

NIGHTHAWK SYSTEMS INC  
Form 10QSB  
November 14, 2007

**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

(Mark One)

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QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

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TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**NIGHTHAWK SYSTEMS, INC.**

(Exact name of registrant as specified in charter)

**Nevada**  
(State or other jurisdiction  
of incorporation)

**0-30786**  
(Commission File Number)

**87-0627349**  
(IRS Employer  
Identification No.)

**10715 Gulfdale, Suite 200 San Antonio, TX 78216**  
(Address of principal executive offices)

**210 341-4811**

(Registrant's Telephone Number, including Area Code)

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

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

As of November 14, 2007, there were 128,877,504 shares of common stock, par value \$.001 per share, of the registrant issued and outstanding.

Transitional Small Business Disclosure Format (Check one): Yes  No

**NIGHTHAWK SYSTEMS, INC.**

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**Nighthawk Systems, Inc.****Condensed Consolidated Balance Sheet****September 30, 2007****(unaudited)****ASSETS****Current assets :**

|                          |    |         |
|--------------------------|----|---------|
| Cash                     | \$ | 34,016  |
| Accounts receivable, net |    | 268,827 |
| Inventories              |    | 119,252 |
| Prepaid expenses         |    | 2,957   |
| Total current assets     |    | 425,052 |

|  |    |           |
|--|----|-----------|
| Furniture, fixtures and equipment, net |    | 16,965    |
| Intangible assets, net                 |    | 20,270    |
| Deposit on acquisition                 |    | 250,000   |
| Other assets                           |    | 327,847   |
|  |    | 615,082   |
|  | \$ | 1,040,134 |

**LIABILITIES AND STOCKHOLDERS' DEFICIT****Current liabilities:**

|  |    |           |
|--|----|-----------|
| Accounts payable                               | \$ | 278,787   |
| Accrued expenses                               |    | 703,990   |
| Line of credit                                 |    | 19,192    |
| Notes payable:                                 |    |           |
| Convertible debt, net of discount of \$957,787 |    | 1,802,390 |
| Other  |    | 325,662   |
| Total liabilities (all current)                |    | 3,130,021 |

**Commitments and contingencies****Stockholders' deficit:**

|   |            |
|---|------------|
| Preferred stock; \$0.001 par value; 5,000,000<br>shares authorized; no shares issued and outstanding  | -          |
| Common stock; \$0.001 par value; 200,000,000<br>shares authorized; 119,141,392 issued and outstanding | 119,142    |
| Additional paid-in capital  | 11,812,827 |

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|                             |              |
|-----------------------------|--------------|
| Accumulated deficit         | (14,021,856) |
| Total stockholders' deficit | (2,089,887)  |
|                             | \$ 1,040,134 |

The accompanying notes are an integral part of these financial statements.

**Nighthawk Systems, Inc.****Condensed Consolidated Statements of Operations****(unaudited)**

|   | <b>Three months ended September 30,</b> |              | <b>Nine months ended September 30,</b> |                |
|---|---|--------------|--|----------------|
|   | <b>2007</b>                             | <b>2006</b>  | <b>2007</b>                            | <b>2006</b>    |
| Revenue   | \$ 368,855                              | \$ 231,710   | \$ 920,560                             | \$ 625,236     |
| Cost of revenue   | 276,783                                 | 136,690      | 641,147                                | 400,983        |
| Gross profit  | 92,072                                  | 95,020       | 279,413                                | 224,253        |
| Selling, general and administrative expenses                            | 468,408                                 | 555,375      | 1,708,713                              | 1,866,749      |
| Loss from operations  | (376,336)                               | (460,355)    | (1,429,300)                            | (1,642,496)    |
| Interest expense:   |   |              |  |                |
| Related parties   | -                                       | 346          | 610                                    | 1,677          |
| Other   | 210,556                                 | 145,050      | 866,935                                | 910,820        |
|   | 210,556                                 | 145,396      | 867,545                                | 912,497        |
| Net loss  | \$ (586,892)                            | \$ (605,751) | \$ (2,296,845)                         | \$ (2,554,993) |
| Net loss per basic and diluted common share                             | \$ (0.01)                               | \$ (0.01)    | \$ (0.02)                              | \$ (0.04)      |
| Weighted average number of common shares outstanding, basic and diluted | 116,176,969                             | 74,712,976   | 103,198,977                            | 67,270,080     |

The accompanying notes are an integral part of these financial statements.

**Nighthawk Systems, Inc.****Condensed Consolidated Statement of Stockholders Deficit****Nine Months Ended September 30, 2007****(Unaudited)**

|   | <b>Common Stock</b> |               | <b>Additional</b>          |                                | <b>Total</b>   |
|---|---------------------|---------------|----------------------------|--------------------------------|----------------|
|   | <b>Shares</b>       | <b>Amount</b> | <b>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Deficit</b> |                |
| Balances,<br>December 31,<br>2006   | 85,681,150          | \$ 85,681     | \$ 9,719,022               | \$ (11,725,011)                | \$ (1,920,308) |
| Common stock<br>issued upon<br>conversion of<br>notes payable                               | 21,628,323          | 21,629        | 786,991                    |                                | 808,620        |
| Common stock<br>issued for cash   | 3,661,529           | 3,661         | 247,600                    |                                | 251,261        |
| Common stock<br>issued in<br>satisfaction of<br>convertible<br>debt and<br>accrued interest | 5,985,505           | 5,986         | 359,905                    |                                | 365,891        |
| Beneficial<br>conversion<br>feature on<br>convertible<br>debt                               |                     |               | 214,286                    |                                | 214,286        |
| Warrants issued<br>in connection<br>with note<br>payable                                    |                     |               | 100,000                    |                                | 100,000        |
| Common stock<br>issued for<br>accrued<br>liabilities  | 1,934,885           | 1,935         | 217,963                    |                                | 219,898        |
| Stock-based<br>compensation,<br>vesting of  |                     |               | 146,810                    |                                | 146,810        |

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|  |             |            |               |                 |                |
|--|-------------|------------|---------------|-----------------|----------------|
| options                                      |             |            |               |                 |                |
| Common stock issued upon exercise of options | 250,000     | 250        | 20,250        |                 | 20,500         |
| Net loss                                     |             |            |               | (2,296,845)     | (2,296,845)    |
| Balances, September 30, 2007                 | 119,141,392 | \$ 119,142 | \$ 11,812,827 | \$ (14,021,856) | \$ (2,089,887) |

The accompanying notes are an integral part of these financial statements.



**Nighthawk Systems, Inc.****Condensed Consolidated Statement of Cash Flows****(Unaudited)**

|   |                |                |
|---|----------------|----------------|
| Cash flows from operating activities:                                       |                |                |
| Net loss  | \$ (2,296,845) | \$ (2,554,993) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                |                |
| Bad debt expense  | 12,442         | 1,987          |
| Depreciation and amortization   | 7,673          | 7,413          |
| Stock-based compensation  | 146,810        | 102,714        |
| Loan discounts and warrants   | -              | 133,789        |
| Beneficial conversion feature   | 416,693        | 254,281        |
| Consulting services expense   | 300,000        | 251,550        |
| Common stock issued for interest  | -              | 88,109         |
| Amortization of debt issue costs  | 108,725        | 233,267        |
| Change in assets and liabilities:   |                |                |
| Increase in accounts receivable   | (113,692)      | (70,839)       |
| Increase in inventories   | (6,739)        | (24,747)       |
| Increase in other assets  | (45,000)       | (4,652)        |
| Decrease in prepaid expenses  | 57,134         | (9,434)        |
| Increase (decrease) in accounts payable                                     | 64,121         | (64,000)       |
| Increase in accrued expenses  | 323,867        | 91,601         |
| Decrease in deferred revenue  | (4,754)        | -              |
| Total adjustments   | 1,267,280      | 991,039        |
| Net cash used in operating activities                                       | (1,029,565)    | (1,563,954)    |
| Cash flows from investing activities:                                       |                |                |
| Purchases of furniture, fixtures and equipment                              | (6,644)        | (13,283)       |
| Deposit on acquisition  | (250,000)      | -              |
| Net cash used in investing activities                                       | (256,644)      | (13,283)       |
| Cash flows from financing activities:                                       |                |                |
| Payments on notes payable, related parties                                  | (407)          | (1,678)        |
| Proceeds from notes payable, convertible debt                               | 750,000        | 1,615,000      |
| Payments on notes payable, other  | (326,439)      | (5,500)        |
| Net proceeds from notes payable, other                                      | 355,000        | -              |
| Payments on line of credit  | (600)          | -              |
| Net proceeds from issuance of common stock                                  | 271,761        | -              |
| Net cash provided by financing activities                                   | 1,049,315      | 1,607,822      |

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|   |              |              |
|---|--------------|--------------|
| Net (decrease) increase in cash   | (236,894)    | 30,585       |
| Cash, beginning   | 270,910      | 91,205       |
| Cash, ending  | \$ 34,016    | \$ 121,790   |
| Supplemental disclosure of cash flow information:                       |              |              |
| Cash paid for interest  | \$ 15,463    | \$ 24,409    |
| Supplemental disclosure of non-cash investing and financing activities: |              |              |
| Common shares issued in exchange for debt and accrued liabilities       | \$ 1,394,409 | \$ 1,482,943 |
| Common shares and warrants issued in connection with notes payable      | \$ 100,000   | \$ 385,980   |
| Conversion of accrued expenses to common stock                          |              | \$ 35,000    |

The accompanying notes are an integral part of these financial statements

**NIGHTHAWK SYSTEMS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2007 AND 2006**

**1. ORGANIZATION, GOING CONCERN AND MANAGEMENT'S PLANS**

**INTERIM FINANCIAL STATEMENTS**

The accompanying unaudited condensed consolidated financial statements of Nighthawk Systems, Inc. (the Company or Nighthawk ) have been prepared in accordance with the instructions to quarterly reports on Form 10-QSB. In the opinion of Management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and changes in financial position at September 30, 2007, and for all periods presented have been made. Certain information and footnote data necessary for fair presentation of financial position and results of operations in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted. It is therefore suggested that these financial statements be read in conjunction with the summary of significant accounting policies and notes to financial statements included in the Company's Annual Report on Form 10-KSB. The results of operations for the three and nine month periods ended September 30, 2007, are not necessarily an indication of operating results for the full year.

**ORGANIZATION**

The Company designs and manufactures intelligent wireless power control products that enable simultaneous activation or de-activation of multiple assets or systems on demand. Nighthawk's installed customer base includes major electric utilities, internet service providers and fire departments in over 40 states.

The unaudited condensed consolidated financial statements of the Company also include its non-operating subsidiary, Peregrine Control Technologies, Inc. Intercompany accounts and transactions have been eliminated in consolidation.

**GOING CONCERN AND MANAGEMENT'S PLANS**

The Company incurred a net loss of approximately \$2.3 million during the nine month period ended September 30, 2007, and had a working capital deficiency of approximately \$2.7 million and a stockholders' deficit of approximately \$2.1 million as of September 30, 2007. The Company's ability to continue as a going concern depends on the success of management's plans to overcome these conditions and ultimately achieve profitability and positive cash flows from operations.

Effective October 9, 2007, the Company sold 600,000 shares of Series B convertible preferred stock and a warrant to purchase up to 10 million shares of common stock for aggregate proceeds of \$ 6 million; this sales was made to Dutchess Private Equities Fund, Ltd. ( Dutchess ). On October 11, 2007, approximately \$4,750,000 of the proceeds from the sale of the preferred stock were used to purchase the Internet Protocol Television set-top box ( IPTV Set-Top Box ) operations of Eagle Broadband, Inc. ( Eagle Broadband ) a publicly-traded company (Note 5). The remaining proceeds, net of administrative costs of approximately \$300,000, remained with the Company for use in funding the Company's operations, including the newly-acquired IPTV Set-Top Box operations, going forward.

The Company expects the investment from Dutchess and subsequent acquisition of the IPTV Set-Top Box operations to strengthen its financial position and positively impact the financial results of the Company going forward. While no assurance can be given that this will be the case, the Company anticipates that net cash flows from the set-top box operations going forward will reduce the ongoing funding needs of the Company and enhance its ability to continue as a going concern.

In 2004, the Company signed an investment agreement under which Dutchess agreed to purchase up to \$10.0 million in common stock from the Company, at the Company's discretion, subject to certain limitations including the Company's current stock trading volume (Note 3). Although the amount and timing of specific cash infusions available under the Dutchess financing arrangement cannot be predicted with certainty, the arrangement represents a contractual commitment by Dutchess to provide funds to the Company. Since entering into the arrangement with Dutchess, the Company has received approximately \$5.0 million from Dutchess under this agreement, which has been used to cover the Company's operating cash flow deficits. The investment agreement, unless extended by mutual agreement, is scheduled to expire in December 2007. Although no assurance may be given that it will be able to do so, the Company expects to be able to continue to access funds if needed under this arrangement through December 2007.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of assets or the amounts of liabilities that might be necessary should the Company be unsuccessful in implementing these plans, or otherwise be unable to continue as a going concern.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

### **CONCENTRATIONS**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. Receivables arising from sales to customers are not collateralized and, as a result, management continually monitors the financial condition and its relationships with its customers to reduce the risk of loss. The maximum loss that might be sustained if customer receivables are not collected is limited to the carrying amount of the accounts receivable, net of the allowance for doubtful accounts. Approximately \$200,516 of the September 30, 2007 balance, or 74%, was from four customers, all of which was collected subsequent to September 30, 2007.

During the three months ended September 30, 2007, five customers accounted for approximately 21%, 17%, 15%, 10% and 10% of total revenue, respectively, and during the nine months ended September 30, 2007, three customers accounted for approximately 15%, 13% and 11% of total revenue, respectively. During the three months ended September 30, 2006, two customers accounted for approximately 32% and 14% of total revenue, respectively, and during the nine months ended September 30, 2006, one customer accounted for approximately 12% of total revenue.

During the three months ended September 30, 2007, the Company's three largest suppliers accounted for approximately 41%, 25%, and 19% respectively, of the Company's purchases of pre-manufactured component materials, and during the nine months ended September 30, 2007, the Company's four largest suppliers accounted for approximately 41%, 24%, 13% and 10% of the Company's purchases of pre-manufactured component materials. During the three months ended September 30, 2006, the Company's two largest suppliers accounted for approximately 38% and 18%, respectively, of the Company's purchases of pre-manufactured component materials, and during the nine months ended September 30, 2006, the Company's three largest suppliers accounted for

approximately 46%, 14% and 14% of the Company's purchases of pre-manufactured component materials. As the pre-manufactured components are a crucial integral component of the Company's product, the loss of one or more of the Company's major suppliers could have an adverse effect on the Company's ability to maintain production of its products on a cost effective basis in the future.

## **NET LOSS PER SHARE**

Basic net loss per share is computed by dividing the net loss applicable to common stockholders by the weighted-average number of shares of common stock outstanding for the year. Diluted net loss per share reflects the potential dilution that could occur if dilutive securities were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, unless the effect of such inclusion would reduce a loss or increase earnings per share. For each of the periods presented in the accompanying financial statements, the effect of the inclusion of dilutive shares would have resulted in a decrease in loss per share. Common stock options and warrants aggregating 18,491,666 and 6,635,000 as of September 30, 2007 and 2006, respectively, have been excluded from the calculation of loss per common share.

**RECENT ACCOUNTING PRONOUNCEMENT**

In July 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No.48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109* ( FIN 48 ) which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. The Company adopted FIN 48 for the fiscal year beginning January 1, 2007. The Company did not have any unrecognized tax benefits and there was no effect on The Company's financial condition or results of operations as a result of implementing FIN 48. The Company files income tax returns in the U.S. federal and state of Colorado jurisdictions. The Company is no longer subject to tax examinations for years before 2004, and management does not believe there will be any material changes in the Company's unrecognized tax positions over the next 12 months. The Company recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized by the Company during the quarter related to unrecognized tax benefits. The Company's effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses and is offset somewhat by state tax credits.

**3. NOTES PAYABLE**

At September 30, 2007, notes payable consist of the following:

|   |              |
|---|--------------|
| Convertible notes payable to Dutchess; substantially all notes at 10% interest; maturing between December 2009 and October 2011; net of discount of \$957,787 | \$ 1,802,391 |
| Other:  |              |
| Note payable; unsecured; interest at prime rate plus 5.5% (13.99% at September 30, 2007); due on demand   | \$ 8,835     |
| Convertible notes payable to stockholder, interest at 8%, in default and due on demand, collateralized by all assets of the Company <sup>(1)</sup>            | 125,000      |
| Note payable to Dutchess, collateralized by accounts receivable, interest at 3%, paid in November, 2007 <sup>(2)</sup>  | 185,000      |
| Unsecured note with a financial institution, 18.24% interest rate, interest and principal due monthly through November 2008                                   | 6,827        |
|   | \$ 325,662   |

(1) In January 2007, the Company paid \$150,000 to the stockholder to reduce the amount outstanding on one of the notes. In July 2007, the stockholder converted \$50,000 into 555,556 shares of common stock of the Company, and agreed to extend the maturity dates of the notes. In October 2007, the stockholder converted an additional \$50,000 outstanding on the notes into an additional 625,000 shares of common stock of the Company. As of the date of this report, the Company is still in discussions with the stockholder in an effort to determine the new maturity dates.

(2) During June 2007, the Company received \$170,000 from Dutchess in exchange for a \$170,000 promissory note. The Company expensed \$10,000 in legal costs associated with this transaction to Dutchess. The note was collateralized by approximately \$191,000 in accounts receivable, and was paid in full by the Company in August 2007. During September 2007, the Company received \$185,000 from Dutchess in exchange for a \$185,000 promissory note. The Company expensed \$5,000 in legal costs associated with this transaction to Dutchess. The note was collateralized by approximately \$217,000 in accounts receivable, and was paid in full by the Company in November 2007.



In June 2007, the Company entered into a \$500,000, 10%, unsecured convertible debenture with Dutchess which is due in June 2012. The Company paid \$40,000 to Dutchess in legal and administrative costs associated with the issuance of the note, the total of which is being amortized over the term of the note. The note is convertible at any time into shares of the Company's common stock at 70% of the market price of the Company's common stock on the date of conversion. The Company recorded a beneficial conversion feature of \$214,286 related to this debenture. Along with the debenture, the Company issued a five-year warrant, valued at \$100,000 based on a Black-Scholes option pricing model, to purchase 1,000,000 shares of common stock at \$0.001 per share.

In September 2007, the Company entered into a \$260,000, 10% unsecured convertible debenture with Dutchess which was due in September 2012. The Company paid \$10,000 to Dutchess in legal and administrative costs associated with the issuance of the note, which was recorded as a reduction to the amount owed under the debenture. Proceeds from the debenture were used to make a deposit of \$250,000 with Eagle Broadband (Note 5). When the acquisition occurred in October 2007, Dutchess canceled the \$260,000 debenture and rolled the amount into its \$6 million purchase of Series B convertible preferred stock. The deposit was applied to the purchase price of the assets acquired.

During the nine months ended September 30, 2007, approximately \$758,620 of debentures were converted into 21,072,767 shares of the Company's common stock. Total interest expense during the nine months ended September 30, 2007 related to the Dutchess debentures, which included amortization of the discount and \$80,998 of early redemption penalties was \$819,232, which represented an effective interest rate of 40%. Total interest expense during the nine months ended September 30, 2006 related to the Dutchess debentures, which included amortization of the discount and \$36,250 of early redemption penalties was \$881,501, which represented an effective interest rate of 48%.

All of the convertible notes payable to Dutchess at September 30, 2007, contain a clause calling for an early redemption penalty of 20%. In addition, although Dutchess has not provided any indication it will do so, each of the convertible debenture agreements contain a provision under which Dutchess may request the Company to make amortizing payments on a monthly basis in an amount to be determined by the Company and Dutchess. As such, the total amount of debentures outstanding is classified as a current liability. The total amount of discount amortized to interest expense during the nine months ended September 30, 2007 and 2006 was \$416,693 and \$254,280, respectively (\$74,671 and \$54,680 during the three months ended September 30, 2007 and 2006, respectively).

Subsequent to September 30, 2007, Dutchess converted an additional \$328,000 of debentures into 9,111,112 shares of the Company's common stock.

#### **4. STOCKHOLDERS' DEFICIT**

##### **COMMON STOCK**

During the nine months ended September 30, 2007, the Company issued Dutchess 3,661,529 shares of common stock in exchange for cash of \$251,261 and 5,985,505 shares of common stock in order to reduce the amount of convertible debt and accrued interest owed to them by \$398,373. The Company accrued \$32,482 in commissions related to these transactions. Dutchess also converted \$758,620 of a convertible debenture into 21,072,767 shares of common stock during the period.

## **STOCK-BASED COMPENSATION**

No options were granted during the three-month period ended September 30, 2007. The estimated fair value of options granted during the nine month period ended September 30, 2007, as well as during the three and nine-month periods ended June 30, 2006, were calculated using the following estimated weighted average assumptions:

|  | Three months ended September 30, |               | Nine months ended September 30, |               |
|--|----------------------------------|---------------|---------------------------------|---------------|
|  | 2007                             | 2006          | 2007                            | 2006          |
| Stock options granted                  | -                                | 4,150,000     | 4,450,000                       | 4,450,000     |
| Weighted-average exercise price        | -                                | \$ 0.08       | \$ 0.07                         | \$ 0.08       |
| Weighted-average grant date fair value | -                                | \$ 0.02       | \$ 0.04                         | \$ 0.02       |
| Assumptions:                           |                                  |               |                                 |               |
| Expected volatility                    | -                                | 1.246%-1.261% | 1.27%                           | 1.246%-1.303% |
| Expected term (in years)               | -                                | 2 years       | 1-2 years                       | 2 years       |
| Risk-free interest rate                | -                                | 4.50%         | 4.50%                           | 4.50%         |
| Dividend yield                         | -                                | 0%            | 0%                              | 0%            |

Most of the employee options vest over three years, which is considered to be the requisite service period. Stock options issued in exchange for consultant services vest over the period defined in the contract. During the nine month period ended September 30, 2007, two employees, including the Company's Chief Executive Officer, were granted a total of 3,500,000 options, one third of which vested immediately, one third of which vested on June 30, 2007 and one third of which vest on December 31, 2007. The Company's board member was also awarded 500,000 options, half of which vested immediately, and half of which vest in January 2008.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option.

The Company currently expects, based on an analysis of historical forfeitures as of December 31, 2006, that approximately 90% of our options will actually vest, and therefore have applied a forfeiture rate of 10% per year to all unvested options as of September 30, 2007. This analysis will be re-evaluated periodically and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Expected volatilities are based on the historical volatility of the price of our common stock. The expected term of options is derived based on the sum of the vesting term plus the original option term, divided by two.

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A summary of stock option activity of options to employees and directors for the nine months ended September 30, 2007, is presented below:

|                                      | <b>Shares Under<br/>Option</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> | <b>Weighted Average<br/>Remaining<br/>Contractual Life<br/>(Years)</b> | <b>Aggregate<br/>Intrinsic Value</b> |
|--------------------------------------|--------------------------------|--|--|--------------------------------------|
| Outstanding at January 1,<br>2007    | 8,035,000                      | \$ 0.10  |  | \$                                   |
| Granted                              | 4,450,000                      | 0.07   |  |                                      |
| Exercised                            | (250,000)                      | 0.08   |  |                                      |
| Forfeited                            | (500,000)                      | 0.20   |  |                                      |
| Outstanding at September<br>30, 2007 | 11,735,000                     | \$ 0.09  | 6.0  | \$ 194,667                           |
| Exercisable at September<br>30, 2007 | 9,068,333                      | \$ 0.09  | 5.1  | \$ 111,113                           |

As of September 30, 2007, there were 2,666,667 non-vested options outstanding that had a weighted average exercise price of \$0.06 and a weighted average grant date fair value of \$0.04 per share. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between our closing stock price on September 30, 2007 of \$0.10 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders, had all option holders been able to and in fact, had exercised their options on September 30, 2007.

## **5. SUBSEQUENT EVENTS EQUITY FINANCING AND ACQUISITION OF IPTV SET-TOP BOX OPERATIONS**

### **EQUITY FINANCING**

Effective October 9, 2007, the Company sold to Dutchess 600,000 shares of unregistered, Series B convertible preferred stock for \$10 per share (the Series B ), along with a warrant to purchase up to 10 million shares of the Company's common stock. The sale of this Series B preferred stock and warrants was for \$6 million cash.

The Series B preferred shares provide for cumulative annual dividends at 12%, payable in cash or shares of Series B preferred stock, at the sole option of the holder. Preferred shares are convertible at the option of the holder into shares of the Company's common stock, where the number of conversion shares shall be equal to the greater of (i) Thirteen Dollars (\$13.00) worth of common stock based on the lowest closing bid price of the Company's stock during the twenty day trading period immediately preceding the date of the conversion notice, or (ii) one hundred (100) shares of common stock.

The warrant has a term of seven years and provides for the option to purchase up to 10 million shares of the Company's common stock at \$0.05 per share on cash-less exercise basis.

### **ACQUISITION OF IPTV SET-TOP BOX OPERATION**

Effective October 11, 2007, the Company acquired the IPTV Set-Top Box operations of Eagle Broadband, a Houston, Texas-based publicly-traded company for cash of \$4,750,000 (of which \$250,000 was paid as a deposit as of September 30, 2007).

The IPTV Set-Top Box operation designs and manufactures an advanced line of set-top boxes that are utilized to deliver high-definition multi-media content and applications to the hospitality industry. The assets acquired consist primarily of technical parts, supplies, inventory and equipment directly associated with this business, net of certain assumed liabilities. This acquisition was made primarily to enhance the future cash flows of the Company in and

effort to reduce or eliminate monthly operating cash flow deficits.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **FORWARD-LOOKING STATEMENTS**

This management's discussion and analysis of results of operations and financial condition contains forward-looking statements that involve risks and uncertainties. In some cases, you can identify these statements by forward-looking words such as "may," "might," "will," "should," "expect(s)," "plan(s)," "anticipate(s)," "believe(s)," "estimate(s)," "predict(s)," "intend(s)," "potential" and similar expressions. All of the forward-looking statements contained in this report are based on estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market and other factors. Although we believe such estimates and assumptions are reasonable, they are inherently uncertain and involve risks and uncertainties. In addition, management's assumptions about future events may prove to be inaccurate. We caution you that the forward-looking statements contained in this report are not guarantees of future performance and we cannot assure you that such statements will be realized. In all likelihood, actual results will differ from those contemplated by such forward-looking statements as a result of a variety of factors, including, but not limited to, those factors discussed in our Form 10-KSB as filed on April 18, 2007. Except as required by law, we undertake no obligation to update any of these forward-looking statements.

The following information should be read in conjunction with the unaudited condensed consolidated financial statements included herein which are prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information.

### **GENERAL**

The Company designs and manufactures intelligent remote monitoring and power control products that are easy to use, inexpensive and can remotely control virtually any device from any location. Our proprietary, wireless products are ready to use upon purchase, so they are easily installed by anyone, regardless of technical ability, and are also easily integrated into third-party products, systems and processes. They allow for intelligent control by interpreting instructions sent via paging and satellite media, and executing the instructions by switching the electrical current that powers the device, system or process. Our intelligent products can be activated individually, in pre-defined groups, or en masse, and for specified time periods with a simple click of a mouse or by dialing a telephone number.

Our products have been uniquely designed and programmed to be simple and ready to use upon purchase by anyone, almost anywhere, at affordable prices. As such, it is the Company's goal to have its products become commonplace, accepted and used by businesses and consumers alike in their daily routines.

We save consumers and businesses time, effort and expense by eliminating the need for a person to be present when and where an action needs to be taken. By utilizing existing wireless technology, we give our users the flexibility to move their application from place to place, without re-engineering their network. Currently, most commercial control applications utilize telephone lines, which tether the system to a single location and have associated installation and monthly charges. Our products make companies more profitable by eliminating installation costs and monthly charges for telephone lines, and allow for remote control of unmanned or remote locations that may operate on traditional electrical power, or solar or battery generated power.

Applications for our intelligent products include, but are not limited to:

- Rebooting remotely located computer equipment
- Remote switching of residential power
- Managing power on an electrical grid
- Activation/deactivation of alarm and warning devices
- Displaying or changing a digital or printed message or warning sign
- Turning pumps on or off
- Turning heating or cooling equipment on or off



Companies both large and small are seeking ways to save money and lower the risk of liability by replacing processes that require human intervention with processes that can be controlled remotely without on-site human intervention. Today, the remote control of industrial or commercial assets and processes is performed mainly through the use of telephone-line based systems. Opportunities exist for companies that provide intelligent wireless solutions, as telephone lines are expensive and limited in availability and function. Nighthawk's products are wireless, and can be designed to work with a variety of wireless media. The number of applications for wireless remote control is virtually limitless. The Company has identified primary markets (Utility, IT Professional, Traffic Control), as well as secondary markets (Irrigation, Outdoor Advertising, Oil/Gas, Security) for its products.

On October 11, 2007, the Company entered into an Asset Purchase Agreement (the Agreement) with Eagle Broadband, Inc. (Eagle Broadband), pursuant to which Nighthawk purchased from Eagle Broadband, and Eagle Broadband sold and transferred to Nighthawk, all right, title, and interest in and to Eagle Broadband's set-top box business. The set-top box business purchased by Nighthawk allows for the delivery of High Definition, IP-based television and Internet services to the Hospitality industry. The purchase price was \$4,750,000 which was paid on the closing date of the Acquisition, which was October 12, 2007. Nighthawk assumed certain liabilities of Eagle Broadband relating to the Business.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENT**

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No.48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109* (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. We adopted FIN 48 for the fiscal year beginning January 1, 2007. We did not have any unrecognized tax benefits and there was no effect on our financial condition or results of operations as a result of implementing FIN 48. We file income tax returns in the U.S. federal and state of Colorado jurisdictions. We are no longer subject to tax examinations for years before 2004. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months. Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the quarter related to unrecognized tax benefits. Our effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses and is offset somewhat by state tax credits.

#### **COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 30, 2007 AND SEPTEMBER 30, 2006**

**Revenue**

The components of revenue and their associated percentages of total revenues, for the three months ended September 30, 2007 and 2006 are as follows:

|                    | <u>2007</u> |         | <u>2006</u> |    | <u>\$</u>     |      | <u>%</u>      |          |      |
|--------------------|-------------|---------|-------------|----|---------------|------|---------------|----------|------|
|                    |             |         |             |    | <u>Change</u> |      | <u>Change</u> |          |      |
| Utility products   | \$          | 314,440 | 85%         | \$ | 125,804       | 54%  | \$            | 188,636  | 150% |
| Rebooting products |             | 20,197  | 6%          |    | 57,847        | 25%  |               | (37,650) | -65% |
| Logic boards       |             | 14,550  | 4%          |    | 24,555        | 11%  |               | (10,005) | -41% |
| Airtime            |             | 11,435  | 3%          |    | 10,628        | 5%   |               | 807      | 8%   |
| Other              |             | 8,233   | 2%          |    | 12,876        | 5%   |               | (4,643)  | -36% |
| Total Revenues     | \$          | 368,855 | 100%        | \$ | 231,710       | 100% | \$            | 137,145  | 59%  |

Revenues for the three-month period ended September 30, 2007 were \$368,855 as compared to \$231,710 for the prior year, an increase of 59% between periods. Sales of the Company's utility products, primarily its CEO700 remote disconnect product, increased 150% or \$93,436 between the periods presented. The Company sold and produced more CEO700's during the quarter ending September 30, 2007 than in any previous quarter in the Company's history. Sales of these products constituted 85% of all revenues generated during the three month period ended September 30, 2007. In an effort to streamline operations and to improve results, Company management has focused more marketing and sales effort towards electric utilities as the utilities continue to look for ways to automate tasks. The Company feels that it can generate more and larger sales from the electric utility sector. The Company has also worked to assemble a network of resellers and distributors during 2007 that have started generating orders for the CEO700 product. Sales of the Company's other products declined between the periods presented as less marketing dollars and sales effort was spent on these products. Going forward, it is the Company's intention in the near term to focus sales and marketing efforts, and therefore financial resources, for power control products on its utility products division, which management believes affords the Company the best opportunity to produce sales volumes sufficient to produce positive cash flows.

Airtime sales, generated on a recurring basis by the Company by reselling access to wireless networks, increased 8% from the third quarter of 2006 to the 2007 period. The increase in airtime revenues is a direct result of more of the Company's units being purchased and placed into operation by customers.

Cost of revenues includes parts and pre-manufactured components used to assemble our products as well as allocated overhead for production personnel and facilities costs. Cost of revenues increased by \$140,093 or 102% to \$276,783 for the three months ended September 30, 2007 from \$136,690 for the corresponding period of the prior year and increased as a percentage of revenues between the periods from 59% in 2006 to 75% in 2007. As a result, the Company's gross margin decreased between the periods from 41% to 25%. As a result of increasing sales of its CEO700 units, the Company utilized a third-party manufacturer to build its CEO700 product for the first time in its history during the third quarter of 2007. By doing so, the Company was able to produce units more quickly after orders were received, allowing the Company to both sell and produce more CEO700's during the three month period ending September 30, 2007 than in any previous fiscal quarter. Because these production runs were done by an outside party for the first time, they were done on a test basis, with final testing of the units still performed by the Company's own in-house production personnel. Going forward, if sales volumes of the CEO700 continue to increase, it is the Company's desire to have the units built, tested and shipped by outside manufacturers on a reduced per-unit cost basis. However, during the quarter ended September 30, 2007, the Company still maintained a full in-house production staff. As a result, total direct labor costs associated with producing the Company's CEO 700's was higher than normal, and overall gross margins on product sales declined. The Company expects this cost of production to go down if sales of the CEO700's continue to increase and third party manufacturers assume responsibility for full production of the units. In addition, the Company is currently developing new printed circuit boards for its core products for use in 2008. These new boards will be incorporated into several of the Company's core products, including the CEO700. While these boards will enhance the capabilities of the Company's products, the Company also expects to be able to build such boards on a lower per unit cost basis.

Selling, general and administrative expenses for the three months ended September 30, 2007 decreased by \$86,967 or 16% from the three-month period ended September 30, 2006. This decrease was due primarily to decreases in expenses associated with consulting services utilized by the Company in 2006 which have not been utilized in 2007, as well as a decrease in legal costs between the periods presented. These decreases more than offset approximately \$39,000 in noncash expenses associated with options previously awarded to employees, as well as to a

Company board member, that was recognized during the 2007 period.

Interest expense increased \$65,160, or 45%, between the periods presented. During the last quarter of 2006, the Company entered into several convertible debentures with Dutchess on which the Company is recognizing non-cash interest expense on a monthly basis for the beneficial conversion feature and incentive warrants associated with these debentures. The Company also recognized approximately \$20,000 in expense related to factoring arrangements entered into during the three-month period ended September 30, 2007.

The net loss to common shareholders for the three-month period ended September 30, 2007 was \$586,892 compared to \$605,751 for the three-month period ended September 30, 2006.

**COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND SEPTEMBER 30, 2006****Revenue**

The components of revenue and their associated percentages of total revenues, for the nine months ended September 30, 2007 and 2006 are as follows

|                                 | <u>2007</u> |         | <u>2006</u> |    | \$            | %             |    |          |      |
|---------------------------------|-------------|---------|-------------|----|---------------|---------------|----|----------|------|
|                                 |             |         |             |    | <u>Change</u> | <u>Change</u> |    |          |      |
| Utility products                | \$          | 652,130 | 71%         | \$ | 337,329       | 54%           | \$ | 314,801  | 93%  |
| Rebooting products              |             | 71,652  | 8%          |    | 139,563       | 22%           |    | (67,911) | -49% |
| Logic boards                    |             | 121,359 | 13%         |    | 60,930        | 10%           |    | 60,429   | 99%  |
| Emergency notification products |             | 19,414  | 2%          |    | 44,126        | 7%            |    | (24,712) | -56% |
| Airtime                         |             | 38,628  | 4%          |    | 27,755        | 4%            |    | 10,873   | 39%  |
| Other                           |             | 17,377  | 2%          |    | 15,533        | 3%            |    | 1,844    | 12%  |
| Total Revenues                  | \$          | 920,560 | 100%        | \$ | 625,236       | 100%          | \$ | 295,324  | 47%  |

Revenues for the nine-month period ended September 30, 2007 were \$920,560 as compared to \$625,236 for the prior year, an increase of 47% between periods. Sales of the Company's utility products, primarily its CEO700 remote disconnect product, increased 93% or \$314,801 between the periods presented, and sales of the Company's PT1000 logic boards increased 99% or \$60,429 between the periods presented. Sales of the Company's utility products constituted 71% of all revenues generated during the six month period ended September 30, 2007. In an effort to streamline operations and to improve results, Company management has focused more marketing and sales effort towards electric utilities as the utilities continue to look for ways to automate tasks. The Company feels that it can generate more and larger sales from the electric utility sector. The Company has also worked to assemble a network of resellers and distributors during 2007 that have started generating orders for the CEO700 product. Sales of the Company's logic boards increased between the periods presented largely due to two particular sales made during the 2007 period, one of which was \$61,625 and the other of which was for \$21,000. Sales of the Company's other primary product, the NH100 rebooting unit, decreased between the periods presented, as did sales of emergency notification products. Going forward, it is the Company's intention in the near term to focus sales and marketing efforts on its utility products division, which management believes affords the Company the best opportunity to produce sales volumes sufficient to produce positive cash flows.

Airtime sales, generated on a recurring basis by the Company by reselling access to wireless networks, increased 39% from the first nine months of 2006 to the 2007 period. The increase in airtime revenues is a direct result of more of the Company's units being purchased and placed into operation by customers.

Cost of revenues includes parts and pre-manufactured components used to assemble our products as well as allocated overhead for production personnel and facilities costs. Cost of revenues increased by \$240,164 or 60% to \$641,147 for the nine months ended September 30, 2007 from \$400,983 for the corresponding period of the prior year, and increased slightly as a percentage of revenues between the periods from 64% in 2006 to 70% in 2007. In spite of the decline in the gross margin between the periods from 36% to 30%, the Company produced more margin dollars during the three month period ended September 30, 2007 than it did in the previous year's period due to the increased number of units sold and produced. As a result of increasing sales of its CEO700 units, the Company utilized a third-party manufacturer to build its CEO700 product for the first time in its history during the third quarter of 2007.

By doing so, the Company was able to produce units more quickly after orders were received, allowing the Company to both sell and produce more CEO700's during the three month period ending September 30, 2007 than in any previous fiscal quarter. Because these production runs were done by an outside party for the first time, they were done on a test basis, with final testing of the units still performed by the Company's own in-house production personnel.

Going forward, if sales volumes of the CEO700 continue to increase, it is the Company's desire to have the units built, tested and shipped by outside manufacturers on a reduced per-unit cost basis. However, during the quarter ended September 30, 2007, the Company still maintained a full in-house production staff. As a result, total direct labor costs associated with producing the Company's CEO 700's was higher than normal, and overall gross margins on product sales declined. The Company expects this cost of production to go down if sales of the CEO700's continue to increase and third party manufacturers assume responsibility for full production of the units. In addition, the Company is currently developing new printed circuit boards for its core products for use in 2008. These new boards will be incorporated into several of the Company's core products, including the CEO700. While these boards will enhance the capabilities of the Company's products, the Company also expects to be able to build such boards on a lower per unit cost basis.

Selling, general and administrative expenses for the nine months ended September 30, 2007 decreased by \$158,036 or 8% from the nine-month period ended September 30, 2006. This decrease was due primarily to decreases in expenses associated with consulting services utilized by the Company as well as a decrease in research and development costs between the periods presented. The Company also recognized less legal fees during the current year period as it decreased the number of associated financing transactions from the 2006 period to the 2007 period. These decreases more than offset approximately \$146,000 in noncash expenses associated with options previously awarded to employees, as well as to a Company board member, that was recognized during the 2007 period.

Interest expense decreased \$44,952 or 5% between the first nine months of 2006 and the first six months of 2007.

During the first nine months of 2006, six Dutchess debentures and notes were paid off prior to their maturity date. When this occurs, the Company expenses any unamortized discount associated with the debt being paid off, as well as any unamortized expense associated with incentive shares issued with the debt and any early redemption penalties. During the first nine months of 2007, only one Dutchess debenture was paid off prior to its maturity date.

The net loss to common shareholders for the nine-month period ended September 30, 2007 was \$2,296,845 compared to \$2,554,993 for the nine-month period ended September 30, 2006.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company's financial statements for three and nine month periods ended September 30, 2007 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business.

The Report of our Independent Registered Public Accounting Firm on the Company's financial statements as of and for the year ended December 31, 2006 includes a "going concern" explanatory paragraph which means that the auditors expressed substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern depends on the success of management's plans to overcome these conditions and ultimately achieve profitability and positive cash flows from operations.



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Effective October 12, 2007, the Company sold \$6 million in unregistered Series B convertible preferred stock, along with a warrant to purchase up to 10 million shares of the Company's common stock at \$0.05 per share, to Dutchess Private Equities Fund, Ltd. (Dutchess). The Series B preferred stock is redeemable, but only at the Company's option. That same day, approximately \$4,750,000 of the proceeds from the sale of the preferred stock were used to purchase the IPTV set-top box operations of Eagle Broadband. The remaining proceeds, net of administrative costs of approximately \$300,000, remained at the Company for use in funding the Company's operations, including the newly-acquired IPTV set-top box operations, going forward.

The Company expects the investment from Dutchess and subsequent acquisition of the set-top box operations to strengthen its financial position and positively impact the financial results of the Company going forward. As part of the transaction, Nighthawk was assigned a purchase contract with a hospitality solutions provider under which the provider has forecasted purchases that could generate in excess of \$6 million in revenues to Nighthawk over a period of approximately one year. The purchase agreement does not commit the solutions provider to purchase units from Nighthawk, but as of the date of this report, the customer has in excess of \$880,000 in orders placed with the Company that have yet to be delivered by the Company. While no assurance can be given that this will be the case, the Company anticipates that net cash flows from the set-top box operations going forward will reduce the ongoing funding needs of the Company and enhance its ability to continue as a going concern.

In 2004, the Company signed an investment agreement with Dutchess under which Dutchess agreed to purchase up to \$10.0 million in common stock from the Company, at the Company's discretion, subject to certain limitations including the Company's then current trading volume (Note 3). Although the amount and timing of specific cash infusions available under the entire financing arrangement cannot be predicted with certainty, the arrangement represents a contractual commitment by Dutchess to provide funds to the Company. Since entering into the arrangement with Dutchess, the Company has received approximately \$5.0 million from Dutchess which has been used to cover its operating cash flow deficits. The investment agreement, unless extended by mutual agreement, is scheduled to expire in December 2007. Although no assurance may be given that it will be able to do so, the Company expects to be able to continue to access funds under this arrangement through December 2007.

As a result of higher sales volumes made during the first nine months of 2007, combined with decreased cash-based selling, general and administrative expenses, cash used in operating activities decreased \$534,389 to \$1,029,565 during the first nine months of 2007 as compared to \$1,563,954 during the first nine months of 2006. In order to cover monthly cash flow deficits during the first nine months of 2007 and shortly thereafter, the Company generated cash proceeds from the exercise of puts to Dutchess totaling \$271,761 during the 2007 period and borrowed \$500,000 under a convertible debenture with Dutchess. In an effort to limit sales of its common stock, the Company also began utilizing factoring arrangements with Dutchess during 2007 to help fund the purchase of parts and inventory. During the first nine months of 2007, the Company borrowed \$355,000 under factoring arrangements, of which \$170,000 had been paid back as of September 30, 2007. The Company paid down \$150,000 in debt owed to one of its creditors during the 2007 period utilizing cash on hand.

In September 2007, the Company entered into a \$260,000, 10% unsecured convertible debenture with Dutchess which was due in September 2012. The Company paid \$10,000 to Dutchess in legal and administrative costs associated with the issuance of the note, which has recorded as a reduction to the amount owed under the debenture. Proceeds from the debenture were used to make a deposit of \$250,000 with Eagle Broadband as called for in a Letter of Intent to

purchase the set-box assets from Eagle Broadband. See Footnote 1. When the acquisition took place on October 12, 2007, Dutchess canceled the \$260,000 debenture and rolled the proceeds from the note into its \$6 million purchase of Series B Convertible Preferred Stock. The deposit was applied to the purchase price of the assets acquired.

The Company issued 5,985,505 shares to Dutchess during the nine-month period ended September 30, 2007 which was used to pay down \$398,373 in debt and accrued interest during the period, and converted \$758,620 in notes payable to Dutchess into 21,072,767 shares of common stock. Subsequent to September 30, 2007, Dutchess converted an additional \$328,000 of debentures into 9,111,112 shares of the Company's common stock.

Until the Company is able to generate positive cash flows from operations in an amount sufficient to cover its current liabilities and debt obligations as they become due, it will remain reliant on borrowing funds from or selling equity to Dutchess or other parties to meet those obligations. Although the amount and timing of specific cash infusions available under the entire financing arrangement cannot be predicted with certainty, the arrangement represents a contractual commitment by Dutchess to provide funds to the Company.

## **CRITICAL ACCOUNTING ESTIMATES**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP), which requires management to make estimates and assumptions that affect reported amounts and related disclosures. Management identifies critical accounting estimates as:

-

Those that require the use of assumptions about matters that are inherently and highly uncertain at the time the estimates are made; and

-

Those for which changes in the estimate or assumptions, or the use of different estimates and assumptions, could have a material impact on our consolidated results of operations or financial condition.

Management has discussed the development, selection and disclosure of our critical accounting estimates with the Board of Directors. For a description of our critical accounting estimates that require us to make the most difficult, subjective or complex judgments, please see our Annual Report on Form 10-KSB for the year ended December 31, 2006. We have not changed these policies from those previously disclosed.

## **ITEM 3. CONTROLS AND PROCEDURES**

### **(a) Evaluation of Disclosure Controls and Procedures:**

The Company's management, including the Company's principal executive officer and principal accounting and financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the periods covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal executive officer and principal financial and accounting officer have concluded that the disclosure controls and procedures were effective as of September 30, 2007 to provide reasonable assurance that material information relating to the

Company is made known to management including the CEO.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

The Company is in default on three loans from Mr. Revesz, a former board member, as of the date of this report and is in discussions to extend the maturity dates on those notes.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS AND REPORTS**

(a) Exhibits

31.1

Certification of H. Douglas Saathoff, Chief Executive Officer and Principal Financial and Accounting Officer, pursuant to Rule 13A-14 or 15D-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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Certification pursuant to the 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

None

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NIGHTHAWK SYSTEMS, INC.**

(Registrant)

Date: November 14, 2007

By: /s/ H. Douglas Saathoff

H. Douglas Saathoff

Chief Executive Officer

Principal Accounting and Financial Officer