

AWARE INC /MA/  
Form 10-Q  
October 29, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 Or 15(d) Of The  
Securities Exchange Act of 1934

For the quarter ended September 30, 2013

Commission file number 000-21129

AWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Massachusetts  
(State or Other Jurisdiction of  
Incorporation or Organization)

04-2911026  
(I.R.S. Employer Identification No.)

40 Middlesex Turnpike, Bedford, Massachusetts, 01730  
(Address of Principal Executive Offices)  
(Zip Code)

(781) 276-4000  
(Registrant's Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):  
Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

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

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Indicate the number of shares outstanding of the issuer's common stock as of October 21, 2013:

Class	Number of Shares Outstanding
Common Stock, par value \$0.01 per share	22,570,794 shares

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AWARE, INC.

FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2013

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PART 1. FINANCIAL INFORMATION  
ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS  
AWARE, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)

	September 30, 2013 (unaudited)	December 31, 2012 (audited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$75,418	\$71,074
Accounts receivable, net	2,754	3,457
Receivable from patent arrangement	-	1,121
Deferred tax assets	916	817
Prepaid expenses and other current assets	1,093	528
Total current assets	80,181	76,997
Property and equipment, net	5,644	5,904
Investments	2,962	2,010
Intangible assets	201	-
Long term deferred tax assets	659	943
Total assets	\$89,647	\$85,854
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$243	\$328
Accrued expenses	101	148
Accrued compensation	589	817
Accrued professional	156	142
Due to customers	3,732	-
Deferred revenue	1,529	2,204
Total current liabilities	6,350	3,639
Long-term deferred revenue	40	319
Stockholders' equity:		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized, none outstanding	-	-
Common stock, \$.01 par value; 70,000,000 shares authorized; issued and outstanding 22,570,794 as of September 30, 2013 and 22,509,518 as of December 31, 2012	226	225

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Additional paid-in capital	100,917	100,561
Accumulated other comprehensive loss	(57 )	(50 )
Accumulated deficit	(17,829 )	(18,840 )
Total stockholders' equity	83,257	81,896
Total liabilities and stockholders' equity	\$89,647	\$85,854

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (in thousands, except per share data)  
 (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue:				
Software licenses	\$ 2,334	\$ 3,387	\$ 7,704	\$ 8,070
Software maintenance	1,023	661	.02%	(.02%)

The following table will identify charge-offs by category for the periods ending June 30:

	2001	2000
<b>CHARGE-OFFS:</b>		
Domestic:		
Commercial, Financial and Agricultural	\$ 113	\$ 57
Real Estate - Construction	0	0
Real Estate - Mortgage	148	13
Installment Loans to individuals	177	51
Lease financing	0	0
Credit Cards	36	20
Total	(\$ 474)	(\$ 141)
<b>RECOVERIES:</b>		
Domestic:		
Commercial, Financial and Agricultural	\$ 130	\$ 10
Real Estate - Construction	0	0
Real Estate - Mortgage	15	27
Installment Loans to individuals	56	44
Lease financing	0	0
Credit Cards	8	2
Total	\$ 209	\$ 83
Net Charge-offs	(\$ 265)	(\$ 58)

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**LOANS:** Average loans increased 9 percent for second quarter 2001 to \$370.5 million from \$337.5 million in 2000 with growth in both mortgage residential, which increased 10 percent, and Commercial, Financial and Agriculture, which increased 11 percent.

**AGRICULTURAL LOANS:** First Citizens is one of the largest agricultural lenders in the State of Tennessee and is an approved Farm Credit Services lender. Agriculture makes a significant contribution to Dyer County Commerce. Total farmland in production is approximately 231,000 acres or 56% of Dyer County land. Farming is approximately a \$79 million industry. Agricultural credits comprise \$29.3 million or 8 percent of total loans. Loans secured by farmland and other types of real estate represent \$16.8 million or 6 percent of agricultural credits. Approximately 4% of total agricultural loans are 30 days or more past due.

**LOAN LOSS EXPERIENCE AND RESERVES FOR LOAN LOSSES:** An analytical model based on historical loss experience, current trends and economic conditions as well as reasonably foreseeable events is used to determine the amount of provision to be recognized and to test the adequacy of the loan loss allowance. The ratio of allowance for loan losses to total loans, net of unearned income, was 1.04 percent as of June 30, 2001 compared to 1.15 percent as of June 30, 2000. Activity posted to the Reserve Account during second quarter consisted of (1) loan charge-off - \$474,000; (2) recovery of loans previously charged off - \$209,000; and (3) additions to reserve - \$232,000. The provision increased \$38,000 or 19.59% since last quarter end (March 31, 2001) because of loans charged off and loan growth that exceeded budget projections. The ratio of net charge offs during the quarter to average net loans outstanding was .07% compared to .01% for the same quarter in 2000. Projected charge-off total for the year 2001 is \$474,000, while projected recoveries are \$209,000. Non-performing loans decreased from \$3 million or .89% of total loans at June 30, 2000 to \$2.7 million or .73% of total loans at June 30, 2001. The decrease is attributed mainly to charge-offs and the transfer of properties to Other Real Estate Owned. Other Real Estate Owned total as of quarter end is \$1.2 million a net increase of \$919 thousand for the quarter. Asset quality is likely to deteriorate somewhat from current levels as the economy remains in a period of slow growth. A local textile manufacturer, employing approximately 900 workers announced its closing in July 2001. However, the closing can be partially offset with the re-location of an injection molding company that manufactures automotive components for General Motors line of sports utility vehicles in Dyer County. First Citizens had no concentrations of credit of 10 percent or more of total loans in any single industry. There are no material reportable contingencies as of this report date.

**LIQUIDITY:** Liquidity refers to the ability or the financial flexibility to manage future cash flows to meet the needs of depositors and borrowers and fund operations. Maintaining appropriate levels of liquidity allows the Company to have sufficient funds available for reserve requirements, customer demand for loans, withdrawal of deposit balances and maturities of deposits and other liabilities. First Citizen's source of liquidity has improved when comparing June 30, 2001 to June 30, 2000 and December 2000. Improved liquidity is attributed to the calling of Callable Agencies representing approximately 50% of the bond portfolio as well as deposit growth exceeding budget projections. First Citizens deposit growth in second quarter has reflected "consumers flight to quality" in transferring deposits from marketable securities to Federal Deposit Insured transaction accounts. The Wall Street transaction account, tied to the 90 day T-bill rate, has attracted deposits in excess of \$36 million in one year. Exceptional deposit growth experienced this year has resulted in increased pressure on the bank's funds reserve ratio as well as Federal Deposit Insurance cost. No material impact to net income levels is expected.

First Citizen's liquidity position is strengthened by ready availability to a diversified base of wholesale borrowings. The list includes borrowings from Federal Home Loan Bank, brokered certificates of deposits, Federal Funds purchased, Securities Sold Under Agreements to Repurchase, and others. Pre-approved lines of credit available with the Federal Home Loan Bank and Correspondents total \$138 million.

A crisis liquidity plan is in place at the Holding Company and Bank level that predefines a defense against material downturns in liquidity components.

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## INVESTMENT SECURITIES

First Citizens had approximately 50% of the bond portfolio called in the year 2001. Investments called were Callable US Agencies. Called amounts will be reinvested primarily in mortgage backed agencies with an average life of less than five years. The volume of called agencies materially improved the bank's liquidity position. A twelve month investment strategy calls for a majority of the called volume to be re-invested into non-callable agencies with an average life of less than five years. First Citizens will use caution with future purchases with extended maturities over five years given the current low rate environment.

The book value of listed investment securities as of the dates indicated are summarized as follows:

Composition of Investment Securities  
(June 30)

	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
U.S. Treasury & Government Agencies	\$ 74,665	\$ 82,103	\$ 88,321	\$ 73,311	\$ 66,322
State & Political Subdivisions	13,770	14,402	13,606	12,078	11,321
All Others	<u>7,568</u>	<u>3,788</u>	<u>3,160</u>	<u>2,676</u>	<u>3,032</u>
TOTALS	\$ 96,003	\$ 100,293	\$ 105,087	\$ 88,065	\$ 80,675
	=====	=====	=====	=====	=====

First Citizens National Bank does not engage in derivative activities as defined by paragraph 5 thru 7 of FASB 119 (reference footnote 7).

Investment Securities

June 30, 2001

(in thousands)

	<u>Held to Maturity</u>		<u>Available for Sale</u>	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury Securities	\$ 0	\$ 0	\$ 0	\$ 0
U.S. Government agency and corporation obligations	3,011	3,046	71,167	71,654
Securities issued by states and political subdivisions in the U.S.:				
Taxable Securities	0	0	0	0
Tax-exempt securities	1,641	1,684	11,802	12,129
U.S. Securities:				
Debt Securities	0	0	2,433	2,492
Equity Securities (including Federal Reserve stock)	0	0	5,025	5,077
Foreign securities:				
Debt Securities	N/A	N/A	N/A	N/A
Equity Securities	N/A	N/A	N/A	N/A
Total	\$ 4,652	\$ 4,730	\$ 90,427	\$ 91,352

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## CAPITAL RESOURCES

Total capital on June 30, 2001 was \$48.8 million, up 4.12% from \$46.9 million on December 31, 2000. The increase in capital was from undistributed net income and positive market moves in the bond portfolio (FASB115). Bancshares has historically maintained capital in excess of minimum levels established by the Federal Reserve Board. The risk based capital ratio reflects continuous improvement when reviewing prior years. Risk based capital ratio as of June 30, 2001 was 13.60%, significantly in excess of the 8% mandated by Regulatory Authorities. Capital as a percentage of total assets for the quarter ending June 30, is presented in the following table for the years indicated (excluding loan loss reserves):

<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
9.25%	9.33%	9.26%	9.37%	9.48%



The dividend payout ratio is 70% for the current period compared to 59.71% for prior year. Bancshares has purchased 9,358 shares in the open market since December 31, 2000. Strategic direction is to purchase and retire \$1 million in Bancshares stock per year for the next five years.

The ESOP liability has been reduced from \$808 thousand to \$232 thousand since yearend 2000 resulting in a \$0.16 value improvement.

The table below presents for First Citizens Bancshares, Inc. certain operating ratios as of June 30: (quarterly)

	2001	2000	1999	1998
Percentage of Net Income to:				
Average Total Assets	1.17%	1.14%	1.24%	1.22%
Average Shareholders' Equity	12.79%	12.10%	13.83%	12.58%
Percentage of Dividends Declared Per				
Common Share to Net Income	60.01%	61.98%	45.90%	36.09%
* Percentage of Average Shareholders'				
Equity to Average Total Assets	9.90%	10.24%	10.21%	9.63%

\* Represents primary capital - including reserve for loan losses account

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## RECENT ISSUED ACCOUNTING STANDARDS

Recent accounting standards for business combinations and accounting for goodwill is expected to have an impact on the company's financials. Implementation of the accounting standard will be as of January 1, 2002. First Citizens will perform goodwill impairment testing within six months of adopting the standard. The test will consist of a Fair value calculation for goodwill purchased in acquisitions of Ripley, Troy and First Citizens Insurance units. Results of the calculations will be compared against each unit's book value. Comparisons that result in book value below fair value assessment will indicate that goodwill has not been impaired and no write down is necessary. However, a fair value assessment resulting in a level below book value, will indicate goodwill impairment and a write down will be required. The Pooling of interest method used in previous assessment of goodwill was eliminated as of June 30, 2001. First Citizens will most likely seek advice or methodologies of accounting valuation experts before adopting testing methods. Estimated cost of outsourcing the process is estimated at a pre-tax expense of \$20,000 or less. The impact of the accounting rule change to the company's financial statements cannot be reasonably estimated as of the filing date of this report with the Securities Exchange Commission.

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## PART I - ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The bank maintains a formal asset and liability management process to quantify, monitor and control interest rate risk. The Asset/Liability Committee strives to maintain stability in net interest margin under various interest rate cycles. First Citizens has materially improved interest rate risk exposure since year-end 2000. Steps implemented are as follows: (1) increased long-term Federal Home Loan Bank borrowings by \$8 million; (2) purchased variable rate investments; (3) encouraged existing deposit customers to extend maturities past one year; and (4) reduced overnight borrowings exposure.

First Citizens swapped a \$1,500,000 fixed investment cash flow for a variable cash flow stream tied to a 90 day libor rate June 2000. The new variable investment cash flow is matched with a variable borrowing, resulting in an ongoing positive spread of 250 basis points with no interest rate risk. The transaction was implemented to increase earnings

and reduce interest rate risk. The cash flow hedge has produced a positive income, but because the bank swapped a fixed cash flow for a variable cash flow and rates have declined the value of the derivative has decreased since inception. The volume and risk associated with this derivative is well within the Funds Management Policy of the bank. There have been no material changes since year-end 2000 applicable to this transaction.

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**PART II - OTHER INFORMATION**
**Item 1. Legal Proceedings**

There are no legal proceedings filed against First Citizens Bancshares or its subsidiaries as of this report date.

**Item 2. Changes in Securities**

None.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. Submission of Matters To a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8K**

None.

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**EX 20 -VOLUNTARY SCHEDULE - CERTAIN FINANCIAL INFORMATION  
DATA STATED IN THOUSANDS**

REGULATION	STATEMENT CAPTION	SECOND QTR. 2001	SECOND QTR. 2000	YEAR TO DATE 2001	YEAR TO DATE 2000
5-02 (1)	Cash and Cash Items	29,422	16,326	29,422	16,326
5-02 (2)	Marketable Securities	96,003	100,293	96,003	100,293
5-02 (3) (b) (1)	Notes Receivable	370,576	337,565	370,576	337,565

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5-02 (4)	Allowance for Doubtful Accounts	3,886	3,898	3,886	3,898
5-02 (15)	Total Assets	528,085	486,277	528,085	486,277
5-02 (24)	Other Liabilities	479,262	440,899	479,262	440,899
5-02 30	Common Stock (Net of Treasury Stock)	3,718	3,718	3,718	3,718
5-02 (31) (a) (2)	Additional Capital Other	15,302	15,300	15,302	15,300
5-02 (31) (a) (3) (ii)	Retained Earnings - Unappropriated	30,028	26,383	30,028	26,383
	Treasury Stock	(225)	(23)	(225)	(23)
5-03 (b) (1) (e)	Other Revenues	11,782	10,888	23,093	21,471
5-03 (b) (2) (e)	Cost of Other Revenues	4,480	4,147	9,104	8,265
5-03 (b) (8)	Interest and Amortization of Debt Discount	5,094	4,642	10,385	8,951
5-03 (b) (10)	Income Before Taxes and Other Items	2,208	2,099	3,604	4,255
5-03 (b) (11)	Income Tax Expense	677	731	1,007	1,413
5-03 (b) (14)	Income/Loss from Continuing Operations	1,531	1,368	2,597	2,842
5-03 (b) (19)	Net Income or Loss	1,531	1,368	2,597	2,842

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SIGNATURES

Pursuant to the requirements of Sections 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.

First Citizens Bancshares, Inc.  
(Registrant)

Date: August 14, 2001

/s/ KATIE WINCHESTER  
PRESIDENT & CEO

Date: August 14, 2001

/s/ JEFF AGEE

EXECUTIVE VICE PRESIDENT &  
CHIEF FINANCIAL OFFICER

First Citizens National Bank  
(Principal Subsidiary)