ELECTRONIC CLEARING HOUSE INC
Form 10-Q
August 09, 2007

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

FORM 10-Q

(Mark One)

R Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007

OR

£ 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)	(I.R.S. Employer Identification No.)

730 Paseo Camarillo
Camarillo, California 93010
(Address of principal executive offices)

Telephone Number (805) 419-8700, Fax Number (805) 419-8682
www.echo-inc.com
(Registrant's telephone number, including area code; fax number; web site address)

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 R No £

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

Large accelerated filer £ Accelerated filer R Non-accelerated filer £

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

As of August 1, 2007, there were 6,917,491 shares of the Registrant's Common Stock outstanding.

ELECTRONIC CLEARING HOUSE, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ELECTRONIC CLEARING HOUSE, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

ASSETS

	June 30, 2007	September 30, 2006
Current assets:		
Cash and cash equivalents	$ 9,770,000	$ 11,604,000
Restricted cash	1,141,000	1,594,000
Settlement deposits and funds held in trust	4,930,000	23,282,000
Settlement receivables, less allowance of $70,000 and $16,000	336,000	1,499,000
Accounts receivable, less allowance of $618,000 and $392,000	3,577,000	2,914,000
Prepaid expenses and other assets	904,000	494,000
Deferred tax asset	454,000	506,000
Total current assets	21,112,000	41,893,000
Noncurrent assets:		
Property and equipment, net	2,404,000	2,521,000
Software, net	10,644,000	10,340,000
Other assets, net	225,000	253,000
Total assets	$ 34,385,000	$ 55,007,000

LIABILITIES AND STOCKHOLDERS' EQUITY

	June 30, 2007	September 30, 2006
Current liabilities:		
Short-term borrowings and current portion of long-term debt	$ 293,000	$ 291,000
Accounts payable	391,000	352,000
Settlement payable and trust payable	5,266,000	24,781,000
Accrued expenses	2,850,000	2,257,000
Accrued compensation expenses	2,739,000	1,670,000
Total current liabilities	11,539,000	29,351,000
Noncurrent liabilities:		
Long-term debt, net of current portion	228,000	448,000
Deferred tax liability	1,092,000	2,922,000
Total liabilities	12,859,000	32,721,000
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value, 500,000 shares authorized, none outstanding at June 30, 2007 and September 30, 2006	-0-	-0-

Common stock, $.01 par value, 36,000,000 shares authorized; 6,937,660 and 6,839,333 shares issued; 6,899,391 and 6,801,064 shares outstanding, respectively	69,000	68,000
Additional paid-in capital	28,857,000	27,350,000
Accumulated deficit	(6,934,000)	(4,666,000)
Less treasury stock at cost, 38,269 and 38,269 common shares	(466,000)	(466,000)
Total stockholders' equity	21,526,000	22,286,000
Total liabilities and stockholders' equity	$ 34,385,000	$ 55,007,000

See accompanying notes to consolidated financial statements

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ELECTRONIC CLEARING HOUSE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2007	2006	2007	2006
REVENUES:	$ 19,029,000	$ 19,869,000	$ 58,401,000	$ 56,023,000
COSTS AND EXPENSES:				
Processing and transaction expense	13,803,000	13,299,000	40,701,000	37,357,000
Other operating costs	1,646,000	1,438,000	4,831,000	4,266,000
Research and development expense	605,000	316,000	1,614,000	1,189,000
Selling, general and administrative expenses	3,192,000	3,009,000	10,277,000	8,323,000
Legal settlements and fees	238,000	22,000	3,136,000	1,261,000
Merger related costs	28,000	-0-	934,000	-0-
Severance costs	1,185,000	-0-	1,185,000	-0-
	20,697,000	18,084,000	62,678,000	52,396,000
(Loss) income from operations	(1,668,000)	1,785,000	(4,277,000)	3,627,000
Interest income	105,000	73,000	370,000	173,000
Interest expense	(13,000)	(21,000)	(43,000)	(68,000)
(Loss) income before income tax benefits/provision	(1,576,000)	1,837,000	(3,950,000)	3,732,000
Benefit (provision) for income taxes	894,000	(827,000)	1,682,000	(1,706,000)
Net (loss) income	$ (682,000)	$ 1,010,000	$ (2,268,000)	$ 2,026,000
Basic net (loss) earnings per share	$ (0.10)	$ 0.15	$ (0.34)	$ 0.31
Diluted net (loss) earnings per share	$ (0.10)	$ 0.14	$ (0.34)	$ 0.29
Weighted average shares outstanding				
Basic	6,760,456	6,630,055	6,732,704	6,596,737
Diluted	6,760,456	7,156,204	6,732,704	7,016,342

See accompanying notes to consolidated financial statements.

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ELECTRONIC CLEARING HOUSE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended June 30,	
	2007	**2006**
Cash flows from operating activities:		
Net (loss) income	$ (2,268,000)	$ 2,026,000
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	716,000	581,000
Amortization of software and other intangible assets	2,543,000	1,939,000
Loss on disposal of fixed assets and capitalized software	160,000	-0-
Provisions for losses on accounts and notes receivable	288,000	443,000
Provision for deferred income taxes	(1,778,000)	1,367,000
Stock-based compensation	905,000	698,000
Restricted stock issued to director	13,000	38,000
Excess tax benefit from stock-based compensation	(147,000)	(236,000)
Changes in assets and liabilities:		
Restricted cash	453,000	(317,000)
Settlement deposits and funds held in trust	18,352,000	(513,000)
Accounts receivable	(897,000)	(1,158,000)
Settlement receivable	1,109,000	(498,000)
Accounts payable	39,000	358,000
Settlement payable and trust payable	(19,515,000)	1,288,000
Accrued expenses	740,000	655,000
Accrued compensation expenses	1,039,000	247,000
Prepaid expenses	(410,000)	(141,000)
Net cash provided by operating activities	1,342,000	6,777,000
Cash flows from investing activities:		
Other assets	-0-	3,000
Purchase of equipment	(614,000)	(662,000)
Purchased and capitalized software	(2,964,000)	(3,011,000)
Net cash used in investing activities	(3,578,000)	(3,670,000)
Cash flows from financing activities:		
Repayment of notes payable	(218,000)	(209,000)
Repayment of capitalized leases	-0-	(98,000)
Proceeds from exercise of stock options	473,000	482,000
Excess tax benefit from stock-based compensation	147,000	236,000
Net cash provided by financing activities	402,000	411,000
Net (decrease) increase in cash and cash equivalents	(1,834,000)	3,518,000
Cash and cash equivalents at beginning of period	11,604,000	6,732,000

Cash and cash equivalents at end of period	$ 9,770,000	$ 10,250,000

See accompanying notes to consolidated financial statements.

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ELECTRONIC CLEARING HOUSE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Basis of Presentation:

The accompanying consolidated financial statements as of June 30, 2007 and for the three-month and nine-month periods ended June 30, 2007, are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and the results of operations for the interim periods. The consolidated financial statements herein should be read in conjunction with the consolidated financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006. The results of operations for the nine months ended June 30, 2007 are not necessarily indicative of the likely results for the entire fiscal year ending September 30, 2007.

Reclassifications:

Certain amounts in the June 30, 2006 consolidated financial statements have been reclassified to conform to the current year presentation. The Company previously included the amount of the Trust Collection bank account in Restricted Cash. That cash account has been reclassified to Settlement Deposits and the Statement of Cash Flows was adjusted accordingly for the affected periods. Also, the Company reclassified a small portion of Settlements Receivable relating to an accrual resulting in a corresponding reduction in Settlement Payable. The Statement of Cash Flows was adjusted accordingly for the affected periods. The Company also broke out Accrued Compensation Expenses from Accrued Expenses, and the Statement of Cash Flows has been adjusted accordingly. The Company further reclassified amounts related to the excess tax benefit from stock-based compensation and has reflected the change in the Statement of Cash Flows for the affected periods. Lastly, the company broke out the 2006 patent settlement from selling, general and administrative expenses in the statement of operations.

New Accounting Pronouncements:

In 2006, the FASB issued SFAS No. 157, “Fair Value Measurement” (SFAS No. 157). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities. The standard expands required disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS No. 157 does not expand the use of fair value in any new circumstances. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management of the Company does not expect the impact to be material to its financial condition or results of operations.

In 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109” (FIN 48). This interpretation clarifies the accounting for uncertain taxes recognized in a company’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes.” The interpretation requires us to analyze the amount at which each tax position meets a “more likely than not” standard for sustainability upon examination by taxing authorities. Only tax benefit amounts meeting or exceeding this standard will be reflected in tax provision expense and deferred tax asset balances. The interpretation also requires that any differences between the amounts of tax benefits reported on tax returns and tax benefits reported in the financial statements be recorded in a liability for unrecognized tax benefits. The liability for unrecognized tax benefits is reported separately from deferred tax assets and liabilities and classified as current or noncurrent based upon the expected period of payment. Additional disclosure in the footnotes to the audited financial statements will be required concerning the

income tax liability for unrecognized tax benefits, any interest and penalties related to taxes that are included in the financial statements, and open statutes of limitations for examination by major tax jurisdictions. The requirement of FIN 48 will be effective for our fiscal year beginning October 1, 2007. Management is currently evaluating the potential impact of FIN 48 on the Company's consolidated financial statements.

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NOTE 1: (Continued)

In February 2007 the FASB issued SFAS 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard’s objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company’s choice to use fair value on its earnings. It also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new standard does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS 157, “Fair Value Measurements,” and SFAS 107, “Disclosures about Fair Value of Financial Instruments.” SFAS 159 is effective as of the start of fiscal years beginning after November 15, 2007. Early adoption is permitted. We are in the process of evaluating this standard and therefore have not yet determined the impact that the adoption of SFAS 159 will have on our financial position, results of operations or cash flows.

NOTE 2 – Stock-Based Compensation:

Effective October 1, 2005, the Company began recording compensation expense associated with stock options in accordance with SFAS No.123(R), Share-Based Payment. Prior to October 1, 2005, the Company accounted for stock-based compensation related to stock options under the recognition and measurement principles of Accounting Principles Board Opinion No. 25; therefore, the Company measured compensation expense for its stock option plan using the intrinsic value method, that is, as the excess, if any, of the fair market value of the Company’s stock at the grant date over the amount required to be paid to acquire the stock, and provided the disclosures required by SFAS Nos. 123 and 148. The Company has adopted the modified prospective transition method provided under SFAS No. 123(R), and as a result, has not retroactively adjusted results from prior periods. Under this transition method, compensation expense associated with stock options recognized in fiscal year 2006 includes expense related to the remaining unvested portion of all stock option awards granted prior to October 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. The Company has not granted any stock options since the adoption of SFAS No. 123(R).

Stock Options:

At June 30, 2007, the Company had one stock option plan. The plan is administered by the Board of Directors or its designees and provides that options granted under the plan will be exercisable at such times and under such conditions as may be determined by the Board of Directors at the time of grant of such options; however, options may not be granted for terms in excess of ten years. Compensation expense related to stock options granted is recognized ratably over the service vesting period for the entire option award. The total number of stock option awards expected to vest is adjusted by estimated forfeiture rates. The terms of the plan provide for the granting of options at an exercise price not less than 100% of the fair market value of the stock at the date of grant, as determined by the closing market value stock price on the grant date. During December 2006, the Company amended certain stock option grant agreements with some of its employees who were previously granted in-the-money options in error. The primary purpose of the amendments was to increase the option exercise price equal to the fair market value on the measurement dates. All options outstanding at June 30, 2007 were granted at 100% of the fair market value of the stock at the date of grant and have five-year vesting terms.

A summary of the status of the Company’s stock option plan as of June 30, 2007 and of changes in options outstanding under the plan during the nine months ended June 30, 2007 is as follows:

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NOTE 2: (Continued)

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at September 30, 2006	972,275	$ 5.61		
Options granted	-0-			
Options exercised	(86,350)	$ 5.48		
Options forfeited or expired	(13,400)	$ 8.88		
Options outstanding at June 30, 2007	872,525	$ 5.67	5.8	$ 7,278,000
Options vested and exercisable at June 30, 2007	567,725	$ 5.11	5.1	$ 5,055,000

Non-vested share activity under our Stock Option Plan for the nine-month period ended June 30, 2007 is summarized as follows:

	Non-vested Number Of Shares	Weighted Average Grant-Date Fair Value
Non-vested balance at October 1, 2006	490,600	$ 4.47
Vested	(178,400)	$ 3.81
Forfeited	(7,400)	$ 5.50
Non-vested balance at June 30, 2007	304,800	$ 4.70

As of June 30, 2007, there was $1,433,000 of unamortized compensation cost related to non-vested stock option awards, which is expected to be recognized over a remaining weighted-average vesting period of 2.2 years.

Cash received from stock option exercises for the nine-month periods ended June 30, 2007 and 2006 was $473,000 and $482,000, respectively. The income tax benefits from stock option exercises totaled $147,000 and $236,000 for the nine-month periods ended June 30, 2007 and 2006, respectively.

Restricted Stock:

Restricted Stock is granted under the 2003 Option Plan. Compensation expense related to restricted stock issued is recognized ratably over the service vesting period. Restricted stock grants are normally vested over a five-year

period.

In accordance with SFAS No. 123(R), the fair value of restricted stock awards is estimated based on the closing market value stock price on the date of share issuance. The total number of restricted stock awards expected to vest is adjusted by estimated forfeiture rates. As of June 30, 2007, there was $1,189,000 of unamortized compensation cost related to non-vested restricted stock awards, which is expected to be recognized over a remaining weighted-average vesting period of 3.7 years.

A summary of the status of the Company's restricted stock awards as of June 30, 2007, and of changes in restricted stock outstanding under the plan during the nine months ended June 30, 2007 is as follows:

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NOTE 2: (Continued)

	Number Of Shares		Weighted-Average Grant Date Fair Value Per Share
Restricted stock awards outstanding at September 30, 2006	133,088	$	11.16
Shares issued	12,500	$	12.55
Shares forfeited	(1,600)	$	10.25
Restricted stock awards outstanding at June 30, 2007	143,988	$	11.29

In May 2006, the Company entered into an agreement with certain of its employees and executives to potentially grant 80,000 shares of restricted stock and 10,000 shares payable in cash. The restricted stock will only be granted and cash only be paid if the Company achieves predetermined cumulative Earnings Before Income Taxes and Depreciation and Amortization ("EBITDA") for the fiscal years ending 2006, 2007 and 2008 or upon a change in control. Cumulative EBITDA results must be reached or a reduced number of shares will be granted, if any. As required by SFAS 123(R), 80,000 shares of this award have been treated as an equity award, with the fair value measured at the grant date and 10,000 shares have been treated as a liability award, with the fair value measured at the grant date and remeasured at the end of each reporting period (marked to market). In June 2007, the cumulative EBITDA targets were reduced and this was treated as a modification of an award under SFAS No. 123(R). In conjunction with this award, the Company recognized a benefit of $98,000 and compensation expense of $74,000 for the three and nine months ended June 30, 2007. The Company recognized $42,000 of compensation expense for the three and nine months ended June 30, 2006.

In June 2007, the Company entered into an agreement with certain of its employees and executives to potentially grant 100,000 shares of restricted stock and 21,000 shares payable in cash. The restricted stock will only be granted and cash only be paid if the Company achieves predetermined cumulative Earnings Before Income Taxes and Depreciation and Amortization ("EBITDA") for the fiscal years ending 2007, 2008 and 2009 or upon a change in control. Cumulative EBITDA results must be reached or a reduced number of shares will be granted, if any. As required by SFAS 123(R), 100,000 shares of this award have been treated as an equity award, with the fair value measured at the grant date and 21,000 shares have been treated as a liability award, with the fair value measured at the grant date and remeasured at the end of each reporting period (marked to market). In conjunction with this award, the Company recognized $90,000 of compensation expense for the three and nine months ended June 30, 2007.

NOTE 3 – Earnings Per Share:

The Company calculates earnings per share as required by Statement of Financial Accounting Standard No. 128, "Earnings per Share."

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2007	2006	2007	2006

Numerator:				
Net (loss) income	$ (682,000)	$ 1,010,000	$ (2,268,000)	$ 2,026,000
Denominator:				
Weighted average shares outstanding for basic (loss) earnings per share	6,760,456	6,630,055	6,732,704	6,596,737
Effect of dilutive stock options	-0-	526,149	-0-	419,605
Adjusted weighted average shares outstanding for diluted (loss) earnings per share	6,760,456	7,156,204	6,732,704	7,016,342
Basic net (loss) earnings per share	$ (0.10)	$ 0.15	$ (0.34)	$ 0.31
Diluted net (loss) earnings per share	$ (0.10)	$ 0.14	$ (0.34)	$ 0.29

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NOTE 3: (Continued)

Due to the net loss for the three and nine month periods ended June 30, 2007, the diluted share calculation result was anti-dilutive. Thus, the basic weighted average shares were used and shares of common stock equivalents of approximately 1.0 million shares were excluded from the calculations. For the three and nine month periods ended June 30, 2006, approximately 4,000 shares of common stock equivalents were excluded from the calculation of diluted EPS because the effect was anti-dilutive.

NOTE 4 – Supplemental Cash Flow Information:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Cash paid for:				
Interest	$ 13,000	$ 21,000	$ 43,000	$ 68,000
Income Taxes	$ 8,000	$ 39,000	$ 306,000	$ 42,000

Significant non-cash transactions for the nine months ended June 30, 2007 were as follows:

- Restricted stock valued at $157,000 was issued to certain executives and employees.

Significant non-cash transaction for the nine months ended June 30, 2006 was as follows:

- Restricted stock valued at $745,000 was issued to certain executives and employees.
- Capital equipment of $2,000 was acquired under a capital lease.

NOTE 5 – Segment Information:

The Company primarily operates in two business segments: Bankcard and transaction processing and check-related products, all of which are located in the United States.

The Company's reportable operating segments have been determined in accordance with the Company's internal management structure, which is organized based on the Company's product lines. The Company evaluates performance based upon two primary factors; one is the segment's operating income and the other is based on the segment's contribution to the Company's future strategic growth.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenues:				
Bankcard and transaction processing	$ 15,843,000	$ 15,118,000	$ 47,097,000	$ 42,370,000
Check-related products	3,186,000	4,751,000	11,304,000	13,653,000
	$ 19,029,000	$ 19,869,000	$ 58,401,000	$ 56,023,000
Operating (loss) income:				
Bankcard and transaction processing	$ 2,212,000	$ 2,762,000	$ 7,074,000	$ 7,156,000
Check-related products	(770,000)	1,418,000	(226,000)	3,685,000
Other – Corporate Expenses	(3,110,000)	(2,395,000)	(11,125,000)	(7,214,000)
	$ (1,668,000)	$ 1,785,000	$ (4,277,000)	$ 3,627,000

	June 30, 2007	September 30, 2006
Total assets:		
Bankcard and transaction processing	$ 13,051,000	$ 12,707,000
Check-related products	12,564,000	31,412,000
Other	8,770,000	10,888,000
	$ 34,385,000	$ 55,007,000

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NOTE 6 – Commitments, Contingent Liabilities, and Guarantees:

The Company currently relies on cooperative relationships with, and sponsorship by, two banks in order to process its Visa, MasterCard and other bankcard transactions. The agreement between the banks and the Company requires the Company 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 the Company is unable to collect this amount from the merchant's account, and if the merchant refuses or is unable to reimburse the Company for the chargeback due to merchant fraud, insolvency or other reasons, the Company will bear the loss for the amount of the refund paid to the cardholders. The Company utilizes a number of systems and procedures to manage merchant risk. In addition, the Company requires cash deposits by certain merchants, which are held by the Company's sponsoring banks to minimize the risk that chargebacks are not collectible from merchants. A cardholder, through its issuing bank, will generally initiate a dispute within four months after the date a transaction is processed or the delivery of the product or service, resulting in a chargeback to the Company's sponsoring banks as the merchant processor. Therefore, management believes that a reasonable estimate of 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 June 30, 2007, this potential exposure totaled approximately $678 million. At June 30, 2007, the Company, through its sponsoring bank, had approximately $148,000 of unresolved chargebacks that were in the process of resolution. At June 30, 2007, the Company, through its sponsoring bank, had access to $20.6 million in merchant deposits to cover any potential chargeback losses.

For the three-month periods ended June 30, 2007 and 2006, the Company processed approximately $496 million and $472 million, respectively, of Visa and MasterCard transactions, which resulted in $3.0 million in gross chargeback activities for the three months ended June 30, 2007 and $2.6 million for the three months ended June 30, 2006. Substantially all of these chargebacks were recovered from the merchants.

The Company's contingent obligation with respect to chargebacks constitutes a guarantee as defined in Financial Accounting Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantee, Including Indirect Guarantees of Others" ("FIN 45"). FIN 45 requires that guarantees issued or modified subsequent to December 31, 2002 be initially recorded as liabilities in the Statement of Financial Position at fair value. Since the Company's agreement with its sponsoring bank, which establishes the guarantee obligation, was entered into prior to December 31, 2002 and has not been modified since that date, the measurement provisions of FIN 45 are not applicable to this guarantee arrangement.

In accordance with SFAS No. 5, "Accounting for Contingencies," the Company records a reserve for chargeback loss allowance based on its processing volume and historical trends and data. As of June 30, 2007 and 2006, the allowance for chargeback losses, which is classified as a component of the allowance for uncollectible accounts receivable, was $489,000 and $439,000, respectively. The expense associated with the valuation allowance is included in processing and transaction expense in the accompanying consolidated statements of income. For the three-month period ended June 30, 2007 and 2006, the Company expensed $121,000 and $91,000, respectively.

With regard to the Company's check processing activation, all funds are moved using the Automated Clearing House (ACH) system of the Federal Reserve. Submission of an ACH request to withdraw funds may be refused by the receiving bank for a number of reasons, the two most common being the account did not have an adequate balance to honor the request or the account was closed. In each of these situations, the Company first looks to the merchant account for the return of any funds advanced. In some situations, specific merchant reserves are set up in advance in

order to honor all returns for that specific merchant. In the event neither the merchant bank account nor a specific reserve is adequate to cover a return, the Company allows either of its processing banks to look to the Company's own reserve accounts to cover the return activity. In such cases, the Company then actively looks to recover its advanced funds from subsequent day's processing activity for the merchant or from one-time deposits requested of the merchant. In the event such recovery is not possible, the Company could suffer a loss on that ACH return activity. The amount the Company considered uncollectible over the past three months was $29,000.

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NOTE 6: (Continued)

In its check guarantee business, the Company charges the merchant a percentage of the face amount of the check and guarantees payment of the check to the merchant in the event the check is not honored by the checkwriter'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 the Company. Accordingly, management believes that its best estimate of the Company's maximum potential exposure for dishonored checks at any given balance sheet date would not exceed the total amount of checks guaranteed in the last 10 days prior to the balance sheet date. As of June 30, 2007, the Company estimates that its maximum potential dishonored check exposure was approximately $2,693,000.

For the quarters ended June 30, 2007 and 2006, the Company guaranteed approximately $24,156,000 and $19,463,000 of merchant checks, respectively, which resulted in $114,000 and $196,000 of dishonored checks presented to the Company for payments, respectively. The Company has the right to collect the full amount of the check from the checkwriter. The Company establishes a reserve for this activity based on historical and projected loss experience. For the quarters ended June 30, 2007 and 2006, the check guarantee loss was $64,000 and $160,000, respectively. The check guarantee loss is included in processing and transaction expense in the accompanying consolidated statements of income.

NOTE 7 – Litigation:

On March 27, 2007, the Company entered into a Non-Prosecution Agreement, pursuant to which the Office of the United States Attorney for the Southern District of New York (the "U.S. Attorney's Office") agreed not to pursue actions against the Company and its subsidiaries for activities related to its provision of payment processing services to Internet wallets that provided services to online gaming websites during the period from January 2001 through and including the date of the signing of the Non-Prosecution Agreement. Pursuant to the terms of the Non-Prosecution Agreement, the Company agreed to pay estimated profits to the United States in the amount of a $2,300,000 civil disgorgement settlement upon the execution of the Non-Prosecution Agreement, which represented management's estimate of the Company's profits from processing and collection services provided to Internet wallets since 2001.

Additionally, the Company is involved in various legal cases arising in the ordinary course of business. Based upon current information, management, after consultation with legal counsel, believes the ultimate disposition thereof will have no material affect, individually or in the aggregate, on the Company's business, financial condition or results of operations. It is possible that in the future, the Company could become a party to such proceedings.

NOTE 8 – Effective Tax Rate:

The effective tax rate for the quarter and nine months ended June 30, 2007 was a benefit of 56.7% and 42.6% as compared to a provision of 45.0% and 45.7%, respectively, for the corresponding prior year periods. The difference in the tax rate was primarily due to the Company having a loss before income taxes for the three and nine months ended June 30, 2007 as compared to income before taxes for the corresponding prior year periods. The Company also, based upon a study conducted during the three months ended June 30, 2007, recorded certain research and development tax credits for fiscal years ended September 30, 2003 and 2006 and for the nine months ended June 30, 2007 in the third quarter of 2007. These tax credits resulted in an income tax benefit of $576,000.

NOTE 9 – Merger Transaction:

On December 14, 2006, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) to be acquired by Intuit, Inc. (Intuit) in a merger transaction in which *ECHO* would have become a wholly owned

subsidiary of Intuit (the merger). Pursuant to the terms of the Merger Agreement and subject to the conditions thereof, Intuit would have acquired all of the outstanding shares of the Company's common stock and all outstanding equity awards (which would have vested in connection with the transactions) for a cash amount of $18.75 per share (less the applicable exercise price in the case of *ECHO* options), for a total purchase price of approximately $142 million on a fully diluted basis. The transaction was subject to regulatory review, the Company's shareholder approval and other customary closing conditions. On March 26, 2007, the Company mutually agreed with Intuit and Elan Acquisition Corporation, a Nevada corporation and wholly owned subsidiary of Intuit ("Elan"), to terminate the Merger Agreement. The parties determined that it was in the mutual best interest of each party to terminate the proposed agreement. In connection with the termination, the Company, Intuit and Elan agreed to release each other from all claims arising under or related to the terminated merger agreement. The Company also cancelled its previously adjourned special stockholders' meeting relating to the proposed acquisition, which was scheduled to reconvene on March 27, 2007. As of result of the termination of the merger agreement, the Company recorded approximately $28,000 and $934,000, respectively, for the three and nine-month periods ended June 30, 2007 of costs related to the merger.

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NOTE 10 – Severance Costs

The Company accrued $1.2 million as a result of its negotiation of a retirement and separation arrangement for former Chairman and Chief Executive Officer Joel M. ("Jody") Barry. During and since the three months ended June 30, 2007, the Company has been negotiating a retirement and separation package for Mr. Barry. Given the status of the negotiations, management determined that it was appropriate to reserve for the aggregate costs being negotiated as of June 30, 2007. Such costs will include cash compensation, accelerated vesting of certain equity-based awards and other non-monetary benefits. Former President and Chief Operating Officer, Charles J. ("Chuck") Harris succeeded Mr. Barry in the position of Chief Executive Officer effective July 2, 2007.

NOTE 11 – Subsequent Events

Subsequent to year-end, the Company entered into a lease line agreement for $932,000. This line is payable over four years with an interest rate of 7.25%. The lease line contains debt covenants consistent with the other debt of the Company.

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

FORWARD-LOOKING STATEMENTS

The discussion of the financial condition and results of operations of the Company should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere herein. This discussion contains forward-looking statements, including statements regarding the Company's strategy, financial performance and revenue sources, which involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth elsewhere herein, and in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

OVERVIEW

Electronic Clearing House, Inc. is an electronic payment processor that provides for the payment processing needs of both online and retail merchants. *ECHO* or through sales channels that include technology partners, banks, collection agencies and other trusted resellers, derives the majority of its revenue from two main business segments: 1) 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 2) 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), 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 credit card, debit card and check 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 check verification, check conversion capture services, and for membership to collection agencies;
- *XPRESSCHEX*, Inc. for check collection services; and
- *ECHO,* for wholesale credit card and check processing services to the bank, technology partner, reseller channels.

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

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 Capital Market under the ticker symbol “ECHO.” Information on our website, www.echo-inc.com, does not constitute part of this quarterly report.

Bankcard and transaction processing services provide for the majority of our revenues. We typically receive a percentage-based fee on the dollar amount processed and a transaction fee on the number of transactions processed. For the quarter ended June 30, 2007, the bankcard and transaction processing business segment accounted for approximately 83.3% of the Company’s total revenue.

We purchased a fully integrated, multi-modular bankcard processing system which, once fully implemented, should provide us with greater flexibility to price our credit card processing services and allow us to offer our services to other third parties. The clearing portion of this system was deployed in the last quarter of 2006 and was completely implemented in the second fiscal quarter of 2007.

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In October 2006, the Unlawful Internet Gaming Enforcement Act was passed and signed into law. As a result of the passed legislation, several of our Internet Wallet merchants, all of which used our check services, had a significant drop in processing activities during the quarter ended December 31, 2006 as we wound down the services we provided to them. During February 2007, the Company decided to cease processing and collection services for all Internet wallet customers. On March 27, 2007, the Company entered into a Non-Prosecution Agreement pursuant to which the Office of the United States Attorney for the Southern District of New York agreed not to pursue actions against the Company and its subsidiaries for activities related to its provision of payment processing services to Internet wallets that provided services to online gaming websites during the period from January 2001 through and including the date of the signing of the Non-Prosecution Agreement.

Approximately 70% of *ECHO*'s credit card processing merchants operate their businesses in non-face-to-face environments such as mail order, phone order and the Internet. These relationships historically have higher margins than those seen with normal retail merchants because of the higher risk of fraud. We have been able to effectively manage this risk historically.

ECHO has established an integrated processing relationship with the largest check cashing provider to the land-based gaming and casino market. Our services are primarily centered on providing check verification (using our NCN data base), funds movement, and several sophisticated risk management services that are used to assist the provider in confidently accepting checks.

ECHO is both a Third-Party Processor and an Acquirer Processor for the Visa POS Check Program. Visa officially released its POS Check Service as of December 2002 and several national banks have entered the program since its inception to both sell the service to their merchants and to connect all of their checking accounts to the Visa network. Visa's connectivity to checking account balances is approximately 30% and higher in many metropolitan areas.

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.

In addition to being a Third-Party Processor, we 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. 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.

On December 14, 2006, we entered into an Agreement and Plan of Merger (the Merger Agreement) to be acquired by Intuit, Inc. (Intuit) in a merger transaction in which we would have become a wholly owned subsidiary of Intuit (the Intuit merger). Pursuant to the terms of the Merger Agreement and subject to the conditions thereof, Intuit would have acquired all of the outstanding shares of our common stock and all outstanding equity awards (which would have vested in connection with the transactions) for a cash amount of $18.75 per share, for a total purchase price of approximately $142 million on a fully diluted basis. The transaction was subject to regulatory review, our shareholder approval and other customary closing conditions. On March 26, 2007, the Company mutually agreed with Intuit and Elan Acquisition Corporation, a Nevada corporation and wholly owned subsidiary of Intuit ("Elan"), to terminate the Merger Agreement. The parties determined that it was in the mutual best interest of each party to terminate the proposed agreement. In connection with the termination, the Company, Intuit and Elan agreed to release each other from all claims arising under or related to the terminated merger agreement. The Company also cancelled its previously adjourned special stockholders' meeting relating to the proposed acquisition, which was scheduled to reconvene on March 27, 2007. As of result of the termination of the merger agreement, the Company recorded approximately $28,000 and $934,000, respectively, for the three and nine-month periods ended June 30, 2007 of costs related to the merger.

STRATEGY

Overview

From June 2006 until the recent mutual termination of the Intuit merger agreement, management progressively became more focused on a potential merger opportunity with Intuit. This redirected focus diminished the Company's ability to aggressively continue to implement a long term strategy for growth and profitability. Now that the parties have mutually terminated the proposed merger, management is able to direct 100% of its attention to the implementation of its long term strategy and active evaluation of other growth opportunities.

ECHO has refocused on its service strategy which is to provide merchants, banks, technology partners and collection agencies with electronic payment services that combine credit card, debit card and electronic check and collection services with quality customer support. *ECHO's* services enable merchants to maximize revenue by offering a wide variety of payment options, minimize costs by dealing with one source and improve their bad debt collection rates through use of *ECHO*'s integrated collection and risk management services.

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Electronic Payment Services for Technology Partners Providing POS Systems
We believe there are significant opportunities in working closely with those firms that specialize in certain industries and provide a point-of-sale (POS) capability to merchants of some nature. By integrating our processing with these parties, we believe we can leverage our sales activity and have longer term relationships with merchants than are historically the case for most processors. We also believe our full processing capability allows us to provide the POS system partner with some economic benefit from the processing volume of the users of its system.

Along similar lines, we believe there are quality independent sales organizations, many of which are focused on select markets, where we can establish a viable and mutually profitable relationship wherein they sell our processing services.

Promote Merchant Payment Processing for Regional and Community Banks
ECHO pursues small regional and community banks for credit card and check payment programs that 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. 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 credit card and real time check processing services 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 revenue 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. 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. We, in turn, benefit from the increased processing and transaction revenue. Additional benefits of the *ECHO* 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
- Reduction of fraud risk.

In addition to the benefits that the bank receives from the *ECHO* 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; all returned checks being automatically referred to our collection agency; 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 June 2007 had 40 participating banks. *ECHO* estimates that there are approximately 8,000 community banks in the United States. Based on third-party research, we estimate that approximately 57% of these banks offer payment solutions for their merchants. We believe these banks will be very responsive to the *ECHO* value proposition when a comparison of features and costs is reviewed.

Promote to Associations and Guilds
There are over 8,000 associations and guilds in the United States and many of the 4.1 million merchants belong to one of these organizations. We believe our combination of services and our controlled cost structure will allow us to attract many of these organizations to actively refer their members to us for meeting their payment processing needs.

Promote Visa POS Check Service Program

Given *ECHO's* role as a "first adopter" in the early stages of the Visa Program and our subsequent investment of significant resources and management focus with respect to the Visa Program, we expect to see ongoing sales opportunities in check services as the marketing efforts of participating banks in the Visa Program become more widely implemented.

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

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SALES AND MARKETING

ECHO offers its payment services through several sales channels.

- *Primary Sales Channels*– Direct sales personnel are dedicated to various industries and/or services. We employ approximately 20 people who serve in either field or office positions that are dedicated to sales.
- *Secondary Sales Channels*– All or a portion of our services are sold through banks who sign up with our MerchantAmerica Agent Bank program, through banks who are selling the Visa POS Check Program, through authorized resellers, technology partners, independent sales organizations (ISOs) and through one of our 236 NCN Collection Agency Members. These channels offer lower margins to us due to the added participation in the overall revenue such channels require. Currently, *ECHO* has approximately 300 authorized resellers registered to sell *ECHO's* check products.

Management believes that we are distinctive in the number of payment methods that we enable, 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 pursue direct sales opportunities where there is a significant amount of card and check acceptance; to build processing relationships with certain providers of POS software/hardware that serve select merchant markets; to maximize cross-selling opportunities within our existing base of retail merchants and financial institutions; to sell integrated suites of check, credit and debit card processing services through small banks; to enhance and market MerchantAmerica.com; and to pursue associations aggressively.

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.

Of the top 50 credit card acquirers in the nation, approximately 40 of them are independent sales organizations or banks that may manage the front-end authorization service but they outsource the back-end clearing and settlement services from a full service processor. There are probably 10 or fewer firms capable of full credit card processing and these would include First Data Corporation, Total Systems, NPC (Bank of America), Global Payments, Heartland Payments, Alliance Data Systems, Nova and RBS Lynx. We believe we hold the distinction of being the smallest public company who, with the installation of the Oasis Clearing module in 2006, will serve as a full service processor in credit cards. All 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.

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 (purchased by Fidelity) and Global Payments. While all four have major national accounts, we have been successful in winning the processing relationships for national accounts when competing for such business against these parties. *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 been certified as both a Third-Party Processor and Acquirer Processor with the Visa POS Check Program.

We believe that being the smallest processor also has some advantages. There are many merchants who are sizable to us that the larger processors do not consider to be major merchants. We are finding that these merchants appreciate receiving preferential treatment from their processor. Also, our willingness to send top management into the field to meet regularly with our major merchants at their locations is a perceived distinction and we are using it as a merchant retention tool. While we understand that slightly lower costs can be generated by processing high volumes, we do not think the economic advantages that high volume affords are enough to eliminate *ECHO* as an acceptable and competitive processor in most cases. Despite these potential advantages, we believe that our success will depend largely on our ability to continuously exceed expectations in terms of performance, service, and price, on our ability to develop new products and services, and on how well and how quickly we enhance our current products and introduce them into the market.

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RESULTS OF OPERATIONS

Three Months Ended June 30, 2007 and 2006

Financial highlights for the third quarter of fiscal 2007 as compared to the same period last year were as follows:

- Total revenue decreased 4.2% to $19.0 million
- Gross margins from processing and transaction revenue was 27.5% for the current quarter as compared to 33.1% for the prior year
- Operating income decreased 193.4% from $1,785,000 to an operating loss of $1,668,000
- Diluted loss per share was $0.10 as compared to diluted net earnings of $0.14 per share
- Bankcard and transaction processing revenue increased 4.8% to $15.8 million
- Bankcard processing volume increased 5.1% from $472.1 million to $496.0 million
- Check-related revenue decreased 32.9% to $3.2 million
- ACH transactions processed decreased 33.7% to 6.2 million transactions

Revenue. Total revenue decreased 4.2% to $19,029,000 for the three months ended June 30, 2007, from $19,869,000 for the same period last year. The decrease can be primarily attributed to the 4.8% growth in the bankcard processing revenue offset by the 32.9% decrease in the check services business segment as compared to the same period last year. The bankcard processing growth has occurred organically from our existing merchants and from our marketing initiatives. The decrease in check revenue primarily reflects the wind-down of the Company's Internet wallet business and the discontinuation of services to several merchant categories that management determined were carrying unacceptable levels of business or financial risk. We have one merchant who generated approximately 12.1% of the total bankcard processing revenue during the current quarter. The increase in revenue was primarily the result of a 5.1% increase in bankcard processing volume offset by the 33.7% decrease in ACH transactions processed as compared to the prior year quarter.

Cost of Sales. Bankcard processing expenses are directly related to the changes in processing revenue. A major component of the Company's bankcard processing expense, the interchange fees paid to the card issuing banks, is normally fixed as a percentage of each bankcard transaction dollar processed. Processing-related expenses, consisting primarily of data center processing costs, interchange fees, third-party processing fees, and communication expense, increased from $13,299,000 in the third fiscal quarter of 2006 to $13,803,000 in the current quarter, a 3.8% increase. The increase was primarily attributable to the 4.8% increase in bankcard processing revenue for the current quarter.

Gross margin was 27.5% for the current quarter as compared to 33.1% for the same period last year. The decrease in gross margin was primarily attributable to several high volume merchants that contributed slightly lower margin and a 32.9% decrease in check-related revenue due to the termination of our Internet wallet business, which generally has a higher gross margin than bankcard revenue.

Expense. Total operating expenses increased 14.4% to $20.7 million for the third quarter of fiscal 2007 as compared with $18.1 million for the third quarter of fiscal 2006. Included in total operating expenses are approximately $1.4 million of one-time expenses for the third quarter ended June 30, 2007, such as severance costs for the Company's

former CEO and legal settlement expense related to the resolution of a government non-prosecution agreement entered into in connection with our Internet wallet business.

Other operating costs such as personnel costs, telephone and depreciation expenses increased, from $1,438,000 in the third quarter of 2006 to $1,646,000 for the current fiscal quarter, a 14.5% increase. This increase was attributable to the increase in personnel costs to support the product development group.

Research and development expenses increased from $316,000 for the quarter ended June 30, 2006 to $605,000 in the current year quarter. Continued investment in research and development and IT initiatives is critical to our ability to maintain our competitive position and strengthen our infrastructure to support growth. Several of our major IT projects were completed in the first and second quarter of the current fiscal year. However, we anticipate making continued investments in our IT initiatives and expect research and development expenses to remain at current levels for the remainder of the 2007 fiscal year as we strive to stay competitive in our product offerings.

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Selling, general and administrative expenses increased from $3,009,000 in the third fiscal quarter of 2006 to $3,192,000 for the current fiscal quarter, an increase of 6.1%. This increase was primarily attributable to $143,000 in write-offs of previously capitalized projects. As a percentage of total revenue, selling, general and administrative expenses increased from 15.1% in the prior year quarter to 16.8% in the current quarter.

Legal Settlements and Fees - On March 27, 2007, we entered into a Non-Prosecution Agreement pursuant to which the Office of the United States Attorney for the Southern District of New York agreed not to pursue actions against us or our subsidiaries for activities related to its provision of payment processing services to Internet wallets that provided services to online gaming websites during the period from January 2001 through and including the date of the signing of the Non-Prosecution Agreement. Pursuant to the terms of the Non-Prosecution Agreement, we agreed to pay estimated profits to the United States in the amount of a $2,300,000 civil disgorgement settlement upon the execution of the Non-Prosecution Agreement, which represented management's estimate of our profits from processing and collection services provided to Internet wallets since 2001. Also included is approximately $238,000 for legal fees and expenses related to the settlement for the quarter ended June 30, 2007. We settled a patent related lawsuit during the quarter ended March 31, 2006 and also incurred $22,000 of related legal expenses in the quarter ended June 30, 2006.

Merger Related Costs - On March 26, 2007, we mutually agreed with Intuit and Elan Acquisition Corporation, a Nevada corporation and wholly owned subsidiary of Intuit ("Elan"), to terminate the Agreement and Plan of Merger previously entered into on December 14, 2006. The Company incurred approximately $28,000 of legal, professional and other fees and expenses related to the failed merger for the quarter ended June 30, 2007.

Severance Costs – The Company accrued $1,185,000 as a result of its negotiation of a retirement and separation arrangement for former Chairman and Chief Executive Officer Joel M. Barry. During and since the three months ended June 30, 2007, we have been negotiating a retirement and separation package for Mr. Barry. Given the status of the negotiations, management determined that it was appropriate to reserve for the aggregate costs being negotiated as of June 30, 2007. Such costs will include cash compensation, accelerated vesting of certain equity-based awards and other non-monetary benefits.

Operating Loss/Income. Operating loss for the quarter ended June 30, 2007 was $1,668,000, as compared to operating income of $1,785,000 in the same period last year, a 193.4% decrease. The decrease was due to the factors described above.

Interest Expense and Income. Net interest income was $92,000 for the three months ended June 30, 2007 as compared to $52,000 interest income for the prior year quarter. The increase was due to the increased cash and cash equivalents balances and increase in interest rates being earned.

Effective Tax Rate. The effective tax rate for the quarter ended June 30, 2007 was a benefit of 56.7% as compared to a provision of 45.0% for the corresponding prior year period. The difference in the tax rate was primarily due to the Company having a loss before income taxes for the three months ended June 30, 2007 as compared to income before taxes for the corresponding prior year period. The Company also, based upon a study conducted during the three months ended June 30, 2007, recorded certain research and development tax credits for fiscal years ended September 30, 2003 and 2006 and for the nine months ended June 30, 2007 in the third quarter of 2007. These tax credits resulted in an income tax benefit of $576,000.

Segment Results

Bankcard and Transaction Processing. Bankcard processing and transaction revenue increased 4.8%, from $15,118,000 in the fiscal quarter ended June 30, 2006 to $15,843,000 for the current year quarter ended June 30, 2007. This revenue increase was mainly attributable to organic growth from our existing merchants and several new

merchants with high processing volume. We have one bankcard merchant who generated approximately 12.1% of the total bankcard processing revenue and a total of 16.3% of the bankcard processing volume during the current quarter. Bankcard revenue made up 83.3% of total revenue for the current quarter as compared to 76.1% for the same period last year.

Operating income from our bankcard and transaction processing segment was $2,212,000 for the current period as compared to $2,762,000 in the same period last year, a 19.9% decrease. The decrease in operating income was primarily attributable to the 4.8% revenue growth and offset by an increase in personnel to support the revenue growth and an increase of $281,000 in software amortization. .

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Check Related Products. Check-related revenues decreased from $4,751,000 for the prior year quarter to $3,186,000 for the current fiscal quarter, a decrease of 32.9%. This decrease was primarily attributable to a 51.5% decrease in ACH processing revenue. In October 2006, the Unlawful Internet Gambling Enforcement Act was passed and signed into law. During February 2007, the Company decided to cease processing for all Internet Wallet customers. As a result, our processing activities had a significant drop during the quarter ended March 31, 2007 which continued into the current quarter. Additionally, the discontinuation of services to several merchant categories that management determined were carrying unacceptable levels of business or financial risk contributed to a decrease in check revenue during the current quarter. Accordingly, our ACH processing and check verification revenue were substantially lower as compared to the prior year quarter.

Check services revenue made up 16.7% of total revenues in the current quarter as compared to 23.9% in the prior year quarter. Check-related operating loss was $770,000 for the quarter ended June 30, 2007 as compared to operating income of $1,418,000 in the same period last year based on the factors described above.

Other Corporate Expense. Other corporate expense increased from $2,395,000 for the quarter ended June 30, 2006 to $3,110,000 for the current year quarter, an increase of 29.9%. The increases were primarily attributable to the legal settlement fees, merger related costs and expenses related to the severance accrual for the Company's former CEO.

Nine Months Ended June 30, 2007 and 2006

Financial highlights for the nine months ended June 30, 2007, as compared to the same period last year, were as follows:

--Total revenue increased 4.2% from $56.0 million to $58.4 million

--Gross margins from processing and transaction revenue decreased from 33.3% to 30.3%

--Diluted loss per share was $ 0.34 as compared to diluted net earnings of $0.29 per share

--Bankcard and transaction processing revenue increased 11.2% to $47.1 million

--Bankcard processing volume increased 12.5% to $1.5 billion

--Check-related revenue decreased 17.2% to $11.3 million

--ACH transactions processed decreased 22.6% to 21.8 million transactions

Revenue. Total revenue increased 4.2% to $58,401,000 for the nine months ended June 30, 2007, from $56,023,000 for the same nine-month period last year. The 11.2% increase in our bankcard processing revenue was the result of organic growth from our existing merchants and new merchants generated from our sales and marketing programs. Our bankcard processing volume increased 12.5% for the nine months ended June 30, 2007, as compared to the same period last year offset by a decrease in check related revenue described below.

Cost of Sales. Processing-related expenses increased from $37,357,000 for the nine-month period in 2006 to $40,701,000 for the same nine months ended June 30, 2007, a 9.0% increase. This increase was directly attributable to the 4.2% increase in revenue. Gross margin from processing and transaction services decreased to 30.3% in the current nine-month period from 33.3% for the same nine-month period last year. The decrease in gross margin was primarily attributable to several high volume merchants who yielded lower margins, particularly one merchant who

generated 12.2% of the total bankcard processing revenue during the nine months ended June 30, 2007 and a 17.2% decrease in check related revenue which generally has a higher gross margin than bankcard revenue.

Expense. Other operating costs increased from $4,266,000 for the nine months ended June 30, 2006 to $4,831,000 for the nine months ended June 30, 2007, an increase of 13.2%. This increase was directly related to the increase in personnel costs to support the 4.2% revenue growth.

Research and development expense increased from $1,189,000 in the nine months ended June 30, 2006 to $1,614,000 in the current nine-month period. We are continuing to invest in infrastructure improvement and software enhancement to remain competitive in our industry.

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Selling, general and administrative expenses increased from $8,323,000 for the nine months ended June 30, 2006 to $10,277,000 in the current nine-month period, an increase of 23.5%. This increase was primarily attributable to 1) a $586,000 expense associated with the investigation, consumer notification and administration of an identified security intrusion; 2) a $923,000 increase in salaries and bonuses; and 3) a $201,000 increase in stock compensation expense. As a percentage of total revenue, selling, general and administrative expenses increased from 14.9% for the nine months ended June 30, 2006 to 17.6% in the current nine-month period.

Legal Settlements and Fees - On March 27, 2007, we entered into a Non-Prosecution Agreement pursuant to which the Office of the United States Attorney for the Southern District of New York agreed not to pursue actions against us or our subsidiaries for activities related to its provision of payment processing services to Internet wallets that provided services to online gaming websites during the period from January 2001 through and including the date of the signing of the Non-Prosecution Agreement. Pursuant to the terms of the Non-Prosecution Agreement, we agreed to pay estimated profits to the United States in the amount of a $2,300,000 civil disgorgement settlement upon the execution of the Non-Prosecution Agreement, which represented management's estimate of our profits from processing and collection services provided to Internet wallets since 2001. Also included is approximately $836,000 for legal fees and expenses related to the settlement for the nine months ended June 30, 2007. We settled a patent related lawsuit during the nine months ended June 30, 2006 for $600,000 and also incurred $661,000 of related legal expense.

Merger Related Costs - On March 26, 2007, we mutually agreed with Intuit Inc. and Elan Acquisition Corporation, a Nevada corporation and wholly owned subsidiary of Intuit ("Elan"), to terminate the Agreement and Plan of Merger previously entered into on December 14, 2006. The Company incurred approximately $934,000 of legal, professional and other fees and expenses related to the merger for the nine months ended June 30, 2007.

Severance Costs – The Company accrued $1,185,000 as a result of its negotiation of a retirement and separation arrangement for former Chairman and Chief Executive Officer Joel M. Barry. During and since the three months ended June 30, 2007, we have been negotiating a retirement and separation package for Mr. Barry. Given the status of the negotiations, management determined that it was appropriate to reserve for the aggregate costs being negotiated as of June 30, 2007. Such costs will include cash compensation, accelerated vesting of certain equity-based awards and other non-monetary benefits.

Operating Loss/Income. Operating loss for the nine months ended June 30, 2007 was $4,277,000, as compared to operating income of $3,627,000 for the same period last year. The decrease was due to the factors described above.

Interest. Net interest increased from $105,000 for the nine months ended June 30, 2006 to $327,000 for the current nine-month period. This is attributable to the higher interest earned and a reduction in the total loan balances.

Effective Tax Rate. The effective tax rate for the nine months ended June 30, 2007 was a benefit of 42.6% as compared to a provision of 45.7% for the corresponding prior year period. The difference in the tax rate was primarily due to the Company having a loss before income taxes for the nine months ended June 30, 2007 as compared to income before taxes for the corresponding prior year periods. The Company also, based upon a study conducted during the three months ended June 30, 2007, recorded certain research and development tax credits for fiscal years ended September 30, 2003 and 2006 and for the nine months ended June 30, 2007 in the third quarter of 2007. These tax credits resulted in an income tax benefit of $576,000.

Segment Results

Bankcard and Transaction Processing. Bankcard processing and transaction revenue increased 11.2%, from $42,370,000 for the nine months ended June 30, 2006 to $47,097,000 for the current nine month period. This revenue increase was mainly attributable to the 12.5% increase in bankcard processing volume as compared to the same nine

month period last year. The processing volume increase was due to our organic growth, particularly several high processing volume merchants. One bankcard merchant contributed 12.2% of the total revenue and 16.3% of the total bankcard processing volume during the current nine-month period.

Operating income from our bankcard and transaction processing segment was $7,074,000 for the current nine-month period as compared to $7,156,000 in the same period last year, a 1.1% decrease. The decrease in operating income was primarily attributable to the 11.2% revenue growth, offset by an increase in personnel to support the revenue growth and an increase in software amortization of $593,000. .

Check-Related Products. Check-related revenues decreased from $13,653,000 for the nine months ended June 30, 2006 to $11,304,000 for the current nine-month period, a decrease of 17.2%. This was attributable to the 27.8% revenue decrease in ACH and 10.5% decrease in check verification revenue related to our decision to cease processing Internet wallet merchants after February 10, 2007 and discontinuation of services to merchants that represent unacceptable levels of business and financial risk to the Company (as previously described) and to terminate certain other check merchants with unacceptable risk profiles.

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Check services revenue accounted for 19.4% of our total revenue for the current nine-month period as compared to 24.4% in the same prior year period. Check-related operating loss was $226,000 for the current nine-month period as compared to operating income of $3,685,000 in the same period last year, a decrease of 106.1%. The decline in operating income was primarily attributable to the 17.2% decrease in check services revenue over the same period last year related to the wind-down of the higher margin Internet wallet business.

Other Corporate Expense. Other corporate expense increased from $7,214,000 for the nine months ended June 30, 2006 to $11,125,000 for the nine months ended June 30, 2007, an increase of 54.2%. The increases were primarily attributable to a legal settlement, merger related costs, expenses related to the security intrusion, and the CEO severance.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2007 we had available cash and cash equivalents of $9,770,000, restricted cash of $1,141,000 in reserve with our primary processing bank and working capital of $9,573,000.

Accounts receivable, net of allowance for doubtful accounts, increased from $2,914,000 at September 30, 2006 to $3,577,000 at June 30, 2007. Allowance for doubtful accounts reserved mainly for chargeback losses increased to $618,000 at June 30, 2007 from $392,000 at September 30, 2006. The higher allowance was primarily related to provision for doubtful accounts related to several bankcard merchants' chargeback receivables.

Net cash provided by operating activities for the nine months ended June 30, 2007 was $1,342,000, as compared to net cash provided by operating activities of $6,777,000 for the nine months ended June 30, 2006. This decrease was mainly attributable to the net loss of $2,268,000 for the nine months ended June 30, 2007, as compared to the net income of $2,026,000 for the nine months ended June 30, 2006.

Cash amounts classified as settlement receivable/payable are amounts due to/from merchants and result from timing differences in our settlement process with those 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 and the timing of the cut-off date. Settlement deposits are cash deposited in our bank accounts from the merchant settlement transactions.

In the nine months ended June 30, 2007, we used $614,000 mainly for the purchase of computer equipment and $2,964,000 for the acquisition and capitalization of software costs, as compared to $662,000 for the purchase of equipment and $3,011,000 for the acquisition and capitalization of software costs for the same nine-month period last year. During the nine months ended June 30, 2007, we paid off $218,000 of notes payable obligations. During the nine months ended June 30, 2007, we had proceeds of $473,000 from stock option exercises, as compared to $482,000 of cash proceeds from stock option exercise for the same period last year.

At June 30, 2007 we had the following contractual 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	$ 518,000	$ 285,000	$ 233,000	$ -0-	$ -0-

Capital lease obligations	43,000	37,000	6,000	-0-	-0-
Operating leases	635,000	518,000	117,000	-0-	-0-
Minimum vendor commitments	325,000	300,000	25,000	-0-	-0-
Total contractual cash obligations	$ 1,521,000	$ 1,140,000	$ 381,000	$ -0-	$ -0-

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Our primary source of liquidity is expected to be cash flow generated from operations and cash and cash equivalents currently on hand. As of June 30, 2007, the $3 million line of credit with Bank of the West was unused. We also obtained a modification for one debt covenant that put us in compliance at June 30, 2007 and for the remainder of our fiscal year. Management believes that our cash flow from operations together with cash on hand will be sufficient to meet our working capital and other commitments. Subsequent to year-end, we entered into a lease line agreement for $932,000. This line is payable over four years with an interest rate of 7.25%.

OFF-BALANCE SHEET ARRANGEMENTS

At June 30, 2007, we did not have any off-balance sheet arrangements.

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 have two primary bankcard processing and sponsorship relationships, one with First Regional Bank in Agoura Hills, California, and another one with National Bank of California in Los Angeles, California, entered into on April 12, 2007. Our agreement with First Regional Bank continues through July 2010 and through April 2012 with National Bank of California. 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 relationship 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 its terms, and may therefore determine to terminate their agreement prior to its 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 banks 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 June 30, 2007, we maintained a dedicated chargeback reserve of $816,000 at our primary bank specifically earmarked for such activity. Additionally, through our sponsoring bank, as of June 30, 2007, we had access to approximately $20.6 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.

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Excessive chargeback losses could significantly affect our results of operations and liquidity.

Our agreements with our sponsoring banks require us to assume and compensate the banks 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 banks 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 June 30, 2007, this potential exposure totaled approximately $678 million. At June 30, 2007, we, through our sponsoring bank, had approximately $148,000 of unresolved chargebacks that were in the process of resolution. At June 30, 2007, we, through our sponsoring bank, had access to $20.6 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 three-month periods ended June 30, 2007 and 2006, we processed approximately $496 million and $472 million, respectively, of Visa and MasterCard transactions, which resulted in $3.0 million in gross chargeback activities for the three months ended June 30, 2007 and $2.6 million for the three months ended June 30, 2006. 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.

Excessive check return activity could significantly affect our results of operations and liquidity

All check settlement funds are moved utilizing the Automated Clearing House (ACH) system of the Federal Reserve. Submission of an ACH request to withdraw funds may be refused by the receiving bank for a number of reasons, the two most common being the account did not have an adequate balance to honor the request or the account was closed. In each of these situations, we first look to the merchant account for the return of any funds deposited. In some situations, specific merchant reserves are set up in advance in order to honor all returns. In the event neither the merchant bank account nor a specific reserve is adequate to cover a return, we allow either of the processing banks to look to our reserve accounts to cover the return activity. In such cases, we then actively look to recover our advanced funds from the merchant, either from a subsequent day's processing activity or from one-time deposits requested of the merchant. In the event such recovery is not possible, we could suffer a loss on return ACH activity which could affect our results of operations and liquidity. The amount we considered uncollectible over the past three months was $29,000.

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.

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Our failure to adequately market our services through this relationship 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.

Our inability to implement, and/or the inability of third-party software vendors to continue to support and provide maintenance services with respect to, the third-party vendors' products, could significantly affect our results of operations and financial condition.

We utilize various third-party software applications and depend on the providers of such software applications to provide support and maintenance services to us. In the event that a third-party software vendor fails to continue to support and maintain its software application, or fails to do so in a timely manner, this could significantly affect our results of operations and financial condition.

Our inability to ultimately implement, or a determination to cease the implementation of various of our software technology initiatives will significantly adversely affect our results of operations and financial condition.

We have spent significant time and monetary resources implementing several software technologies, which resulted in significant cost being capitalized by us as non-current software assets. The implementation of these technologies will provide us with substantial operational advantages that would allow us to attract and retain larger merchants, as well as the small and mid-market merchants that have been our target market. Management believes that the implementation of these software technologies, and the technologies themselves, continues to be in the best interests of, and the most viable alternative for, the Company. However, the inability to ultimately implement, or a determination to cease the implementation of these software technologies would cause these assets to become impaired, and the corresponding impairment would significantly adversely affect our results of operations and financial condition.

A significant amount of our bankcard processing revenue is dependent on approximately 100 merchant accounts, several of which are very large merchants. The loss of a substantial portion of these accounts would adversely affect our results of operations.

We depend on approximately 100 key merchant accounts for our organic growth and profitability. One merchant accounted for approximately 12.1% of our bankcard processing revenue during the three months ended June 30, 2007. The loss of this account or the loss of merchants from this select group could adversely affect our results of operations.

The business activities of our merchants, third party independent sales organizations and/or third party processors could affect our business, financial condition and results of operations.

We provide direct and back-end bankcard and check processing and collection services (including check verification, conversion and guarantee services) to merchants across many industries. We provide these services directly and through third party independent sales organizations and third party processors. To the extent any of these merchants, independent sales organizations or third party processors conduct activities which are deemed illegal, whether as a result of the interpretation or re-interpretation of existing law by federal, state or other authorities, or as a result of newly introduced legislation, and/or to the extent these merchants, independent sales organizations or third party processors otherwise become involved in activities that incur civil liability from third parties, (including from federal, state or other authorities), those legal authorities and/or those third parties could attempt to pursue claims against us, including, without limitation, for aiding the activities of those merchants. Those legal authorities and/or those third parties could also pursue claims against us based on their interpretation or re-interpretation of existing law, based on

their interpretation or re-interpretation of newly introduced legislation, and/or based on alternative causes of action that we can not predict. While we believe that the services we provide are not illegal, and while we believe that our services do not directly or indirectly aid in the activities of our merchants, independent sales organizations or third party processors, and while we have no intent to assist any such activities, of our merchants, independent sales organizations or third party processors (other than to provide general processing and collection services, or check verification, conversion and guarantee services in the case of check services, consistent with past practice), any claims by legal authorities or third parties would require us to expend financial and management resources to address and defend such claims. Additionally, the aggregate resolution of any such claims could require us to disgorge revenues or profits, pay damages or make other payments. The occurrence of any of the foregoing would have an adverse impact on our business, financial condition and results of operations.

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As we have previously disclosed, several of our former merchants provided consumers access to "Internet wallets," which subsequently permitted consumers to use funds in those "Internet wallets" to, among other transactions, participate in gaming activities over the Internet. In October 2006, the Unlawful Internet Gaming Enforcement Act was passed and signed into law. As a result of the passed legislation, several of our Internet wallet merchants, all of which used our check services, had a significant drop in processing activities during the quarter ended December 31, 2006 as we wound down the services we provided to them. During February 2007, we decided to cease processing and collection services for all Internet wallet customers. Our "Internet wallet" merchants had no check revenue for the quarter ended June 30, 2007. On March 27, 2007, we entered into a Non-Prosecution Agreement pursuant to which the Office of the United States Attorney for the Southern District of New York agreed not to pursue actions against us and our subsidiaries for activities related to our provision of payment processing services to Internet wallets that provided services to online gaming websites during the period from January 2001 through and including the date of the signing of the Non-Prosecution Agreement. Pursuant to the terms of the Non-Prosecution Agreement, we agreed to pay estimated profits to the United States in the amount of a $2,300,000 civil disgorgement settlement upon the execution of the Non-Prosecution Agreement, which represented our management's estimate of our profits from processing and collection services provided to Internet wallets since 2001. We agreed to maintain a permanent restriction upon providing automated clearing house services to any business entity providing Internet gambling services to customers in the United States, so long as the processing services and gambling services are illegal under the laws of the United States. Additionally, we agreed to, among other matters, cooperate fully and actively with the U.S. Attorney's Office, the Federal Bureau of Investigation, and with any other agency of the government designated by the U.S. Attorney's Office, and to not commit any violations of law. Our cooperation obligations will continue until the later of one year from the date of the signing of the Non-Prosecution Agreement or the date upon which all prosecutions arising out of the conduct described in the Non-Prosecution Agreement are final.

Actions by federal, state or other authorities, or private third parties, could attempt to seize or otherwise attempt to take action against the reserve and settlement accounts we hold pursuant to our agreements with our merchants (to protect against returns and other losses we may incur), the loss of which could adversely affect our financial condition and results of operation.

We hold reserve and settlement accounts on behalf of our bankcard and check merchants to protect us against returns and other losses we may incur as a result of the merchant's activities. To the extent any of these merchants conduct activities which are deemed illegal, whether as a result of the interpretation or re-interpretation of existing law by federal, state or other authorities, or as a result of newly introduced legislation, and/or to the extent these merchants otherwise become involved in activities that incur civil liability from third parties (including from federal, state or other authorities), those federal, state or other authorities, and/or those private third parties, could attempt to seize or otherwise attempt to take action against the reserve and settlement accounts we hold pursuant to our agreements with those merchants. The loss or decrease of any of these reserve or settlement accounts could cause us to become directly responsible for returns and other losses, which could adversely affect our financial condition and results of operation.

New or amended legislation and/or regulations could significantly affect our business operations and the business operations of our merchants.

We provide direct and back-end bankcard and check processing and collection services (including check verification, conversion and guarantee services) to merchants across many industries. We provide these services directly and through third party independent sales organizations and third party processors. To the extent any of these industries, or our services within these industries, become subject to new legislation or regulations, or existing law or regulations are amended in a manner that affects our provision of services within these industries, this could significantly affect our business operations and the business operations of those merchants.

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 product 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, to quickly 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 revenue 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.

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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, we have redesigned and upgraded our check related processing systems and have purchased a high end system to process bankcard activity. 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 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 quarter ended June 30, 2007, we incurred $64,000 in losses from uncollected guaranteed checks.

Security breaches could impact our continued operations, our results of operations and liquidity.

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. With the exception of one incident in December 2006, these systems have worked effectively in the past. The Company continues to strengthen its security processes and systems but 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, results of operations and liquidity.

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.

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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, and/or otherwise improve our technology platforms, 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. This includes investments in our technology platforms to permit them to process higher transaction volumes, to transition some of these technologies to more commonly used platforms, to permit us to process foreign currency transactions, and to expand our point-of-sale connection capability for our bankcard processing services. Research and development expenses increased from $316,000 in the third quarter of fiscal 2006 to $605,000 for the quarter ended June 30, 2007. 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. 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.

Our inability to recover from natural disasters could harm our business.

We currently maintain two data centers: one in Camarillo, California, and one in Albuquerque, New Mexico (co-location facility). Should a natural disaster occur in any of the locations, it is possible that we would not be able to fully recover full functionality at one of our data centers. To minimize this risk, we centralized our data processing functionality in Camarillo during fiscal 2005 and completed a full back-up site in Albuquerque in October of 2006. Despite such contingent capabilities, 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.

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Increases in the costs and requirements of technical compliance could harm our business.

The services which we offer 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. We have personnel dedicated to monitoring our compliance to the specific industries we serve and when possible, we are moving the technical compliance responsibility to other parties. As the compliance issues become more defined in each industry, the costs and requirements 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 we must acquire and/or maintain. Additionally, burdensome or unclear requirements could increase the cost of compliance. 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 we 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 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 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 Capital Market, and there can be substantial volatility in the market price of our common stock. Over the course of the quarter ended June 30, 2007, the market price of our common stock has been as high as $14.50, and as low as $11.28. Additionally, over the course of the year ended September 30, 2006, the market price of our common stock was as high as $18.19 and as low as $9.00. 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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to interest rate risk is very limited. A hypothetical 1% interest rate change would have no impact on our results of operations.

Item 4. Controls and Procedures

As of June 30, 2007, the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based upon that evaluation (except as described below), our Chief Executive Officer and our Chief Financial Officer concluded that as of June 30, 2007, our disclosure controls and procedures were effective.

During the quarter ended June 30, 2007, 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. However, we continued taking steps to enhance our security measures, including the implementation of enhanced systems and procedures to prevent and detect unauthorized access.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

There have been no material developments with respect to the legal proceeding disclosed in the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2007, filed on May 10, 2007.

Item 1a. Risk Factors

For a listing of our Risk Factors, see Part I, Item 2.

Item 4. Submission of Matters to a Vote of Security Holders

The Company held its Annual Meeting of Shareholders on July 2, 2007. At the Annual Meeting, there were 6,864,491 shares of Common Stock entitled to vote, and 5,235,823 (76.27%) were represented at the meeting in person or by proxy.

The following summarizes vote results for those matters submitted to our stockholders for action at the Annual Meeting:

1. Proposal to elect Messrs. Jerry McElhatton and Charles J. Harris to serve as the Company's Class II directors for three years and until their successors have been elected and qualified.

Director	For	Withheld
Jerry McElhatton	4,937,822	298,001
Charles J. Harris	4,963,994	271,829

2.2. Proposal to ratify the selection of BDO Seidman LLP as independent public accountants of the Company for the fiscal year ending September 30, 2007.

For	Against	Abstain	Broker Non-Votes
5,189,450	44,141	2,231	-0-

Item 6. Exhibits

See exhibit index.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ELECTRONIC CLEARING HOUSE, INC.
(Registrant)

Date: August 9, 2007

By: /s/ Alice Cheung
Alice Cheung, Treasurer and
Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	**Exhibit Description**
4.1	Amended and Restated Rights Agreement dated as of January 29, 2003, by and between the Company and OTR, Inc., as Rights Agent, including the Form of Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock, the Form of Rights Certificate, and the Summary of Rights to Purchase Preferred Shares, attached thereto as Exhibits A, B and C, respectively. Filed as an exhibit to the Company's amended Form 8-A filed with the Securities and Exchange Commission on February 10, 2003 and incorporated herein by reference.
4.2	Amendment Number One to Amended and Restated Rights Agreement dated as of September 27, 2004, by and between the Company and OTR, Inc. Filed as an exhibit to the Company's Form 8-K filed with the Securities and Exchange Commission on September 30, 2004 and incorporated herein by reference.
4.3	Amendment Number Two to Amended and Restated Rights Agreement dated as of December 14, 2006, by and between the Company and OTR, Inc. Filed as an exhibit to the Company's Form 8-K filed with the Securities and Exchange Commission on December 14, 2006 and incorporated herein by reference.
4.4	Amendment Number Three to Amended and Restated Rights Agreement dated as of April 24, 2007, by and between the Company and OTR, Inc. Filed as Exhibit 4.3 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 26, 2007 and incorporated herein by reference.
31.1	Certificate of Charles J. Harris, Chief Executive Officer of Electronic Clearing House, Inc. pursuant to Rule 13a-4(a) under the Securities and Exchange Act of 1934, as amended.
31.2	Certificate of Alice L. Cheung, Chief Financial Officer of Electronic Clearing House, Inc. pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.
32.1	Certificate of Charles J. Harris, Chief Executive Officer of Electronic Clearing House, Inc. pursuant to Rule 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, Inc. pursuant to Rule 13a-14(b) under the Securities and Exchange Act of 1934, as amended.