programs we offer more attractive and we believe we cannot obtain similar relationships with larger banks at this time. A bank could at any time curtail or place restrictions on our processing volume because of its internal business policies or due to other adverse circumstances. If a volume restriction is placed on us, it could materially adversely affect our business operations by restricting our ability to process credit card transactions and receive the related revenue. Our relationships with our customers and merchants would also be adversely affected by our inability to process these transactions.

We currently maintain one primary bankcard processing and sponsorship relationship with First Regional Bank in Agoura Hills, California. Our agreement with First Regional Bank continues through 2005. We also maintain several banking relationships for ACH processing. While we believe our current bank relationships are sound, we cannot assure that these banks will not restrict our increasing processing volume or that we will always be able to maintain these relationships or establish new banking relationships. Even if new banking relationships are available, they may not be on terms acceptable to us. With respect to First Regional Bank, while we believe their ability to terminate our respective relationships is cost-prohibitive, they may determine that the cost of terminating their agreement is less than the cost of continuing to perform in accordance with their terms, and may therefore determine to terminate those agreements prior to their expiration. Ultimately, our failure to maintain these banking relationships and sponsorships may have a material adverse effect on our business and results of operations.

MERCHANT FRAUD WITH RESPECT TO BANKCARD AND ACH TRANSACTIONS COULD CAUSE US TO INCUR SIGNIFICANT LOSSES.

We significantly rely on the processing revenue derived from bankcard and ACH transactions. If any merchants were to submit or process unauthorized or fraudulent bankcard or ACH transactions, depending on the dollar amount, ECHO could incur significant losses which could have a material adverse effect on our business and results of operations. ECHO assumes and compensates the sponsoring bank for bearing the risk of these types of transactions.

We have implemented systems and software for the electronic surveillance and monitoring of fraudulent bankcard and ACH use. As of September 30, 2004, we maintained a dedicated chargeback reserve of $708,000 at our primary bank specifically earmarked for such activity. Additionally, through our sponsoring bank, we had access to approximately $9.9 million in merchant deposits to cover any potential chargeback losses. Despite a long history of managing such risk, we cannot guarantee that these systems will prevent fraudulent transactions from being submitted and processed or that the funds set aside to address such activity will be adequate to cover all potential situations that might occur. We do not have insurance to protect us from these losses. There is no assurance that our chargeback reserve will be adequate to offset against any unauthorized or fraudulent processing losses that we may incur. Depending on the size of such losses, our results of operations could be immediately and materially adversely affected.



EXCESSIVE CHARGEBACK LOSSES COULD SIGNIFICANTLY AFFECT OUR RESULTS OF OPERATIONS AND LIQUIDITY.

Our agreements with our sponsoring bank require us to assume and compensate the bank for bearing the risk of "chargeback" losses. Under the rules of Visa and MasterCard, when a merchant processor acquires card transactions, it has certain contingent liabilities for the transactions processed. This contingent liability arises in the event of a billing dispute between the merchant and a cardholder that is ultimately resolved in the cardholder's favor. In such a case, the disputed transaction is charged back to the merchant and the disputed amount is credited or otherwise refunded to the cardholder. If we are unable to collect this amount from the merchant's account, or if the merchant refuses or is unable to reimburse us for the chargeback due to merchant fraud, insolvency or other reasons, we will bear the loss for the amount of the refund paid to the cardholders.

A cardholder, through its issuing bank, generally has until the later of up to four months after the date a transaction is processed or the delivery of the product or service to present a chargeback to our sponsoring bank as the merchant processor. Therefore, management believes that the maximum potential exposure for the chargebacks would not exceed the total amount of transactions processed through Visa and MasterCard for the last four months and other unresolved chargebacks in the process of resolution. For the last four months through September 30, 2004, this potential exposure totaled approximately $352 million. At September 30, 2004, we, through our sponsoring banks, had approximately $168,000 of unresolved chargebacks that were in the process of resolution. At September 30, 2004, we, through our sponsoring banks, had access to $9.9 million belonging to our merchants. This money has been deposited at the sponsoring bank by the merchants to cover any potential chargeback losses.

For the fiscal years 2004 and 2003, we processed approximately $1,053 million (2004) and $961 million (2003) of Visa and MasterCard transactions, which resulted in $7.6 million in gross chargeback activities for the fiscal year ended 2004 and $9.3 million for the fiscal year ended 2003. Substantially all of these chargebacks were recovered from the merchants.

Nevertheless, if we are unable to recover these chargeback amounts from merchants, having to pay the aggregate of any such amounts would significantly affect our results of operations and liquidity.

FAILURE TO PARTICIPATE IN THE VISA POS CHECK SERVICE PROGRAM WOULD CAUSE US TO SIGNIFICANTLY SHIFT OUR OPERATING AND MARKETING STRATEGY.

We have significantly increased our infrastructure, personnel and marketing strategy to focus on the potential growth of our check services through the Visa POS Check Service program. We currently provide critical back-end infrastructure for the service, including our NCN database for verification and our access to the Federal Reserve System's Automated Clearing House for funds settlement and for checks written on bank accounts with banks not participating in the program.

Because we believe the market will continue to gain acceptance of the Visa POS Check Service program, we have expended significant resources to market our check conversion services and verification services to our merchant base, to solidify our strategic relationships with the various financial institutions that have chosen us as their Acquirer Processor and Third-Party processor under the program, and to sell our other check products such as electronic check re-presentments and check guarantee to the Visa member banks. We have also increased our personnel to handle the increased volume of transactions arising directly from our participation in the program.

If we fail to adequately market our services through this relationship, this could materially affect our marketing strategy going forward. Additionally, if we fail to adequately grow our infrastructure to address increases in the volume of transactions, cease providing services as a Third-Party processor or Acquirer Processor or are otherwise removed or terminated from the Visa Program, this would require us to dramatically shift our current operating strategy.

THE BUSINESS IN WHICH WE COMPETE IS HIGHLY COMPETITIVE AND THERE IS NO ASSURANCE THAT OUR CURRENT PRODUCTS AND SERVICES WILL STAY COMPETITIVE OR THAT WE WILL BE ABLE TO INTRODUCE NEW PRODUCTS AND SERVICES TO COMPETE SUCCESSFULLY.

We are in the business of processing payment transactions and designing and implementing integrated systems for our customers so that they can better use our services. This business is highly competitive and is characterized by rapid technological change, rapid rates of product obsolescence, and rapid rates of new products

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introduction. Our market share is relatively small as compared to most of our competitors and most of these competitors have substantially more financial and marketing resources to run their businesses. While we believe our small size provides us the ability to move quickly in some areas, our competitors' greater resources enable them to investigate and embrace new and emerging technologies, quickly to respond to changes in customers needs, and to devote more resources to product and services development and marketing. We may face increased competition in the future and there is no assurance that current or new competition will allow us to keep our customers. If we lose customers, our business operations may be materially adversely affected, which could cause us to cease our business or curtail our business to a point where we are no longer able to generate sufficient revenues to fund operations. There is no assurance that our current products and services will stay competitive with those of our competitors or that we will be able to introduce new products and services to compete successfully in the future.

IF WE ARE UNABLE TO PROCESS SIGNIFICANTLY INCREASED VOLUME ACTIVITY, THIS COULD AFFECT OUR OPERATIONS AND WE COULD LOSE OUR COMPETITIVE POSITION.

We have built transaction processing systems for check verification, check conversion, ACH processing, and bankcard processing activities. While current estimates regarding increased volume are within the capabilities of each system, it is possible that a significant increase in volume in one of the markets would exceed a specific system's capabilities. To minimize this risk, ECHO has redesigned and upgraded its check related processing systems and has purchased a high end system to process bankcard activity. This system is not yet operational, and even when it becomes operational, no assurance can be given that it would be able to handle a significant increase in volume or that the operational enhancements and improvements will be completed in such time to avoid such a situation. In the event we are unable to process increases in volume, this could significantly adversely affect our banking relationships, our merchant customers and our overall competitive position, and could potentially result in violations of service level agreements which would require us to pay penalty fees to the other parties to those agreements. Losses of such relationships, or the requirement to pay penalties, may severely impact our results of operations and financial condition.

WE INCUR FINANCIAL RISK FROM OUR CHECK GUARANTEE SERVICE.

The check guarantee business is essentially a risk management business. Any limitation of a risk management system could result in financial obligations being incurred by ECHO relative to our check guarantee activity. While ECHO has provided check guarantee services for several years, there can be no assurance that our current risk management systems are adequate to assure against any financial loss relating to check guarantee. ECHO is enhancing its current risk management systems and it is being conservative with reference to the type of merchants to which it offers guarantee services in order to minimize this risk but no assurance can be given that such measures will be adequate. During the year ended September 30, 2004, we incurred $128,000 in losses from uncollected guaranteed checks.

SECURITY BREACHES COULD IMPACT OUR CONTINUED OPERATIONS.

We process confidential financial information and maintain several levels of security to protect this data. Security includes hand and card-based identification systems at our data center locations that restrict access to the specific facilities, various employee monitoring and access restriction policies, and various firewall and network management methodologies that restrict unauthorized access through the Internet. While these systems have worked effectively in the past, there can be no assurance that they will continue to operate without a security breach in the future. Depending upon the nature of the breach, the consequences of security breaches could be significant and dramatic to ECHO's continued operations.

THE INDUSTRY IN WHICH WE OPERATE INVOLVES RAPIDLY CHANGING TECHNOLOGY AND OUR FAILURE TO IMPROVE OUR PRODUCTS AND SERVICES OR TO OFFER NEW PRODUCTS AND SERVICES COULD CAUSE US TO LOSE CUSTOMERS.

Our business industry involves rapidly changing technology. Recently, we have observed rapid changes in technology as evidenced by the Internet and Internet-related services and applications, new and better software, and faster computers and modems. As technology changes, ECHO's customers desire and expect better products and services. Our success depends on our ability to improve our existing products and services and to develop and market new products and services. The costs and expenses associated with such an effort could be significant to us. There is no assurance that we will be able to find the funds necessary to keep up with new



technology or that if such funds are available that we can successfully improve our existing products and services or successfully develop new products and services. Our failure to provide improved products and services to our customers or any delay in providing such products and services could cause us to lose customers to our competitors. Loss of customers could have a material adverse effect on ECHO.

OUR INABILITY TO PROTECT OR DEFEND OUR TRADE SECRETS AND OTHER INTELLECTUAL PROPERTY COULD HURT OUR BUSINESS.

We have expended a considerable amount of time and money to develop information systems for our merchants. We regard these information systems as trade secrets that are extremely important to our payment processing operations. We rely on trade secret protection and confidentiality and/or license agreements with employees, customers, partners and others to protect this intellectual property and have not otherwise taken steps to obtain additional intellectual property protection or other protection on these information systems. We cannot be certain that we have taken adequate steps to protect our intellectual property. In addition, our third-party confidentiality agreements can be breached and, if they are, there may not be an adequate remedy available to us. If our trade secrets become known, we may lose our competitive position, including the loss of our merchant and bank customers. Such a loss could severely impact our results of operations and financial condition.

Additionally, while we believe that the technology underlying our information systems does not infringe upon the rights of any third parties, there is no assurance that third parties will not bring infringement claims against us. We also have the right to use the technology of others through various license agreements. If a third party claimed our activities and/or these licenses were infringing their technology, while we may have some protection from our third-party licensors, we could face additional infringement claims or otherwise be obligated to stop utilizing intellectual property critical to our technology infrastructure. If we are not able to implement other technology to substitute the intellectual property underlying a claim, our business operations could be severely effected. Additionally, infringement claims would require us to incur significant defense costs and expenses and, to the extent we are unsuccessful in defending these claims, could cause us to pay monetary damages to the person or entity making the claim. Continuously having to defend such claims or otherwise making monetary damages payments could materially adversely affect our results of operations.

IF WE DO NOT CONTINUE TO INVEST IN RESEARCH AND DEVELOPMENT, WE COULD LOSE OUR COMPETITIVE POSITION.

Because technology in the payment processing industry evolves rapidly, we need to continue to invest in research and development in both the bankcard processing business segment and the check-related products segment in order to remain competitive. Research and development expenses remained constant from $1,464,000 in fiscal 2003 to $1,465,000 in fiscal 2004. Most of our development project costs were capitalized once we entered into coding and testing phases, we continue to evaluate projects, which we believe will assist us in our efforts to stay competitive. Although we believe that our investment in these projects will ultimately increase earnings, there is no assurance as to when or if these new products will show profitability or if we will ever be able to recover the costs invested in these projects. Additionally, if we fail to commit adequate resources to grow our technology on pace with market growth, we could quickly lose our competitive position, including the loss of our merchant and bank customers.

FAILURE TO OBTAIN ADDITIONAL FUNDS CAN IMPACT OUR OPERATIONS AND FUTURE GROWTH.

We use funds generated from operations, as well as funds obtained through credit facilities and equity financing, to finance our operations. In light of our recent financing efforts, and as a result of the cash flow generated from operations, we believe we have sufficient cash to support our business activities, including research, development and marketing costs. However, future growth may depend on our ability to continue to raise additional funds, either through operations, bank borrowings, or equity or debt financings. There is no assurance that we will be able to continue to raise the funds necessary to finance growth or continue to generate the funds necessary to finance operations, and even if such funds are available, that the terms will be acceptable to us. The inability to generate the necessary funds from operations or from third parties in the future may require us to scale back our research, development and growth opportunities, which could harm our overall operations.



WHILE WE MAINTAIN INSURANCE PROTECTION AGAINST CLAIMS RELATED TO OUR SERVICES, THERE IS NO ASSURANCE THAT SUCH PROTECTION WILL BE ADEQUATE TO COVER POTENTIAL CLAIMS AND OUR INABILITY TO OTHERWISE PAY SUCH CLAIMS COULD HARM OUR BUSINESS.

We maintain errors and omissions insurance for the services we provide. While we believe the limit on our errors and omissions insurance policy is adequate and consistent with industry practice, if claims are brought by our customers or other third parties, we could be required to pay the required claim or make significant expenditures to defend against such claims in amounts that exceed our current insurance coverage. There is no assurance that we will have the money to pay potential plaintiffs for such claims if they arise beyond the amounts insured by us. Making these payments could have a material adverse effect on our business.

INVOLVEMENT IN LITIGATION COULD HARM OUR BUSINESS.

We are involved in various lawsuits arising in the ordinary course of business. Although we believe that the claims asserted in such lawsuits are without merit, the cost to us for the fees and expenses to defend such lawsuits could have a material adverse effect on our financial condition, results of operations or cash flow. In addition, there can be no assurance that we will not at some time in the future experience significant liability in connection with such claims. As of September 30, 2004, we have spent approximately $279,000 in legal fees and expenses defending these claims.

OUR INABILITY TO RECOVER FROM NATURAL DISASTERS COULD HARM OUR BUSINESS.

We currently maintain three data centers: one in Camarillo, California, one in Albuquerque, New Mexico and one in Boulder, Colorado. Should a natural disaster occur in any of the locations, it is possible that ECHO would not be able to fully recover full functionality at one of its data centers. To minimize this risk, ECHO centralized its data processing functionality in Camarillo during fiscal 2004 and will make Albuquerque a fully redundant site. Prior to that time, it is possible a natural disaster could limit or completely disable a specific service offered by ECHO until such time that the specific location could resume its functionality. Our inability to provide such service could have a material adverse effect on our business and results of operations.

INCREASES IN THE COSTS OF TECHNICAL COMPLIANCE COULD HARM OUR BUSINESS.

The services which ECHO offers require significant technical compliance. This includes compliance to both Visa and MasterCard regulations and association rules, NACHA guidelines and regulations with regard to the Federal Reserve System's Automated Clearing House and check related issues, and various banking requirements and regulations. ECHO has personnel dedicated to monitoring our compliance to the specific industries we serve and, when possible, ECHO is moving the technical compliance responsibility to other parties, as is the case with the recent purchase of the Oasis Technologies bankcard processing system wherein the vendor, Oasis Technologies, assumes much of the compliance obligations regularly updated by Visa and MasterCard. As the compliance issues become more defined in each industry, the costs associated with that compliance may present a risk to ECHO. These costs could be in the form of additional hardware, software or technical expertise that ECHO must acquire and/or maintain. While ECHO currently has these costs under control, we have no control over those entities that set the compliance requirements so no assurance can be given that ECHO will always be able to underwrite the costs of compliance in each industry wherein we compete.

RISKS ASSOCIATED WITH OUR COMMON STOCK

IF WE NEED TO SELL OR ISSUE ADDITIONAL SHARES OF COMMON STOCK OR ASSUME ADDITIONAL DEBT TO FINANCE FUTURE GROWTH, OUR STOCKHOLDERS' OWNERSHIP COULD BE DILUTED OR OUR EARNINGS COULD BE ADVERSELY IMPACTED.

Our business strategy may include expansion through internal growth, by acquiring complementary businesses or by establishing strategic relationships with targeted customers and suppliers. In order to do so, or to fund our other activities, we may issue additional equity securities that could dilute our stockholders' stock ownership. We

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may also assume additional debt and incur impairment losses related to goodwill and other tangible assets if we acquire another company and this could negatively impact our results of operations. As of the date of this report, management has no plan to raise additional capital through the sale of securities and believes that our cash flow from operations together with cash on hand and our established line of credit with Bank of the West will be sufficient to meet our working capital and other commitments.

WE HAVE ADOPTED A NUMBER OF ANTI-TAKEOVER MEASURES THAT MAY DEPRESS THE PRICE OF OUR COMMON STOCK.

Our rights agreement, our ability to issue additional shares of preferred stock and some provisions of our articles of incorporation and bylaws could make it more difficult for a third party to make an unsolicited takeover attempt of us. These anti-takeover measures may depress the price of our common stock by making it more difficult for third parties to acquire us by offering to purchase shares of our stock at a premium to its market price.

OUR STOCK PRICE HAS BEEN VOLATILE.

Our common stock is quoted on the NASDAQ SmallCap Market, and there can be substantial volatility in the market price of our common stock. Over the course of the quarter ended September 30, 2004, the market price of our common stock has been as high as $9.99, and as low as $6.45. Additionally, over the course of the year ended September 30, 2004, the market price of our common stock has been as high as $13.06 and as low as $6.15. The market price of our common stock has been, and is likely to continue to be, subject to significant fluctuations due to a variety of factors, including quarterly variations in operating results, operating results which vary from the expectations of securities analysts and investors, changes in financial estimates, changes in market valuations of competitors, announcements by us or our competitors of a material nature, loss of one or more customers, additions or departures of key personnel, future sales of common stock and stock market price and volume fluctuations. In addition, general political and economic conditions such as a recession, or interest rate or currency rate fluctuations may adversely affect the market price of our common stock.

WE HAVE NOT PAID AND DO NOT CURRENTLY PLAN TO PAY DIVIDENDS, AND YOU MUST LOOK TO PRICE APPRECIATION ALONE FOR ANY RETURN ON YOUR INVESTMENT.

Some investors favor companies that pay dividends, particularly in general downturns in the stock market. We have not declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth, and we do not currently anticipate paying cash dividends on our common stock in the foreseeable future. Because we may not pay dividends, your return on this investment likely depends on your selling our stock at a profit.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are currently not exposed to any significant financial market risks from changes in foreign currency exchange rates or changes in interest rates and do not use derivative financial instruments. All of our revenue and capital spending is transacted in U.S. dollars. However, in the future, we may enter into transactions in other currencies. An adverse change in exchange rates would result in a decline in income before taxes, assuming that each exchange rate would change in the same direction relative to the U.S. dollar. In addition to the direct effects of changes in exchange rates, such changes typically affect the volume of sales or foreign currency sales price as competitors' products become more or less attractive.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

The Financial Statements and Supplementary Data are listed under "Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8K".

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

None.

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ITEM 9A. CONTROLS AND PROCEDURES

As of September 30, 2004, the end of the period covered by this report, under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective in causing material information to be recorded, processed, summarized and reported by our management on a timely basis and to ensure that the quality and timeliness of our public disclosures complies with its Securities and Exchange Commission disclosure obligations. During the quarter ended September 30, 2004, there was no change in our internal control over financial reporting that materially affects, or that is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The officers and directors of ECHO are:

| Name | Position | Date first became Officer or Director |
|---|---|---|
| Joel M. Barry | Chairman of the Board, Chief Executive Officer, | 1986 |
| Alice L. Cheung | Chief Financial Officer, Treasurer | 1996 |
| Alex Seltzer[1] | Chief Operating Officer/ Chief Information Officer | 2002 |
| Steven Smith[1] | Chief Information Officer | 2004 |
| Sharat Shankar | Senior Vice President | 2003 |
| Patricia M. Williams | Senior Vice President | 1997 |
| Jack Wilson | Senior Vice President | 1994 |
| Kris Winckler | Senior Vice President | 1999 |
| Arnold Feinberg | Vice President | 2000 |
| Jesse Fong | Vice President | 1994 |
| David Griffin | Vice President | 1990 |
| Robert Hare | Vice President | 1999 |
| Steve Hoofring | Vice President | 2003 |
| David Piatt | Vice President | 2003 |
| Rick Slater | Vice President | 1998 |
| Donna L. Rehman | Corporate Secretary | 1990 |
| Herbert L. Lucas | Director | 1991 |
| Aristides W. Georgantas | Director | 1999 |
| Carl R. Terzian | Director | 2002 |
| Richard Field | Director | 2004 |

[1] Steven Smith succeeds Alex Seltzer, with respect to information technology duties previously performed by Mr. Seltzer, and joins us as a result of Mr. Seltzer's decision to pursue other business interests. Mr. Seltzer will continue providing services to us through December 31, 2004, the effective date of his resignation.

JOEL M. BARRY, age 54, has been a Director of ECHO since July 1986, and Chairman of the Board since December 1986. Mr. Barry served as Chief Financial Officer from May 1987 to June 1990, and Executive Vice President from October 1987 to June 1990, when he was designated Chief Executive Officer of ECHO. Mr. Barry is also a Director and Chief Executive Officer of the MerchantAmerica and XPRESSCHEX, Inc. wholly-owned subsidiaries. From August 1981 to June 1991, Mr. Barry was a lecturer and investment counselor for Dynamic Seminars, a firm he founded in 1981, and Basics Financial Planning and Investments, a firm he founded in 1983. From 1972 to 1974, Mr. Barry owned and operated a recording business and from 1975 to 1981 was employed as the Director of Marketing and Sales with Financial Dynamics, a financial planning firm located in Covina, California. Mr. Barry attended Oklahoma State University from 1969 to 1970, majoring in Accounting and Ozark Bible College from 1970 to 1972, majoring in music.

ALICE L. CHEUNG, age 47, has served as Treasurer and Chief Financial Officer since July 1996. Ms. Cheung received her BS degree in business administration/accounting from California State University in Long Beach, California and became a Certified Public Accountant in May 1982. Prior to joining ECHO, Ms. Cheung was the Treasurer and Chief Financial Officer of American Mobile Systems from February 1988 to January 1996, prior to its merger with Nextel Communications, Inc. Ms. Cheung is an active member of the American Institute of Certified Public Accountants and Financial Executive Institute.

ALEX SELTZER, age 52, joined ECHO in August 2002 as Chief Operating Officer and Chief Information Officer. Prior to joining ECHO, Mr. Seltzer was the CIO and co-founder of Online Resources Corporation, an e-financial services outsourcer providing home banking, bill payment, and integrated third-party financial services to small and medium-sized U.S. banks. Mr. Seltzer holds a BS degree in Applied Math and Computer Science from MIT in Cambridge, Massachusetts and an MBA from Stanford Graduate School of Business in Stanford, California.

STEVEN SMITH, age 44, joined ECHO in November 2004 as Chief Information Officer. Prior to joining ECHO, Mr. Smith was Vice President of Engineering for Digital Insight (a financial services ASP providing Internet banking, bill payment, cash management and loan origination capabilities to over 1,500 financial institutions across North America), where he was accountable for all product development. Mr. Smith has also served as a CIO and Vice President of Research and Development for Lombardi Software in Austin, Texas and as a Partner with Ernst & Young/CAP Gemini. Mr. Smith holds a B.A. degree in Computer Science from The University of Texas in Austin.

SHARAT SHANKAR, age 34, joined ECHO in June 2003 as Vice President of Risk Management and Business Intelligence. Prior to joining ECHO, Mr. Shankar worked at TeleCheck for approximately eight years where he held a variety of positions leading up to Vice President of Risk Management. Prior to TeleCheck, Mr. Shankar held positions at MetLife as well as Hong Kong and Shanghai Bank, Madras, India. Mr. Shankar holds a Bachelor of Commerce degree from Loyola College, India, and a Master of Business Administration degree from James Madison University, Virginia.

PATRICIA M. WILLIAMS, age 39, joined ECHO in September 1996, serving as Director of Program Management, Ms. Williams was appointed Vice President of Corporate Program Management in October 1997 and Vice President of Check Services in October 2001. In June of 2003, Ms. Williams was appointed to the position of Vice President of Sales and Marketing. Prior to joining ECHO, Ms. Williams was an Operations Manager for Bank of America Systems Engineering in San Francisco. Ms. Williams has also served as a Senior Program manager for the Los Angeles office of LANSystems, Inc., a nationwide systems integrator as well as a Senior Project Manager and Systems Engineer for Bank of America Systems Engineering in Los Angeles. Ms. Williams holds a B.A. degree in communications from the University of California, Los Angeles.

JACK WILSON, age 60, has served as Vice President of Merchant Services since June 1994 and was Director of Bankcard Relations for ECHO from October 1992 until May 1994. Mr. Wilson served as Vice President for Truckee River Bank from

August 1989 until September 1992. Previously, he was Senior Vice President/Cashier of Sunrise Bancorp and a Vice President of First Interstate Bank. Mr. Wilson holds a teaching credential from the California Community College System in business and finance.

KRIS WINCKLER, age 39, joined ECHO in April, 1999, as Vice President of ECHO's XPRESSCHEX subsidiary. Mr. Winckler is currently the Senior Vice President of Product and Strategic Planning at ECHO. Prior to joining ECHO, Mr. Winckler was a consultant at Andersen Consulting and the President of Magic Software, a company specializing in check verification, conversion, and ACH software. Mr. Winckler has been active in the check and collection industry for over ten years and has been a member of the Electronic Check Council of NACHA since 1998. Mr. Winckler holds a B.S. degree in Electrical Engineering from the University of New Mexico, an MBA from the University of Illinois, and is an Accredited ACH Professional (AAP) and Certified Treasury Professional (CTP).



ARNOLD FEINBERG, age 55, joined ECHO in January 2000 as Vice President of sales. Prior to joining ECHO, Mr. Feinberg was an independent sales consultant for Rocky Mountain Retail Systems, a company that provided check authorization software and transaction processing services and was acquired by ECHO in 2000. From 1986 to 1993, Mr. Feinberg was employed by Lawrence Data Service, Inc. where he developed the franchise division for regional check verification and collection under National Check Association. Mr. Feinberg graduated from the University of Kansas with a B.S. in Accounting and Finance.

JESSE FONG, age 53, has served as Vice President of Information Systems since September 1994. Mr. Fong joined ECHO in 1984 and has served as programmer, Data Processing manager and MIS director. He received a degree major in M.E. and minor in Computer Science in 1972, received an International Marketing certificate in 1975 and a Business Administration certificate in 1976. Mr. Fong worked as Marketing manager, Sales manager and Trainer with the Xerox Corporation in Taiwan from 1974 to 1978. After that, he joined Abbott Laboratory as Country manager for two years. After immigrating to the United States in 1980, he worked as International Marketing manager in a trading firm for four years.

DAVID GRIFFIN, age 56, has served as Vice President of Major Accounts since June 2003. Previous to this capacity, he was Vice President of Check Guarantee from October 2001 to June 2003, Vice President of Check Services for ECHO from June 1990 to October 2001 and Vice President of Operations from January 1986 until September 1989, at which time he became a consultant to ECHO. Mr. Griffin has served as Senior Vice President and General Manager for TeleCheck, Los Angeles and TeleCheck, San Diego, from May 1983 to August 1985. Prior to these appointments, he was Regional Manager of TeleCheck Services, a franchiser of check guarantee services, a division of Tymshare Corporation, which was subsequently acquired by McDonnell Douglas Corporation. Mr. Griffin holds a business administration degree with a major in accounting from the University of Houston.

ROBERT HARE, age 39, joined ECHO in April,1999 through the acquisition of Magic Software Development, a company he co-founded in 1991 to provide check verification, conversion and ACH software. Prior to founding Magic Software Development, Mr. Hare was a software developer with Titan Business Systems and a systems analyst with the University of New Mexico. Mr. Hare holds an A.S. degree in Computer Programming from the University of New Mexico.

STEVE HOOFRING, age 44, joined ECHO in October 2001 as Implementation Manager for the Check Services group and was appointed Vice President of Visa POS Check and Client Services in October 2003. Mr. Hoofring was President of Running Dog

Software, Inc., which developed 'Enterprise' software for small to medium size businesses. Prior to this, Mr. Hoofring held several management positions with Emerson Power Transmission, a subsidiary of Emerson Electric, Inc. Mr. Hoofring holds a B.S. degree in Business Administration from Northern Kentucky University.

DAVID PIATT, age 45, joined ECHO in October 2003 as a Vice President of systems management. Mr. Piatt has over 20 years of reengineering, information technology and business experience in financial transaction processing, grant management, online banking, engineering and manufacturing systems. His business experience includes operations, program/project management, marketing, business development, business process reengineering, Continuous Process Improvement, Total Quality Management, Activity Based Costing, Work Breakdown Structure, cost benefit analysis and ROI analyses. Mr. Piatt was awarded a Master's degree in physics from Texas A&M and a bachelor's degree from Colorado State University.

RICK SLATER, age 44, joined ECHO in May 1995 as Vice President of Computer Based Controls, Inc. ("CBC"). Mr. Slater was appointed President of CBC in December 1995, Vice President of ECHO in November 1998 and Chief Technology Officer in October 1999. Prior to joining ECHO, Mr. Slater was President of Slater Research, which provided contract engineering services to various institutions. During this time, Mr. Slater directly participated in the U.S. Coast Guard COMSTA upgrade project including site surveys, systems design and system upgrade integration in a number of sites within the U.S. Prior to this position, Mr. Slater served as a group leader at Aiken Advanced Systems. Mr. Slater holds a BS degree in electrical engineering technology from Old Dominion University, Norfolk, Virginia.

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DONNA L. REHMAN, age 55, joined ECHO in 1988 and has served as Corporate Secretary since 1990. For three years prior thereto, she was self-employed in Woodland Hills, California in educational books and toys. She attended Southern Illinois University in Carbondale and was employed as an administrative assistant in Chicago for 4 years and Los Angeles for 5 years.

HERBERT L. LUCAS, age 78, has been a Director since 1991. Mr. Lucas received a BA degree in History in 1950 from Princeton University and an MBA degree in 1952 from Harvard University Graduate School of Business Administration. He served as President from 1972 to 1981 of Carnation International in Los Angeles and as a member of the Board of Directors of the Carnation Company. Since 1982, Mr. Lucas has managed his family investment business. He has served on the Board of Directors of various financial and business institutions including Wellington Trust Company, Arctic Alaska Fisheries, Inc., Scolr Pharma, Inc. and Sunworld International Airways, Inc. Mr. Lucas has served as a Trustee of The J. Paul Getty Trust, the Los Angeles County Museum of Art, The Morgan Library, National Association of Independent Schools and Winrock International. He was formerly a member of the Board of Trustees of Princeton University.

ARISTIDES W. GEORGANTAS, age 60, has served as a Director since February 1999. Mr. Georgantas, prior to his retirement, was Executive Vice President and Chief Operating Officer at Chase Manhattan Bank's Global Asset Management/Private Banking Division. He serves as a director of Horizon Blue Cross Blue Shield of New Jersey, the Glenmede Corporation, the Glenmede Trust Company, the Foundation for Public Broadcasting in New Jersey, Mathematica Policy Research, Inc. and the Rita Allen Foundation. Mr. Georgantas is a graduate of the University of Massachusetts and the Columbia University Graduate School of Business.

CARL R. TERZIAN, age 69, has served as a Director since December, 2002. Mr. Terzian graduated magna cum laude from the University of Southern California in 1957. Following his USC education, Mr. Terzian served as an international good will ambassador for President Eisenhower and Secretary of State John Foster Dulles; director of public and church relations for the Lutheran Hospital Society of Southern California; civic affairs consultant to the California savings and loan industry; and dean and professor of government and speech at Woodbury University. In 1965, Mr. Terzian joined Charles Luckman Associates, an architectural firm, to handle its public relations throughout the United States and worldwide and began his own public relations firm, Carl Terzian Associates, in 1969. Mr. Terzian currently serves as a director on the board of Transamerica Investors, Inc. and Mercantile National Bank along with various non-profit boards, commissions, advisory groups, and task forces.

RICHARD FIELD, age 64, became a director of ECHO in July 2004. Mr. Field has worked in the financial services industry for over 35 years as an executive of the Bank of New York, Chase, and Citigroup, and a director of Mastercard International and Chairman of its U.S. Board. Since retiring from full time employment in 1997, he has continued his career in the specialty financial areas as a co-founder and director of LendingTree, Inc. as well as serving on the boards of Providian Financial Corporation and HPSC, Inc. Mr. Field graduated from Salisbury School, Connecticut, in 1959 and Trinity College, Connecticut, in 1963 with a B.A. in English and Economics.

All directors are to be elected to three year terms by the stockholders and serve until their respective terms have expired. The Annual Meeting of Stockholders was held on February 9, 2004, and the election of directors was held at that time.

CODE OF ETHICAL CONDUCT

Our Board of Directors has adopted a Code of Ethical Conduct (the "Code of Conduct"). We require all employees, directors and officers, including our Chief Executive Officer and Chief Financial Officer, to adhere to the Code of Conduct in addressing legal and ethical issues encountered in conducting their work. The Code of Conduct requires that these individuals avoid conflicts of interest, comply with all laws and other legal requirements, conduct business in an honest and ethical manner and otherwise act with integrity and in our best interest. The Code of Conduct contains additional provisions that apply specifically to our Chief Financial Officer and other financial officers with respect to full and accurate reporting. The Code of Conduct is available on our website at www.echo-inc.com.

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AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Aristides W. Georgantas, the Chairman of the Audit Committee of the Board of Directors, is an "audit committee financial expert" as defined in Item 401(h) of Regulation S-K. Mr. Georgantas is "independent" for purposes of Rule 4200(a)(15) of the NASDAQ Marketplace Rules.

IDENTIFICATION OF AUDIT COMMITTEE

Our Board of Directors has a separately standing Audit Committee. The Audit Committee currently consists of Messrs. Richard D. Field, Herbert L. Lucas, Jr., Aristides W. Georgantas, and Carl R. Terzian. Messrs. Field, Lucas, Georgantas and Terzian are "independent directors" within the meaning of Rule 10A-3 promulgated under the Securities Exchange Act of 1934, as amended, and the NASDAQ Marketplace Rules. The Audit Committee's primary duties and responsibilities include appointment of the independent auditors, evaluation of the performance and independence of such auditors and review of the annual audited financial statements and the quarterly financial statements, as well as the adequacy of our internal controls.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers and the holders of 10% or more of our Common Stock to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our equity securities. Based solely on our review of the copies of the forms received by us and written representations from certain reporting persons that they have complied with the relevant filing requirements, we believe that, during the year ended September 30, 2004, all of our executive officers, directors and the holders of 10% or more of our Common Stock complied with all Section 16(a) filing requirements.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth the total compensation paid and stock options offered by us during the fiscal years ended September 30, 2004, September 30, 2003 and September 30, 2002, to our Chief Executive Officer and to each of our five most highly compensated executive officers, other than the Chief Executive Officer (collectively with the Chief Executive Officer, the "Named Executive Officers"), whose compensation exceeded $100,000 during the fiscal year ended September 30, 2004.

SUMMARY COMPENSATION TABLE

| | | | Annual Compensation | | Long Term Compensation | |
|---|---|---|---|---|---|---|
| Name | Capacities in Which Served | Year | Salary | Bonus | Securities Underlying Options[2] | Other[3] |
| Joel M. Barry[1] | Chairman/Chief Executive Officer | 2004 | $241,500 | $ 50,000 | 60,000 | $ -0- |
| | | 2003 | 223,125 | -0- | 40,000 | -0- |
| | | 2002 | 209,000 | -0- | 50,000 | -0- |
| Alex Seltzer[4] | Chief Information Officer/Chief Operating Officer | 2004 | $190,565 | $ 48,000 | 30,000 | $ 5,110 |
| | | 2003 | 148,295 | -0- | 5,000 | 2,250 |
| | | 2002 | 14,230 | -0- | 50,000 | -0- |
| Alice Cheung | Chief Financial Officer/Treasurer | 2004 | $138,000 | $ 40,000 | 35,000 | $ 4,940 |
| | | 2003 | 125,500 | 15,000 | 15,000 | 4,175 |
| | | 2002 | 110,500 | 11,500 | 5,000 | 3,450 |

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| | | | | | | |
|---|---|---|---|---|---|---|
| Sharat Shankar | Sr. Vice President | 2004 | $131,430 | 47,500 | 35,000 | $ 2,343 |
| | | 2003 | 46,333 | 5,000 | 50,000 | -0- |
| | | 2002 | -0- | -0- | -0- | -0- |
| Patricia M. Williams | Sr. Vice President | 2004 | $123,000 | $ 35,000 | 35,000 | -0- |
| | | 2003 | 111,190 | 15,000 | 15,000 | -0- |
| | | 2002 | 103,750 | 16,500 | 10,000 | 3,000 |
| Jack Wilson[1] | Sr. Vice President | 2004 | $123,000 | $ 35,000 | 35,000 | $ 4,412 |

| | | | | | |
|---|---|---|---|---|---|
| 2003 | 111,190 | 15,000 | | 15,000 | 2,998 |
| 2002 | 103,750 | 16,500 | | 5,000 | 2,250 |

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[1] We provide Mr. Barry and Mr. Wilson with an automobile. There has been no compensation paid other than that indicated in the above table.
[2] Mr. Seltzer exercised 1,000 of his options at $1.30 per option, granted in fiscal 2003 and 10,000 of his options at $1.29 per option, granted in fiscal 2002; Ms. Williams exercised 2,000 of her options at $2.15 per option, granted in fiscal 2002.
[3] Represents our match of contributions to our 401(k) Plan. We contribute 50% of the last 6% of each employee's contribution to the 401(k) Plan.
[4] Mr. Seltzer has decided to pursue other business interests. As a result, he will only continue providing services to us through December 31, 2004, the effective date of his resignation.

FISCAL 2004 OPTION GRANTS TABLE

The following table sets forth the stock options granted to our Chief Executive Officer and each of the other Named Executive Officers during the fiscal year ended September 30, 2004. Under applicable Securities and Exchange Commission regulations, companies are required to project an estimate of appreciation of the underlying shares of stock during the option term. We have chosen to project this estimate using the potential realizable value at assumed annual rates of stock price appreciation for the option term at assumed rates of appreciation of 5% and 10%. However, the ultimate value will depend upon the market value of our stock at a future date, which may or may not correspond to the following projections.

| | | | | | Potential Realization Value at Assumed Annual Rates of Stock Price Appreciation for Option Term | |
|---|---|---|---|---|---|---|
| Name | Options Granted[1] | Percent of Total Granted to Employees in Fiscal Year | Exercise Price per share | Expiration Date | 5% | 10% |
| Joel M. Barry | 60,000 | 14.12% | $ 6.85 | 12/15/13 | $ 167,000 | $ 390,0 |
| Alex Seltzer | 30,000 | 7.06% | $ 6.85 | 12/15/13 | $ 84,000 | $ 195,0 |
| Alice Cheung | 35,000 | 8.24% | $ 6.85 | 12/15/13 | $ 98,000 | $ 228,0 |
| Sharat Shankar | 35,000 | 8.24% | $ 6.85 | 12/15/13 | $ 98,000 | $ 228,0 |
| Patricia Williams | 35,000 | 8.24% | $ 6.85 | 12/15/13 | $ 98,000 | $ 228,0 |
| Jack Wilson | 35,000 | 8.24% | $ 6.85 | 12/15/13 | $ 98,000 | $ 228,0 |

[1] All options vest in five equal annual installments beginning 12 months following the date of the grant.

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AGGREGATED OPTION/SAR EXERCISES AND FISCAL-YEAR OPTION/SAR VALUE TABLE

The following table sets forth information concerning the exercise of stock options during the fiscal year ended September 30, 2004 by each of our Named Executive Officers and the number and value of unexercised options held by each of our Named Executive Officers as of the fiscal year ended September 30, 2004.

| Name | Shares acquired on exercise | Value realized | Number of unexercised options/SARS at FY-end | Value of unexercised in-the-money Options/SARS at FY-end[1] |
|---|---|---|---|---|
| Joel M. Barry | 32,500 | $ -0- | 250,000 | $ 1,126,000 |
| Alex Seltzer | 11,000 | $ -0- | 74,000 | $ 389,000 |
| Alice Cheung | 7,500 | $ -0- | 85,000 | $ 361,000 |
| Sharat Shankar | -0- | $ -0- | 85,000 | $ 748,000 |
| Patricia M. Williams | 1,000 | $ -0- | 89,000 | $ 367,000 |
| Jack Wilson | 8,500 | $ 65,400 | 71,500 | $ 287,000 |

[1] Based on the closing sales price of the Common Stock on September 30, 2004 of $8.80 per share, less the option exercise price.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information concerning our equity compensation plans as of September 30, 2004.

| Plan Category | (a) Number of securities to be issued upon exercise of outstanding options | (b) Weighted-average exercise price of outstanding options | (c) Number of securities remaining available for future issuance under equity compensation (excluding securities reflected in column (a)) |
|---|---|---|---|
| Equity compensation plans approved by security holders[1] | 1,133,925 | $ 4.86 | 193,000 |

[1] Plan represents the Officers and Key Employees Incentive Stock Option Plan, which expired in May 2002, and our 2003 Incentive Stock Option Plan.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

No interlocking relationship exists between our Board of Directors or Executive Officers Compensation Committee and the board of directors or compensation committee of any other company.

DIRECTOR COMPENSATION

Each outside director received $48,250 in fiscal 2004; $28,000 and 3,031 shares of Common Stock in fiscal 2003; and $15,000 and 6,912 shares of Common Stock in fiscal 2002. Mr. Field, appointed on July 12, 2004, to fill a vacancy on the Board of Directors, received $13,750 in fiscal 2004. Directors are compensated for all reasonable expenses and are not compensated for special meetings other than regular meetings.



EMPLOYMENT AGREEMENTS

None.

BONUS, PROFIT-SHARING AND OTHER REMUNERATION PLANS AND PENSION AND RETIREMENT PLANS

In addition to salary, the Compensation Committee of the Board of Directors, from time to time, grants options to executive officers and key personnel pursuant to the 2003 Incentive Stock Option Plan. The Compensation Committee thus views option grants as an important component of its long-term, performance-based compensation philosophy. Since the value of an option bears a direct relationship to our stock price, the Compensation Committee believes that options motivate executive officers and key personnel to manage us in a manner which will also benefit shareholders. As such, options are granted at the current market price. One of the principal factors considered in granting options to executive officers or key personnel is their ability to influence our long-term growth and profitability.

The Compensation Committee has also established a bonus program to reward extraordinary performance that exceeds pre-set goals established for executive officers and key personnel. We believe that such a bonus program provides the incentive to exceed such goals, thereby building shareholder value.

We have a contributory 401(K) Retirement Pension Plan, which covers all employees who are qualified under the plan provisions.

STOCK OPTION PLANS

On May 13, 1992, our Board of Directors authorized adoption of an Officers and Key Employees Incentive Stock Option Plan (the "1992 Plan"), ratified by the shareholders at the Annual Meeting held July 10, 1992. The 1992 Plan provided for the issuance of up to 81,250 shares of our Common Stock to be subject to stock options, each to purchase one share of the Common Stock for $3.40 per share, subject to adjustment in the event of stock splits, combinations of shares, stock dividends or the like.

On November 18, 1996, our Board of Directors authorized an increase in the 1992 Plan to 843,750 shares to be subject to stock options, which action was ratified by the shareholders at the Annual Meeting held in February 1997.

On February 4, 1999, our Board of Directors authorized an increase in the 1992 Plan to 1,343,750 shares to be subject to stock options, which action was ratified by the shareholders at the Annual Meeting held in February 1999.

On May 13, 2002, the 1992 Plan expired. The 2003 Incentive Stock Option Plan, which provided for the issuance of up to 900,000 shares of Common Stock underlying stock options, was approved by our Board of Directors and by our shareholders at the Annual Meeting of Shareholders held on February 3, 2003.

On April 19, 2004, our Compensation Committee approved certain non-material changes to our 2003 Incentive Stock Option Plan.

On December 21, 2004, our Compensation Committee authorized an amendment and restatement of the 2003 Incentive Stock Option Plan to, among other matters, (i) increase the number of shares to be issued under the 2003 Incentive Stock Option

Plan from 900,000 to 1,150,000 shares, and (ii) permit the grant of restricted stock under the plan, subject to shareholder approval.

With the exception of the foregoing, we have no stock option plans or other similar or related plans in which any of our officers or directors participate.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

As of December 13, 2004, there were 6,472,331 shares of our Common Stock outstanding. Based on our review of a Schedule 13D/A filed with the Securities and Exchange Commission on September 7, 2004, the following individual has beneficial ownership or control over 5% or more of our outstanding Common Stock:



| Name and Address | Amount and Nature of Beneficial Ownership | Percentage of Outstanding Stock At 12/13/04 |
|---|---|---|
| Melvin Laufer<br>136 Beach 140th Street<br>Far Rockaway, NY 11694 | 519,839 | 8.03% |

Based on our review of a Schedule 13G/A filed with the Securities and Exchange Commission on July 8, 2004, the following entity has beneficial ownership or control of 5% or more of our outstanding Common Stock:

| | | |
|---|---|---|
| William Blair and Company LLC<br>222 W. Adams Street<br>Chicago, IL 60606 | 708,952 | 10.95% |

The following table sets forth the number of shares of Common Stock owned beneficially by our (i) directors, (ii) the Named Executive Officers (as defined below), and (iii) the executive officers and directors as a group, as of December 13, 2004. Such figures are based upon information furnished by the persons named.

| Name and Address | Amount and Nature of Beneficial Ownership | Percentage of Outstanding Stock[1] At 12/13/04 |
|---|---|---|
| Joel M. Barry<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 236,119[2] | 3.58% |
| Alice L. Cheung<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 45,500[2] | 0.70% |
| Richard Field<br>49 Locust Avenue<br>New Canaan, CT 06840 | 100,000 | 1.55% |

| | | |
|---|---|---|
| Aristides W. Georgantas<br>180 Springdale Road<br>Princeton, NJ 08540 | 16,521 | 0.26% |
| Herbert L. Lucas, Jr.<br>12011 San Vicente Blvd.<br>Los Angeles, CA 90049 | 57,880[3] | 0.89% |
| Alex Seltzer<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 36,500[2][6] | 0.56% |
| Sharat Shankar<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 10,000[2] | 0.15% |
| Carl R. Terzian<br>12400 Wilshire Blvd.<br>Los Angeles, CA 90025 | 3,031 | 0.05% |
| Patricia M. Williams<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 39,675[2] | 0.61% |
| Jack Wilson<br>730 Paseo Camarillo<br>Camarillo, CA 93010 | 15,075[2][4] | 0.23% |
| All officers and directors<br>as a group (19 persons) [5] | 778,479 | 11.47% |



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[1] Under Rule 13d-3, certain shares may be deemed to be beneficially owned by more than one person (if, for example, persons share the power to vote or the power to dispose of the shares). In addition, shares are deemed to be beneficially owned by a person if the person has the right to acquire the shares (for example, upon exercise of an option) within 60 days of the date as of which the information is provided. In computing the percentage ownership of any person, the amount of shares outstanding is deemed to include the amount of shares beneficially owned by such person (and only such person) by reason of these acquisition rights. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of Common Stock actually outstanding at December 13, 2004.

[2] Includes stock options according to the terms of the Officers and Key Employees Incentive Stock Option Plan and the 2003 Incentive Stock Option Plan, which for the following number of shares and for the following individuals could be acquired within 60 days through the exercise of stock options: Joel M. Barry, 120,500 shares; Alice Cheung, 34,500 shares; Alex Seltzer, 10,000 shares; Sharat Shankar, 10,000 shares; Patricia Williams, 35,000 shares; and Jack Wilson 10,500 shares.

[3] Includes 17,972 shares indirectly owned by Mr. Lucas through a trust for his wife.

[4] Includes 530 shares indirectly owned by Mr. Wilson through his wife.

[5] Includes shares and stock options according to the terms of the Officers

and Key Employees Incentive Stock Option Plan and the 2003 Incentive Stock Option Plan, which for the following number of shares and for the following individuals could be acquired within 60 days through the exercise of stock options: Arnold Feinberg, 20,000 shares; Jesse Fong, 13,778 shares; David Griffin, 12,686 shares; Robert Hare, 61,032 shares; Steve Hoofring, 8,500 shares; David Piatt, 4,000 shares; Donna Rehman, 3,850 shares; Rick Slater, 34,000 shares; and Kris Winckler, 60,332 shares.

[6] Mr. Seltzer has decided to pursue other business interests. As a result, he will only continue providing services to us through December 31, 2004, the effective date of his resignation.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

There were no related-party transactions.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

AUDIT FEES

PricewaterhouseCoopers, LLP, our independent accountants ("PricewaterhouseCoopers") billed us an aggregate of approximately $135,000 and $113,000 in fees for professional services rendered for the audit of our annual financial statements for the fiscal years ended September 30, 2004 and September 30, 2003, respectively, and the reviews of the financial statements included in our Form 10-Q's for fiscal 2004 and 2003.

AUDIT-RELATED FEES

PricewaterhouseCoopers billed us an aggregate of approximately $50,000 and $7,000 in fees for assurance and related services related to the audit of our annual financial statements for the fiscal years ended September 30, 2004 and September 30, 2003, respectively.

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Our Audit Committee is directly responsible for interviewing and retaining our independent accountant, considering the accounting firm's independence and effectiveness, and pre-approving the engagement fees and other compensation to be paid to, and the services to be conducted by, the independent accountant. The Audit Committee does not delegate these responsibilities. During each of the fiscal years ended September 30, 2004 and 2003, respectively, our Audit Committee pre-approved 100% of the services described above.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8K

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements

All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto.

(b) Reports on Form 8K for fourth quarter ended September 30, 2004:

Current Report on Form 8-K dated July 12, 2004, filed with the Securities and Exchange Commission on July 14, 2004.

Current Report on Form 8-K dated August 11, 2004, filed with the Securities and Exchange Commission on August 11, 2004.

Current Report on Form 8-K dated September 27, 2004, filed with the Securities and Exchange Commission on September 30, 2004.

(c) Exhibits:

| Exhibit Number | Description of Document |
|---|---|
| 2.1 | Copy of Merger Agreement and Plan of Reorganization between Electronic Clearing House, I Acquisition Corporation, and Magic Software Development, Inc., dated April 20, 1999.[5] |
| 2.2 | Copy of Merger Agreement and Plan of Reorganization between Electronic Clearing House, I Acquisition Corporation, and Rocky Mountain Retail Systems, Inc., dated January 4, 2000. |
| 3.1 | Articles of Incorporation of Bio Recovery Technology, Inc., filed with the Nevada Secret December 11, 1981. [1] |
| 3.4 | By-Laws of Bio Recovery Technology, Inc. [1] |
| 4.2 | Specimen Common Stock Certificate. [3] |
| 10.35 | Copy of Merchant Marketing and Processing Services Agreement between Electronic Clearing and First Regional Bank, dated June 24, 1997. [4] |

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| Exhibit Number | Description of Document |
|---|---|
| 10.36 | Copy of Merchant Marketing and Processing Services Agreement between Electronic Clearing and The Berkshire Bank, dated July 31, 1997. [4] |
| 10.41 | Copy of Processing and Software Development and License Agreement between Electronic Cle House, Inc. and National Bank Drafting Systems, Inc., dated October 22, 1999.[6] |
| 10.42 | Copy of Addendum to Agreement between Electronic Clearing House, Inc. and U-Haul Interna January 1, 2000.[6] |

| | |
|---|---|
| 10.44 | Copy of Electronic Check Services Agreement between Electronic Clearing House, Inc. and Drafting Systems, Inc., dated May 17, 2000.[6] |
| 10.46 | Copy of Amended and Restated Merchant Marketing and Processing Services Agreement betwee Electronic Clearing House, Inc. and First Regional Bank, dated August 1, 2000.[6] |
| 10.47 | Copy of Addendum to Amended and Restated Merchant Marketing and Processing Services Agre between Electronic Clearing House, Inc. and First Regional Bank, dated August 1, 2000.[6 |
| 10.48 | Copy of POS Check Third-Party Services Agreement between Visa U.S.A., Inc. and Electroni House, Inc., dated December 12, 2000.[7] |
| 10.49 | Copy of Asset Purchase Agreement between National Check Network, Inc. and Electronic Cle House, Inc., dated April 19, 2001. [7] |
| 10.50 | Copy of Addendum to Agreement between U-Haul International and Electronic Clearing House October 1, 2001. [7] |
| 10.51 | Copy of First Amendment to the POS Check Third-Party Servicer Agreement between Visa U.S and Electronic Clearing House, Inc. dated December 12, 2000. [8] |
| 10.52 | Copy of Second Amendment to the POS Check Third-Party Servicer Agreement between Visa U. Electronic Clearing House, Inc. dated December 12, 2000. [8] |
| 10.53 | Copy of Third Amendment to the POS Check Third-Party Servicer Agreement between Visa U.S Electronic Clearing House, Inc. dated December 12, 2000. [8] |
| 10.54 | Form of Securities Purchase Agreement by and among the Registrant and the Purchasers ide therein. [9] |
| 10.55 | Form of Registration Rights Agreement by and among the Registrant and the Purchasers ide therein. [9] |
| 10.56 | Office Lease dated May 21, 2003, by and between the Registrant and the 1989 Sheehan Fami dated October 24, 1989, with respect to principal executive offices located at 730 Paseo Camarillo, California 93010.[10] |
| 10.57 | Addendum to Office Lease dated July 7, 2004, by and between the Registrant and the 1989 Family Trust dated October 24, 1989, with respect to principal executive offices located Camarillo, Camarillo, California 93010. |
| 21.0 | Subsidiaries of Registrant. [2] |
| 23.1 | Consent of PricewaterhouseCoopers LLP |
| 24.1 | Power of Attorney [11] |
| 31.1 | Certificate of Joel M. Barry, Chief Executive Officer of Electronic Clearing House, Inc. 13a-14(b) under the Securities and Exchange Act of 1934, as amended. |
| 31.2 | Certificate of Alice L. Cheung, Chief Financial Officer of Electronic Clearing House, In 13a-14(b) under the Securities and Exchange Act of 1934, as amended. |
| 32.1 | Certificate of Joel M. Barry, Chief Executive Officer of Electronic Clearing House, Inc. 13a-14(b) under the Securities and Exchange Act of 1934, as amended. |
| 32.2 | Certificate of Alice L. Cheung, Chief Financial Officer of Electronic Clearing House, In 13a-14(b) under the Securities and Exchange Act of 1934, as amended. |

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[1] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 1988 and incorporated herein by reference.

[2] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 1989 and incorporated herein by reference.

[3] Filed as an Exhibit to Registrant's Form S-1, Amendment No. 3, effective November 13, 1990 and incorporated herein by reference.

[4] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal year ended September 30, 1997 and incorporated herein by reference.

[5] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal year ended September 30, 1999 and incorporated herein by reference.

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[6] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal year ended September 30, 2000 and incorporated herein by reference.

[7] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal year ended September 30, 2001 and incorporated herein by reference.

[8] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal

year ended September 30, 2002 and incorporated herein by reference.
[9] Filed as an Exhibit to Registrant's Current Report on Form 8-K dated October 30, 2003 and incorporated herein by reference.
[10] Filed as an Exhibit to Registrant's Annual Report on Form 10-K for fiscal year ended September 30, 2003 and incorporated herein by reference.
[11] Included on signature page.

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SIGNATURES

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

ELECTRONIC CLEARING HOUSE, INC.

By: /s/ Joel M. Barry
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Joel M. Barry, Chief Executive Officer and Chairman

POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Joel M. Barry and Alice L. Cheung, and each of them, as their true and lawful attorneys-in-fact and agents with full power of substitution and resubstitution, for them and in their name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the foregoing, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, or their substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities and on the dates indicated.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ Joel M. Barry<br>Joel M. Barry | Chairman of the Board and Chief Executive Officer | December 29, 2004 |
| /s/ Aristides W. Georgantas<br>Aristides W. Georgantas | Director | |
| /s/ Herbert L. Lucas, Jr.<br>Herbert L. Lucas, Jr. | Director | |
| /s/ Carl R. Terzian | Director | |

| | | |
|---|---|---|
| ---------------------------- Carl R. Terzian | | ) |
| /s/ Richard Field ---------------------------- Richard Field | Director | ) |
| /s/ Alice L. Cheung ---------------------------- Alice L. Cheung | Chief Financial Officer and Treasurer | ) |
| /s/ Marjan Hewson ---------------------------- Marjan Hewson | Controller | ) |



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) on page 44 present fairly, in all material respects, the financial position of Electronic Clearing House, Inc. and its subsidiaries at September 30, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2004 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) on page 44 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with standards of the Public Company Accounting Oversight Board (United States) Those 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the financial statements, effective October 1, 2002, the Company adopted Financial Accounting Standards Board Statement No. 142, "Goodwill and Other Intangible Assets" and changed its method of accounting for good will.

PRICEWATERHOUSECOOPERS LLP
Los Angeles, California
DECEMBER 17, 2004

## ELECTRONIC CLEARING HOUSE, INC.
## CONSOLIDATED BALANCE SHEETS

| | September 30, 2004 | September 30, 2003 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 7,576,000 | $ 2,908,000 |
| Restricted cash | 1,024,000 | 977,000 |
| Settlement deposits | 18,282,000 | 2,733,000 |
| Settlement receivables less allowance of $22,000 and $21,000 | 451,000 | 696,000 |
| Accounts receivable less allowance of $111,000 and $71,000 | 1,943,000 | 1,939,000 |
| Prepaid expenses and other assets | 368,000 | 307,000 |
| Deferred tax asset | 279,000 | 86,000 |
| Total current assets | 29,923,000 | 9,646,000 |
| Noncurrent assets: | | |
| Property and equipment, net | 2,293,000 | 2,928,000 |
| Software, net | 6,844,000 | 4,445,000 |
| Deferred tax asset | -0- | 1,256,000 |
| Other assets, net | 368,000 | 500,000 |
| Total assets | $39,428,000 | $ 18,775,000 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Short-term borrowings and current portion of long-term debt and capital leases | $ 878,000 | $ 901,000 |
| Accounts payable | 305,000 | 779,000 |
| Settlement payable | 18,733,000 | 3,429,000 |
| Accrued expenses | 2,003,000 | 1,336,000 |
| Total current liabilities | 21,919,000 | 6,445,000 |
| Noncurrent liabilities: | | |
| Long-term debt and capital leases | 704,000 | 1,961,000 |
| Deferred tax liability | 565,000 | -0- |
| Total liabilities | 23,188,000 | 8,406,000 |
| Commitments and contingencies - see Note 12 | | |
| Stockholders' equity: | | |
| Common stock, $.01 par value, 36,000,000 shares authorized; 6,451,331 and 5,920,174 shares issued; 6,413,062 and 5,881,905 shares outstanding | 64,000 | 59,000 |
| Additional paid-in capital | 24,658,000 | 21,641,000 |
| Accumulated deficit | (8,016,000) | (10,865,000) |
| Less treasury stock at cost, 38,269 and 38,269 common shares | (466,000) | (466,000) |

| | | |
|---|---|---|
| Total stockholders' equity | 16,240,000 | 10,369,000 |
| Total liabilities and stockholders' equity | $39,428,000 | $ 18,775,000 |