

VIISAGE TECHNOLOGY INC
Form 10-Q/A
June 21, 2004

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

FORM 10-Q/A

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

For the Quarterly Period Ended March 28, 2004.

OR

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

For the Transition Period from _____ to _____.

Commission File Number 000-21559

VIISAGE TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

296 Concord Road, Third Floor, Billerica, MA
(Address of principal executive offices)

Registrant's telephone number, including area code

04-3320515
(I.R.S. Employer
Identification No.)

01821
(Zip Code)

(978) 932-2200

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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 No

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding at May 10, 2004</u>
Common stock, \$.001 par value	35,777,841

EXPLANATORY NOTE

This Form 10-Q/A of Viisage Technology, Inc. is being filed for the purpose of including certain pro forma information with respect to our acquisitions of ZN Vision Technologies AG and Trans Digital Technologies Corporation in Note 6 of our financial statements for the quarters ended March 28, 2004 and March 30, 2003. This amendment has no impact on any other portion of our financial statements for such periods.

PART 1 FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

VIISAGE TECHNOLOGY, INC.**Consolidated Balance Sheets**

(in thousands)

	March 28, 2004 <u>(Unaudited)</u>	*December 31, 2003 <u></u>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 9,282	\$ 6,666
Accounts receivable	9,343	7,057
Inventories and other costs and estimated earnings in excess of billings	4,647	4,050
Other current assets	1,162	439
	<u>24,434</u>	<u>18,212</u>
Total current assets	24,434	18,212
Property and equipment, net	24,810	25,088
Goodwill	63,613	
Intangible assets, net	18,519	2,693
Restricted cash	3,120	6,311
Other assets	796	2,176
	<u>\$ 135,292</u>	<u>\$ 54,480</u>
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 11,051	\$ 6,851
Current portion of project financing	4,175	3,734
Current portion of related party notes	6,765	1,740
	<u>21,991</u>	<u>12,325</u>
Total current liabilities	21,991	12,325
Project financing	7,013	5,813
Related party notes	13,470	2,334
Other liabilities	622	
	<u>43,096</u>	<u>20,472</u>
Total liabilities	43,096	20,472
Shareholders equity	92,196	34,008
	<u>\$ 135,292</u>	<u>\$ 54,480</u>

* Derived from audited financial statements.

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

Viisage Technology, Inc.

Consolidated Statements of Operations

(in thousands, except per share data)

(Unaudited)

	Three Months Ended	
	March 28, 2004	March 30, 2003
Revenue	\$ 12,259	\$ 8,155
Cost of revenue	8,906	6,789
Gross margin	3,353	1,366
Operating expenses:		
Sales and marketing	1,493	1,411
Research and development	959	945
General and administrative	2,137	1,093
Total operating expenses	4,589	3,449
Operating loss	(1,236)	(2,083)
Interest expense	392	219
Other income	(21)	
Loss before income taxes	(1,607)	(2,302)
Provision for income taxes	25	63
Loss before cumulative effect of change in accounting principle	(1,632)	(2,365)
Cumulative effect of change in accounting principle		(12,131)
Net loss	\$ (1,632)	\$ (14,496)
Basic and diluted net loss per share before cumulative effect of change in accounting principle	\$ (0.05)	\$ (0.12)
Cumulative effect of change in accounting principle	0.00	(0.60)
Basic and diluted net loss per share	\$ (0.05)	\$ (0.72)
Weighted average basic and diluted shares	31,362	20,258

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

VIISAGE TECHNOLOGY, INC.

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	<u>Three Months Ended</u>	
	<u>March 28,</u>	<u>March</u>
	<u>2004</u>	<u>2003</u>
Cash Flows from Operating Activities:		
Net loss	\$ (1,632)	\$ (14,496)
Adjustments to reconcile net loss to net cash provided by operating activities, net of effects of acquisitions:		
Depreciation and amortization	2,279	1,844
Impact of cumulative effect of change in accounting Principle		12,131
Directors fees paid in common stock	120	30
Change in operating assets and liabilities:		
Accounts receivable	828	1,926
Costs and estimated earnings in excess of billings	(273)	6,830
Other current assets	(433)	(371)
Accounts payable and accrued expenses	(303)	(1,457)
	<u>586</u>	<u>6,437</u>
Net cash provided by operating activities		
Cash Flows from Investing Activities:		
Decrease in restricted cash	3,191	291
Additions to property and equipment	(369)	(5,711)
Cash paid for acquisitions, net of cash acquired	(5,227)	
Increase in other assets	(415)	(183)
	<u>(2,820)</u>	<u>(5,603)</u>
Net cash used for investing activities		
Cash Flows from Financing Activities:		
Net proceeds from project financing	4,273	
Principal payments on project financing	(1,771)	(1,297)
Net proceeds from issuance of common stock	2,348	34
	<u>4,850</u>	<u>(1,263)</u>
Net cash provided by (used for) financing activities		
Net increase (decrease) in cash and cash equivalents	2,616	(429)
Cash and cash equivalents, beginning of period	6,666	2,212
	<u>\$ 9,282</u>	<u>\$ 1,783</u>
Cash and cash equivalents, end of period		

Supplemental Cash Flow Information:

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Cash paid during the period for interest	\$ 256	\$ 236
	<u> </u>	<u> </u>
Non Cash Activities:		
Directors fees paid in common stock	\$ 120	\$ 30
	<u> </u>	<u> </u>
Services paid in common stock	\$ 14	\$
	<u> </u>	<u> </u>
Acquisitions paid in common stock	\$ 57,486	\$
	<u> </u>	<u> </u>
Acquisitions paid in related party financing	\$ 15,300	\$
	<u> </u>	<u> </u>
Asset purchased with extended payment terms	\$ 800	\$
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these financial statements

VIISAGE TECHNOLOGY, INC.

Notes to Financial Statements

1. DESCRIPTION OF BUSINESS

We deliver advanced technology identity solutions for governments, law enforcement agencies and businesses concerned with enhancing security, reducing identity theft, providing access control, and protecting personal privacy. We focus on identity solutions for civil identification, criminal identification and border management that improve personal convenience and security, deter fraud, reduce identification program costs, and protect personal privacy. By combining secure document and face recognition biometric technologies that quickly, reliably, and accurately identify individuals in both one-to-one and one-to-many situations, we have created innovative identity solutions. Our goal is to help our customers solve three critical aspects of verifying and managing identities:

assurance that an identification document is authentic,
confidence that the person holding the identification document is uniquely tied to and authorized to use the document, and
verification of the privileges granted to the individual holding the document.

Our business involves two closely-related segments: secure credentials and biometrics. Our secure credentials solutions involve the design, development, marketing and implementation of integrated software and hardware solutions that produce identification credentials utilizing face recognition and other biometric technologies. The focus of our biometric technology solutions is primarily on applications designed to deter criminal and terrorist activities, including government research and development contracts.

We combine our proprietary biometric and secure credential software and hardware products with complementary industry standard products to create identity solutions that integrate into its customers' environments. These turnkey solutions integrate secure document technologies, image and data capture, relational databases, and multiple biometrics, improving the customer's ability to process and manage identity information. Applications include passports, driver's licenses, voter registration, national identification credentials, law enforcement, social services, access control, surveillance and PC network and Internet access security. Our primary customers are government agencies with particular penetration in U.S. government agencies such as the Department of State and state departments of motor vehicles, social services, and law enforcement. We are the sole source provider of high security technology and services to the U.S. Department of State for the production of U.S. passports and have captured a large percentage of the domestic driver's license market. We also have provided services under subcontracts for projects in the United Arab Emirates, Jamaica, the Philippines and the U.S. Immigration and Naturalization Service.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial data as of March 28, 2004 and December 31, 2003, and for the three month periods ended March 28, 2004 and March 30, 2003, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The December 31, 2003 balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. These financial statements should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2003.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows as of March 28, 2004 and for the three month periods ended March 28, 2004 and March 30, 2003, have been made. The results of operations for the period ended March 28, 2004 are not necessarily indicative of the operating results for the full year.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Stock-Based Compensation

At March 28, 2004, we account for our stock-based compensation plans using the intrinsic value method, in accordance with the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and comply with the disclosure provisions of Statements of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation- Transition and Disclosure*. No stock-based employee compensation cost was reflected in net loss, as all options granted under those plans had an exercise price equal to the fair market value of the underlying common stock on the date of grant.

The following table illustrates, in accordance with the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the effect on net loss and loss per share if we had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	Three Months Ended	
	March 28, 2004	March 30, 2003
Net loss as reported	\$ (1,632)	\$ (14,496)
Add: stock based employee compensation expense included in reported net loss, net of tax		
Deduct: total stock based employee compensation expense determined under the fair value based method for all awards, net of tax	(993)	(602)
Pro forma net loss	\$ (2,625)	\$ (15,098)
Loss per share:		
Basic and diluted as reported	\$ (0.05)	\$ (0.72)
Basic and diluted pro forma	(0.08)	(0.75)

The fair value of the Company's stock-based option awards to employees was estimated assuming no expected dividends and the following weighted-average assumptions:

	<u>March 28, 2004</u>	<u>March 30, 2003</u>
Risk free interest rate	4.0 5.0 %	4.0 5.0 %
Expected dividend yield		
Expected lives	3 10 years	3 10 years
Expected volatility	80%	80%

Computation of Net Loss per Share

The basic net loss per share calculation is computed based on the weighted average number of shares of common stock outstanding during the period. The impact of approximately 5,379,000 shares of common stock consisting of certain outstanding options and stock warrants were not reflected in the March 28, 2004 dilutive net loss per share calculation. The impact of approximately 3,735,000 shares of common stock consisting of certain outstanding options and stock warrants were not reflected in the March 30, 2003 dilutive net loss per share calculation. Potentially dilutive securities are excluded from the calculation of diluted earnings per share if their effect is anti-dilutive.

3. INCOME TAXES

No provision for federal income taxes has been made for the periods ended March 28, 2004 and March 30, 2003 due to the net loss in both periods. The provision for state income taxes for the periods ended March 28, 2004 and March 30, 2003 was approximately \$25,000 and \$63,000, respectively.

4. RELATED PARTY TRANSACTIONS AND SHAREHOLDERS' EQUITY

Lau Technologies, or Lau, and Mr. Buddy Beck beneficially own approximately 17.1% and 16.4%, respectively, of our outstanding common stock. Readers are referred to the Notes to Financial Statements section of the Company's 2003 Annual Report on Form 10-K for further discussion.

In May 2003 we entered into a loan agreement with Lau, whose principals are significant shareholders of Viisage, which provided for four term notes aggregating \$7.3 million but not to exceed an outstanding principal balance of \$7.0 million at any point in time. Two of these term notes, in the amounts of approximately \$1.6 million and \$287,000, replaced existing system finance lease obligations we had with a commercial leasing organization. These finance lease obligations were paid in full with the proceeds of the two new term notes. The remaining two new term notes with borrowing limits of \$3.0 million and \$2.5 million, are additional financing related to two new state contracts. All four new term notes bear interest at a rate of 8.5%. We believe that the terms of this loan agreement are the same as the terms that would have been provided to us by an unaffiliated lender. In particular, the financial covenants under this loan agreement are the same as the financial covenants under our loan agreement with our primary bank lender. We will draw funding on these notes as needed to meet our obligations for equipment purchases on the related state contracts. As of March 28, 2004 we had approximately \$4.9 million outstanding under this loan agreement. Interest expense related to these term notes was approximately \$95,000 for the three months ended March 28, 2004.

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In connection with the acquisition of TDT on February 14, 2004, we issued a promissory note to Mr. Beck in the amount of \$15.3 million, which is secured by some of TDT's assets. This note bears interest at a rate of 8.5% and is payable in equal installments of principal and interest on December 1, 2004, May 1, 2005 and December 1, 2005. We believe that the terms of this loan agreement are the same as the terms that would have been provided to us by an unaffiliated lender. In particular, the financial covenants under this loan agreement are the same as the financial covenants under our loan

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agreement with our primary bank lender. Interest expense related to this note was approximately \$162,000 for the three months ended March 28, 2004.

At March 28, 2004 we had approximately \$184,000 of accounts payable due to Lau.

5. BUSINESS SEGMENTS, GEOGRAPHICAL INFORMATION AND CONCENTRATIONS OF RISK

We follow SFAS No. 131 *Disclosures about Segments of a Business Enterprise and Related Information*, which establishes standards for reporting information about operating segments. Operating segments are defined as components of a company about which separate financial information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

The following table provides financial information by segment for the three months ended March 28, 2004 and March 30, 2003. We allocate direct costs and administrative expenses to each business segment based on management's analysis of each segment's resource needs. Revenue is reported within the segments by customer contracts. Within the secure credentials segment there is a component of the contract that utilizes our biometrics technology. Total assets as of March 28, 2004 include the preliminary allocation of goodwill to the operating segments.

Three months ended March 28, 2004	Secure		
	Credentials	Biometrics	Total
Secure credentials	\$ 10,184	\$	\$ 10,184
Biometrics	336	1,739	\$ 2,075
Total segment revenue	\$ 10,520	\$ 1,739	\$ 12,259
Segment profit (loss) before taxes	\$ 679	\$ (2,286)	\$ (1,607)
Depreciation and amortization	\$ 2,040	\$ 239	\$ 2,279
Interest expense	\$ 392	\$	\$ 392
Total assets	\$ 100,737	\$ 34,555	\$ 135,292
Expenditures for long lived assets	\$ 311	\$ 58	\$ 369

Three months ended March 30, 2003	Secure		
	Credentials	Biometrics	Total
Secure credentials	\$ 6,487	\$	\$ 6,487
Biometrics	314	1,354	\$ 1,668
Total segment revenue	\$ 6,801	\$ 1,354	\$ 8,155
Segment profit (loss) before taxes and cumulative effect	\$ (600)	\$ (1,702)	\$ (2,302)
Depreciation and amortization	\$ 1,690	\$ 154	\$ 1,844
Interest expense	\$ 219	\$	\$ 219
Total assets	\$ 38,930	\$ 5,044	\$ 43,974
Expenditures for long lived assets	\$	\$ 29	\$ 29

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For the three month period ended March 28, 2004 we derived 96.2%, or \$11.7 million, of our direct revenue within the United States. We derived an additional 1.3%, or \$160,000, of our direct revenue in Canada. The remaining 2.5% was

derived by our German subsidiary, primarily from customers in countries within the European Union. Virtually all of our direct revenue for the three month period ended March 30, 2003 was derived within the United States.

We believe for the near future that we will continue to derive a significant portion of our revenues from a limited number of large contracts. Secure identification segment customers who accounted for more than 10% of our total revenues are as follows:

For the three months ended March 28, 2004, one customer accounted for an aggregate of 13.1%
For the three months ended March 30, 2003, two customers accounted for an aggregate of 28%

No single biometrics customer accounted for over 10% of our total revenue in either three month period.

6. ACQUISITIONS

On January 23, 2004 we acquired all outstanding shares of ZN Vision Technologies AG (ZN) in exchange for an aggregate of 5,221,454 newly issued shares of our common stock and \$493.00 in cash. In addition, we agreed to assume ZN's employee share option plan, and accordingly have reserved 1,138,546 shares of our common stock for issuance to the plan participants. The purchase price for the acquisition was \$31.5 million, based on the per share price of our common stock of \$4.32 per share which is the average trading price of Viisage common stock over the five trading days immediately preceding and the two trading days immediately following March 28, 2003, the date on which the purchase agreement was signed. The acquisition was accounted for as a purchase, and accordingly, the operations of ZN are included in the financial statements since the effective date, the close of business on January 23, 2004. The purchase price has been allocated to net assets acquired based on their estimated fair values. We engaged an independent third party appraiser to perform a review of the acquired assets and have allocated the purchase price based on the preliminary results of their findings. The preliminary valuation is subject to further review which may result in adjustments to allocation of purchase price in the future. We have recorded approximately \$74,000 in amortization related to the acquired intangible assets from the date of the acquisition through March 28, 2004. ZN is a leading German provider of face recognition and computer vision products and services. ZN, now known as Viisage Technology AG, is a wholly owned subsidiary of Viisage and serves as the base of our European operations.

On February 14, 2004 we acquired all outstanding shares of Trans Digital Technologies Corporation (TDT) for \$53.4 million. The purchase price consisted of 5,850,000 newly issued shares of our common stock, which were valued at \$5.13 per share, which is the average price of Viisage common stock over the five trading days immediately preceding and the two trading days immediately following February 14, 2004, plus \$15.3 million in notes and \$5 million in cash. The acquisition was accounted for as a purchase, and accordingly, the operations of TDT are included in the financial statements since the effective date, the close of business on February 14, 2004. The purchase price has been allocated to net assets acquired based on their estimated fair values. We engaged an independent third party appraiser to perform a review of the acquired assets and have allocated the purchase price based on the preliminary results of their findings. The preliminary valuation is subject to further review which may result in adjustments to allocation of purchase price in the future. We have recorded approximately \$383,000 in amortization related to the acquired intangible assets from the date of the acquisition through March 28, 2004. TDT is the sole source provider of high security technology and services to the U.S. Department of State for the production of U.S. passports. TDT is now a wholly owned subsidiary of Viisage.

In connection with the acquisition of TDT, we agreed to pay the former sole shareholder of TDT an additional cash payment of up to \$2.6 million if the U.S. Department of Defense selected TDT for the production of smart cards as part of the agency's Common Access Card (CAC) program and placed orders with an aggregate value of at least \$4 million prior to June 30, 2004. We received an initial purchase order of \$10.2 million for this program and therefore we will record this contingent purchase price of \$2.6 million related to the CAC program as additional goodwill in the second quarter of 2004.

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The preliminary allocation of the purchase price for ZN and TDT, based on the purchase prices calculated for accounting purposes, is as follows (in thousands):

	<u>ZN</u>	<u>TDT</u>
Current assets	\$ 1,639	\$ 3,020
Property and equipment	140	42
Identified intangible assets	1,974	14,460
Goodwill	27,733	35,880
	<u>\$ 31,486</u>	<u>\$ 53,402</u>

Identified intangible assets acquired in connection with the acquisitions of ZN and TDT consist primarily of completed technology and acquired contracts. These intangible assets are amortized using the straight-line method over their estimated useful lives of 1 to 5 years (in thousands).

	<u>March 28,</u> <u>2004</u>	<u>Weighted Average</u> <u>Useful Life</u>
Gross carrying amount:		
Completed technology	\$ 2,004	5 years
Acquired contracts	14,430	5 years
Total intangible assets	<u>16,434</u>	
Accumulated amortization:		
Completed technology	(75)	
Acquired contracts	(383)	
Total accumulated amortization	<u>(458)</u>	
Intangible assets, net	<u>\$ 15,976</u>	

We estimate annual amortization expense related to the identified intangible assets acquired in connection with the acquisitions of ZN and TDT to be approximately \$3.2 million per year for the next five years.

The unaudited pro forma and combined selected operating data are presented as if the acquisitions of ZN and TDT had occurred on January 1, 2003 and 2004 for the three months ended March 30, 2003 and March 28, 2004, respectively. The unaudited pro forma data is for informational purposes only and may not necessarily reflect future results of operations or what the results of operations would have been had Viisage, ZN and TDT been operating as a combined entity for the periods presented. For the three months ended March 30, 2003, we incurred a non-cash charge of \$12.1 million representing the cumulative effect of a change in accounting principle related to our adoption of Emerging Issues Task Force 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, or EITF 00-21, on a cumulative basis as of January 1, 2003. The unaudited pro forma revenue, loss and loss per share information for the three months ended March 30, 2003 and March 28, 2004 are as follows (in thousands):

	For the Three	
	Months Ended	
	March 30, 2003	March 28, 2004
	(unaudited)	
Revenue	\$ 11,966	\$ 15,100
Loss before cumulative effect of change in accounting principle	\$ (3,176)	\$ (1,053)
Net loss	\$ (15,307)	\$ (1,053)
Basic and diluted net loss per share before cumulative effect of change in accounting principle	\$ (0.10)	\$ (0.03)
Basic and diluted net loss per share	\$ (0.76)	\$ (0.03)

7. LEGAL PROCEEDINGS

On July 31, 2003 the superior court for Fulton County, Georgia issued a preliminary injunction prohibiting Georgia's Department of Motor Vehicle Safety from continuing to work with us to install a new drivers' license system for the State of Georgia. This injunction is the result of a lawsuit filed in March 2003 by one of our competitors, Digimarc ID Systems, LLC. The suit claims that the Department of Motor Vehicle Safety did not comply with its own bid process when selecting a vendor for the digital drivers' license program. The merits of Digimarc Corporation's claims against the Department of Motor Vehicle Safety are to be addressed in further court proceedings. The Department of Motor Vehicle Safety has confirmed that our contract with them remains in place. However, if the lawsuit is successful and we

lose the contract, we could lose up to \$19.7 million in revenue that we expected to recognize over the next five and one-half years. In addition, although we expect that the Department of Motor Vehicle Safety would be required to reimburse us for our costs incurred under the contract, if we are unable to obtain reimbursement of those costs, we could be required to recognize a loss of up to approximately \$5 million for costs incurred to date on the Georgia contract.

VIISAGE TECHNOLOGY, INC.

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.

VIISAGE TECHNOLOGY, INC.

Date: June 21, 2004

By: /s/ Bernard C. Bailey

Bernard Bailey

President and Chief Executive Officer

(Principal Executive Officer)

Date: June 21, 2004

By: /s/ William K. Aulet

William K. Aulet

Senior Vice President and Chief Financial Officer

(Principal Financial Officer)