VIISAGE TECHNOLOGY INC
Form POS AM
September 09, 2005
Table of Contents

As filed with the Securities and Exchange Commission on September 9, 2005

Registration No. 333-121212

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

POST-EFFECTIVE AMENDMENT NO. 1 ON

FORM S-1 TO

REGISTRATION STATEMENT ON FORM S-3

UNDER

THE SECURITIES ACT OF 1933

Viisage Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**7373**	**04-3320515**
(State of incorporation)	***(Primary Standard Industrial Classification Code Number)***	***(I.R.S. Employer Identification No.)***

296 Concord Road, Billerica, MA 01821, (978) 932-2200

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Bernard C. Bailey

Chief Executive Officer

Viisage Technology, Inc., 296 Concord Road, Third Floor, Billerica, MA 01821, (978) 932-2200

(Name, address, including zip code, and telephone number, including area code, and address of agent for service)

Copy to:

Elliot J. Mark, Esq.

Viisage Technology, Inc.

296 Concord Road

Billerica, MA 01821

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Approximate date of commencement of proposed sale to public: From time to time, after this registration statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. x

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to completion, dated September 9, 2005

PROSPECTUS

5,717,873 Shares

Viisage Technology, Inc.

Common Stock

We are registering up to 5,717,873 shares of our common stock for offer or sale by the selling stockholders named in this prospectus. The selling stockholders identified in this prospectus or their donees, pledgees, transferees, or other successors in interest may offer or sell their shares publicly or through private transactions at prevailing market prices or at negotiated prices. We will not receive any proceeds from the shares being registered for offer and sale by the selling stockholders.

Investing in our common stock involves risks. See Risk Factors beginning on page 2.

Our shares are quoted on the Nasdaq National Market under the symbol VISG . The last reported sale price of our shares on September 1, 2005 was $4.32 per share.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

_________, 2005

Table of Contents

TABLE OF CONTENTS

	Page
FORWARD LOOKING STATEMENTS	(i)
PROSPECTUS SUMMARY	1
RISK FACTORS	2
PRICE RANGE OF COMMON STOCK	12
DIVIDEND POLICY	12
USE OF PROCEEDS	12
SELECTED FINANCIAL DATA	13
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	15
BUSINESS	33
MANAGEMENT	45
PRINCIPAL STOCKHOLDERS	51
CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	53
PLAN OF DISTRIBUTION	54
SELLING STOCKHOLDERS	57
DESCRIPTION OF CAPITAL STOCK	59
LEGAL MATTERS	61
EXPERTS	61
WHERE YOU CAN FIND ADDITIONAL INFORMATION	61
INDEX TO FINANCIAL STATEMENTS	62

You should rely only on the information contained in this prospectus or other information to which we have referred you. We have not authorized anyone to provide you with information that is different. This prospectus may only be used where it is legal to sell these securities. The information in this prospectus may only be accurate on the date of this prospectus.

FORWARD LOOKING STATEMENTS

This prospectus contains or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. The words anticipate, believe, estimate, will, may, future, plan, intend and expect and similar expressions generally identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure that they will be achieved. Actual results may differ materially due to a number of factors. Actual results may differ materially from the forward-looking statements contained in this prospectus or that may be set forth in other documents that we subsequently incorporate by reference into this prospectus. These factors are not intended to represent a complete list of the general or specific factors that may affect us. It should be recognized that other factors, including general economic factors and business strategies, may be significant, presently or in the future. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Table of Contents

PROSPECTUS SUMMARY

The following summary does not contain all the information that may be important to you in making a decision to acquire our common stock. For a more complete understanding of our company and our common stock, you should read the entire prospectus, including the risks described under Risk Factors found elsewhere in this prospectus.

Overview

We are a leading provider of advanced technology identity solutions that enable governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy. Our identity solutions include secure credential provisioning systems, biometric software and systems and real-time identity databases, as well as systems design, development, integration and support services. These solutions enable our customers to manage the entire life cycle of an individual s identity for a variety of applications including civil identification, criminal identification and border management. Our customers use our solutions to help solve the following three critical problems in identity verification and management:

- assurance that the identification document is authentic and has been issued to the correct person;
- confidence that the person holding the identification is uniquely tied to and authorized to use the document; and
- verification of the privileges the individual is entitled to at a particular point in time.

Our solutions annually produce more than 30 million secure government-issued credentials at more than 2,000 locations. We are the second largest provider of U.S. drivers licenses with a 30% market share. We are the sole source provider of passport production capability to the U.S. Department of State. We also are a recognized leader in biometrics in the field of face recognition. Our customers include governments, law enforcement agencies and businesses in more than 15 countries.

Viisage Technology, Inc. was formed as a division of Lau Technologies in 1992. We were incorporated in Delaware in May 1996. Our principal executive offices are located at 296 Concord Road, Third Floor, Billerica, Massachusetts 01821, our telephone number at that location is (978) 932-2200 and our website address is www.viisage.com. The information contained on, or that can be accessed through, our website is not a part of this prospectus.

The Offering

Common stock offered by the selling shareholders 5,717,873 shares.

Common stock to be outstanding after the offering 48,126,672 shares.

The number of shares of common stock to be outstanding after this offering is based on the number of shares of common stock outstanding as of September 1, 2005, and does not include 5,489,392 shares issuable upon the exercise of options outstanding as of September 1, 2005, or 812,469 shares issuable upon the exercise of warrants outstanding as of September 1, 2005.

Table of Contents

RISK FACTORS

If you purchase shares of our common stock, you will take on financial risk. In deciding whether to invest, you should carefully consider the risk factors set forth below, as well as the risk factors contained in our filings with the Securities and Exchange Commission and the other information to which we have referred you.

We have a history of operating losses.

We have a history of operating losses. Our business operations began in 1993 and, except for fiscal years 1996 and 2000, have resulted in net losses in each fiscal year, including a net loss of $7.0 million in 2004 and $2.1 million for the six months ended July 3, 2005. At July 3, 2005, we had an accumulated deficit of approximately $51.2 million. We will continue to invest in the development of our secure credential and biometric technologies. Accordingly, we cannot predict when or if we will ever achieve profitability on an annual basis.

We may be unable to obtain additional capital required to fund our operations and finance our growth.

The installation of our secure credentials systems requires significant capital expenditures. While we have been successful in the past in obtaining financing for working capital and capital expenditures, we will have ongoing capital needs as we expand our business. We may be unable to obtain additional funds in a timely manner or on acceptable terms, which would render us unable to fund our operations or expand our business. If we are unable to obtain capital when needed, we may have to restructure our business or delay or abandon our development and expansion plans.

We derive over 90% of our revenue from government contracts, which are often non-standard, involve competitive bidding, may be subject to cancellation with or without penalty and may produce volatility in earnings and revenue.

More than 90% of our business involves providing products and services under contracts with U.S. federal, state, local and foreign government agencies. Obtaining contracts from government agencies is challenging, and government contracts often include provisions that are not standard in private commercial transactions. For example, government contracts may:

- include provisions that allow the government agency to terminate the contract without penalty under some circumstances;
- be subject to purchasing decisions of agencies that are subject to political influence;
- contain onerous procurement procedures; and
- be subject to cancellation if government funding becomes unavailable.

Foreign government contracts generally include comparable provisions relating to termination for the convenience of the relevant foreign government. Securing government contracts can be a protracted process involving competitive bidding. In many cases, unsuccessful bidders may challenge contract awards, which can lead to increased costs, delays and possible loss of the contract for the winning bidder.

We derive a significant portion of our revenue from a few customers, the loss of which could have an adverse effect on our revenues.

For the six-month period ended July 3, 2005, one customer, the U.S. Department of State, accounted for an aggregate of 32.8% of our revenue. For the six-month period ended June 27, 2004, one customer, the U.S. Department of State, accounted for 18.9% of our revenue. For the year ended December 31, 2004, two customers, Telos Corporation (U.S. Department of Defense) and U.S. Department of State each accounted for over 10% of our revenue and an aggregate of 31% of our revenue. For the year ended December 31, 2003, two customers, Pennsylvania Department of Transportation and Illinois Secretary of State, each accounted for over 10% of our revenues and an aggregate of 26% of our revenue. For 2002, two customers, Connecticut Department of Information Technology and Mississippi Department of Information Technology Services, each accounted for over 10% of our revenues and an aggregate of 22% of our revenue. Since a small number of customers in our secure credentials segment account for a substantial portion of our revenues, the loss of any of our significant customers would cause revenue to decline and could have a material adverse effect on our business.

Table of Contents

We derive revenue from only a limited number of products and services and we do not have a diversified product or service base.

Substantially all of our revenues are derived from the sale of products and services comprising our identity solutions. We anticipate that substantially all of the growth in our revenue, if any, will also be derived from these sources. If for any reason our sale of these products or services is impeded, and we have not diversified our product and service offerings, our business and results from operations could be harmed.

We could face adverse consequences as a result of our late SEC filings.

We failed to timely file our Annual Report on Form 10-K for the year ended December 31, 2004 and our Quarterly Report on Form 10-Q for the quarter ended April 3, 2005. As a result, we are not eligible to use a short form registration statement on Form S-3 until June 30, 2006. Our inability to use a short form registration statement until June 30, 2006 may impair our ability or increase the costs and complexity of our efforts, to raise funds in the public markets or use our stock as consideration in acquisitions should we desire to do so during this one year period. In addition, if we are unable to remain current in our future filings, we may face additional adverse consequences, including (1) an inability to have a registration statement under the Securities Act of 1933 covering a public offering of securities declared effective by the SEC, (2) an inability to make offerings pursuant to existing registration statements (including registration statements on Form S-8 covering employee stock plans) or pursuant to certain private placement rules of the SEC under Regulation D to any purchasers not qualifying as accredited investors, (3) the possible delisting of our common stock from the Nasdaq National Market, and (4) limitations on the ability of our affiliates to sell our securities pursuant to Rule 144 under the Securities Act. These restrictions may adversely affect our ability to attract and retain key employees and may further impair our ability to raise funds in the public markets should we desire to do so or use our stock as consideration in acquisitions.

In addition, our future success depends largely upon the support of our customers, suppliers and investors. The late SEC filings have resulted in negative publicity and a Nasdaq delisting proceeding, and may have a negative impact on the market price of our common stock. The effects of the late SEC filings could cause some of our customers or potential customers to refrain from purchasing or defer decisions to purchase our products and services. Additionally, current or potential suppliers may re-examine their willingness to do business with us, to develop critical interfaces to our products or to supply products and services if they lose confidence in our ability to fulfill our commitments. Any of these losses could have a material adverse effect on our financial and business prospects.

We have been named as a defendant in eight putative class action lawsuits, an adverse outcome of which could have a material adverse effect on our business, financial condition and results of operations by adversely affecting our cash position.

As described below in Business Legal Proceedings , in March and April 2005, eight putative class action lawsuits were filed against us in the United States District Court for the District of Massachusetts. The suits allege violations of the federal securities laws by us and certain of our officers and directors arising out of purported misrepresentations in the guidance that we provided on our anticipated financial results for fiscal 2004 following the release of our 2004 second and third quarter results, which allegedly artificially inflated the price of our stock during the period May 3, 2004 through March 2, 2005. We are not able to estimate the amount of the loss allegedly suffered by members of the putative class or the amount of legal costs and internal efforts associated with defending ourselves and our officers and directors. If we are unsuccessful in defending ourselves in this litigation, these lawsuits could adversely affect our business, financial condition, results of operations and cash flows as a result of the damages that we would be required to pay. It is possible that our insurance policies either may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. While we believe that the allegations and claims made in these lawsuits are wholly without merit and intend to defend the actions vigorously, we cannot be certain that we will be successful in this litigation.

We have taken an impairment charge to assets of $2.0 million due to litigation in Georgia; if we are unable to use the remaining assets from that contract, we may be required to take further impairment charges which could negatively affect our earnings.

In December 2004, the superior court for Fulton County, Georgia granted summary judgment in favor of Georgia s Department of Motor Vehicle Safety, or DMVS, in connection with litigation brought by Digimarc ID Systems, LLC in March 2003 alleging that DMVS did not comply with its own bid process when it selected Viisage

Table of Contents

as the vendor for its new digital drivers license program. In July 2003, the court had issued a preliminary injunction prohibiting DMVS from continuing to work with us to install the State s new drivers license system. In July 2004, we reached a settlement agreement with the State pursuant to which DMVS terminated the contract for convenience and agreed to pay us $2.0 million in cash and the State agreed to purchase certain equipment from us for $500,000. In its December 2004 ruling, the Georgia court authorized DMVS to issue a new request for proposals for a digital drivers license system, but disallowed the $2.0 million cash payment described above. Without this payment, we believe that either the settlement agreement with DMVS is not effective and that our contract with DMVS remains in place, or that our initial claim for an $8.2 million settlement payment is revived. The State has paid us the $500,000 for the equipment in March 2005, and we appealed the disallowance of the $2.0 million settlement payment. In May 2005, the Georgia Supreme Court voted not to hear our appeal of the summary judgment ruling on procedural grounds. Due to the uncertainty of the cash settlement as a result of the judge s ruling and the uncertainty of future cash flows from this contract to support the book value of certain system assets installed, we have identified $2.2 million of assets deployed within the state that we have deemed to have no alternative use. We reduced the recorded value of these assets from approximately $2.2 million to their estimated fair value of approximately $200,000 based on our estimate of realizable value from liquidation of these assets, which resulted in a $2.0 million charge in the fourth quarter of 2004. In addition, we have removed the contract from our backlog, and we will lose up to $19.7 million in revenue that we expected to recognize over the next five and one-half years, unless the contract remains in place or we are able to win the new contract for the digital drivers license system and the revenues from such new contract are substantially similar to the prior contract. We also have evaluated for impairment the remaining $2.9 million in assets being retained by us from the Georgia contract. These consist of approximately $1.1 million of assets that we anticipate using in Georgia if we win the contract based on the new request for proposals, approximately $150,000 of assets that we anticipate could either be used in Georgia under a new contract or used in other projects, and approximately $1.6 million of assets constituting our central production facility in Georgia. Based upon our current probability-weighted estimate of cash flows, we have determined that these assets are not currently impaired. While we believe we can utilize these either in Georgia, if we win the new contract, or on alternative projects, to the extent that we are unable to utilize these assets or realize value through a sale of these assets or reach a new settlement with DMVS regarding these assets, we would be required to take a further charge to earnings.

If we are unable to successfully address the material weaknesses in our internal controls, our ability to report our financial results on a timely and accurate basis may be adversely affected. As a result, current and potential stockholders could lose confidence in our financial reporting which could have a material adverse effect on our business, operating results and stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 10-K for the year ended December 31, 2004, we were required to furnish a report by our management on our internal control over financial reporting with each year s Form 10-K. Such report must contain, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. Such report must also contain a statement that our auditors have issued an attestation report on management s assessment of such internal controls. Management s report and our auditors attestation report for 2004 were included in our Annual Report on Form 10-K/A for the year ended December 31, 2004 under Item 8.

Our external auditors notified management and the audit committee of our board of directors that they believed there were material weaknesses due to insufficient personnel resources and technical accounting expertise within the accounting function to effect a timely financial close process and to evaluate and resolve non-routine and/or complex accounting transactions, and in the control processes around information technology systems. These material weaknesses could result in a material misstatement to the annual or interim financial statements that would not be prevented or detected. Management has determined that it is in agreement with the auditors initial assessment that these control deficiencies constituted material weaknesses as of December 31, 2004. Because of these material weaknesses, management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2004. Our management has identified the steps necessary to address the material weaknesses described above, and has begun to execute remediation plans, as discussed in Item 8 of our Annual Report on Form 10-K/A for the year ended December 31, 2004 and Item 4 of our Quarterly Report on Form 10-Q for the quarter ended July 3, 2005.

Any failure to implement in a timely manner and maintain the improvements in the controls over our financial reporting that we are currently putting in place, or difficulties encountered in the implementation of these

Table of Contents

improvements in our controls, could cause us to fail to meet our reporting obligations, to fail to produce reliable financial reports or to prevent fraud. Any failure to improve our internal controls to address these identified weaknesses could also cause investors to lose confidence in our reported financial information, which could have a negative impact on our business, operating results and stock price.

We are investing significant time and resources to implement the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which may increase our operating expenses and reduce our profitability in the near future.

Changes in the laws and regulations that have recently been enacted, including regulations under of the Sarbanes-Oxley Act of 2002, are likely to continue to increase our expenses as we devote resources in response to them. For example, we already have deployed significant resources to document, implement and test our financial processes as part of our implementation of the requirements under Section 404 of the Sarbanes-Oxley Act of 2002, and we expect to incur additional time and expenses in connection with the requirements under Section 404 during 2005 and beyond for our management to report on, and our independent registered public accounting firm to attest to, our internal control over financial reporting. Moreover, compliance with these rules could also cause us to further modify our existing review processes or divert our management s time and attention away from otherwise running our business, either of which could result in our company experiencing additional costs and expenses without corresponding increases in revenue. Consequently, as we take steps to further improve and strengthen our financial management and controls, we anticipate corresponding increases in our operating expenses that may reduce our profitability in the near future.

Our strategy of expanding our face recognition business could adversely affect our business operations and financial condition.

Part of our strategy is to enhance our leadership in face recognition technology. Pursuing this strategy involves risks. For instance, to date, face recognition security solutions have not gained widespread commercial acceptance. Some of the obstacles to widespread acceptance of face recognition security solutions include a perceived loss of privacy and public perceptions as to the usefulness of face recognition technologies. Whether the market for face recognition security solutions will expand will be dependent upon factors such as:

- the success of our marketing efforts and publicity campaigns and those of our competitors; and
- customer satisfaction with our products and services, as well as those of our competitors.

We do not know when, if ever, face recognition security solutions will gain widespread commercial acceptance.

We face intense competition, which could result in lower revenues and higher research and development expenditures and could adversely affect our results of operations.

The events of September 11, 2001 and subsequent regulatory and policy changes in the U.S. and abroad have heightened interest in the use of biometric security solutions, and we expect competition in this field, which is already substantial, to intensify. Competitors are developing and bringing to market biometric security solutions that use face recognition as well as eye, fingerprint and other forms of biometric verification. Our products also will compete with non-biometric technologies such as certificate authorities and traditional keys, cards, surveillance systems and passwords. Widespread adoption of one or more of these technologies or approaches in the markets we intend to target could significantly reduce the potential market for our systems and products. Many of our competitors have significantly more cash and resources than we have.

Our competitors may introduce products that are competitively priced, have increased performance or functionality or incorporate technological advances that we have not yet developed or implemented. To remain competitive, we must continue to develop, market and sell new and enhanced systems and products at competitive prices, which will require significant research and development expenditures. If we do not develop new and enhanced products or if we are not able to invest adequately in our research and development activities, our business, financial condition and results of operations could be negatively impacted.

Unless we keep pace with changing technologies, we could lose customers and fail to win new customers.

Our future success will depend upon our ability to develop and introduce a variety of new products and services and enhancements to these new products and services in order to address the changing needs of the marketplace. We may not be able to accurately predict which technologies customers will support. If we do not

Table of Contents

introduce new products, services and enhancements in a timely manner, if we fail to choose correctly among technical alternatives or if we fail to offer innovative products and services at competitive prices, customers may forego purchases of our products and services and purchase those of our competitors.

Security breaches in systems that we sell or maintain could result in the disclosure of sensitive government information or private personal information that could result in the loss of clients and negative publicity.

Many of the systems we sell manage private personal information and protect information involved in sensitive government functions. The protective measures that we use in these systems may not prevent security breaches, and failure to prevent security breaches may disrupt our business, damage our reputation, and expose us to litigation and liability. A party who is able to circumvent security measures used in these systems could misappropriate sensitive or proprietary information or materials or cause interruptions or otherwise damage our products, services and reputation, and the property of our customers. If unintended parties obtain sensitive data and information, or create bugs or viruses or otherwise sabotage the functionality of our systems, we may receive negative publicity, incur liability to our customers or lose the confidence of our customers, any of which may cause the termination or modification of our contracts. Further, our insurance coverage may be insufficient to cover losses and liabilities that may result from such events.

In addition, we may be required to expend significant capital and other resources to protect ourselves against the threat of security breaches or to alleviate problems caused by these breaches. However, protective or remedial measures may not be available at a reasonable price or at all, or may not be entirely effective if commenced.

Loss of limited source suppliers may result in delays or additional expenses.

We obtain certain hardware components and complete products from a limited group of suppliers. Our reliance on these suppliers involves significant risks, including reduced control over quality and delivery schedules. In particular, we obtain all of the printers and consumables for the U.S. Department of State passport contract and the Department of Defense common access card contract from Toppan Printing Co. Ltd. Moreover, any financial instability of our manufacturers or contractors could result in our having to find new suppliers. We may experience significant delays in manufacturing and shipping our products to customers if we lose these sources or if supplies from these sources are delayed. As a result, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. It may take several months to locate alternative suppliers, if required, or to re-tool our products to accommodate components from different suppliers. We cannot predict if we will be able to obtain replacement components within the time frames we require at an affordable cost, or at all. Any delays resulting from suppliers failing to deliver components or products on a timely basis, in sufficient quantities and of sufficient quality or any significant increase in the price of components from existing or alternative suppliers could have a severe negative impact on our business, financial condition and results of operations.

The market for our solutions is still developing and if the industry adopts standards or a platform different from our platform, then our competitive position would be negatively affected.

The market for identity solutions is still emerging. The evolution of this market is in a constant state of flux that may result in the development of different technologies and industry standards that are not compatible with our current products or technologies. In particular, the face recognition market lacks industry-wide standards. Several organizations, such as the International Civil Aviation Organization, which sets standards for travel documents that its member states then put into effect, and the National Institute for Standards and Testing, which is part of the U.S. Department of Commerce, have recently selected face recognition as the biometric to be used in identification documentation. It is possible, however, that these standards may change and that any standards eventually adopted could prove disadvantageous to or incompatible with our business model and product lines.

Legal claims regarding infringement by us or our suppliers of third party intellectual property rights could result in substantial costs, diversion of managerial resources and harm to our reputation.

Although we believe that our products and services do not infringe the intellectual property rights of others, we might not be able to defend successfully against a third-party infringement claim. A successful infringement claim against us or our suppliers could subject us to:

liability for damages and litigation costs, including attorneys fees;

6

Table of Contents

- lawsuits that prevent us from further use of the intellectual property;
- having to license the intellectual property from a third party, which could include significant licensing fees;
- having to develop a non-infringing alternative, which could be costly and delay projects;
- having to indemnify clients with respect to losses they incurred as a result of the alleged infringement; and
- having to establish alternative sources for products supplied to us by third parties, as discussed above in the risk factor regarding our dependence on limited source suppliers.

Even if we are not found liable in a claim for intellectual property infringement, such a claim could result in substantial costs, diversion of resources and management attention, termination of customer contracts and harm to our reputation.

See Business Legal Proceedings below for a description of the settlement of a patent infringement action that had been filed against one of our subsidiaries.

Uncertainties in global economic markets could cause delays in customer purchases.

Many customers and potential customers have delayed purchase intentions as a result of uncertainties in global economic markets. Government budgets, particularly at state and regional levels, have been or are expected to be reduced notably. Government contracts result from purchasing decisions made by public sector agencies that are particularly sensitive to budget changes and cutbacks during economic downturns, and variations in appropriations cycles. Many U.S. state customers are facing budget cuts, and some international customers are facing debt crises, introducing added uncertainty. Any shift in the government procurement process, which is outside of our control and may not be predictable, could impact the predictability of our quarterly results and may potentially have a material negative effect on our financial position, results of operation or cash flows.

If we do not successfully expand our direct sales and services organizations and partnering arrangements, we may not be able to increase our sales or support our customers.

In the fiscal years ended December 31, 2002, 2003 and 2004, and six-month periods ended July 3, 2005 and June 27, 2004, we sold substantially all of our services and licensed substantially all of our products through our direct sales organization. Our future success depends on substantially increasing the size and scope of our direct sales force and partnering arrangements, both domestically and internationally. We will face intense competition for personnel, and we cannot guarantee that we will be able to attract, assimilate or retain additional qualified sales personnel on a timely basis. Moreover, given the large-scale deployment required by some of our customers, we will need to hire and retain a number of highly trained customer service and support personnel. We cannot guarantee that we will be able to increase the size of our customer service and support organization on a timely basis to provide the high quality of support required by our customers. Failure to add additional sales and customer service representatives could result in our inability to increase our sales and support our customers.

Integration of acquired businesses may be difficult and will consume significant financial and managerial resources, which could have an adverse effect on our results of operations.

On January 23, 2004, we completed the acquisition of ZN Vision Technologies AG, or ZN, a leading German provider of face recognition and computer vision products and services. On February 14, 2004, we completed the acquisition of Trans Digital Technologies Corporation, or TDT. On October 5, 2004, we completed the acquisition of Imaging Automation, Inc., a market leader in identity document authentication. The integration of the products and services of these acquired companies with ours will be challenging and will consume significant financial and managerial resources. The challenges involved with this integration include, among others:

- challenges related to technology innovation;
- possible difficulty implementing uniform standards, controls, procedures and policies and
- possible loss of key employees

Table of Contents

In addition, the differences between U.S. and German business cultures and the geographic distance between the companies could present significant obstacles to our timely, cost-effective integration of ZN.

The significant direct and indirect costs of our acquisition and integration of ZN, TDT and Imaging Automation could adversely affect our financial performance.

To date, we have incurred approximately $5.0 million of costs in connection with the acquisitions of ZN, TDT and Imaging Automation, including:

- costs associated with integrating personnel, products and services;
- financial advisory fees; and
- costs and expenses for services provided by our lawyers and accountants.

The transaction costs and expenses attributable to financial advisory, legal and accounting services that we incurred have been capitalized as a component of the purchase price. Goodwill associated with the acquisition will be required to be tested at least annually for impairment, and we will be required to record a charge to earnings if there is an impairment in the value of such goodwill at a later date. Other intangible assets acquired in connection with these acquisitions will be amortized over their estimated useful lives.

The acquisitions of ZN, TDT and Imaging Automation could result in future impairment charges which could adversely affect our results of operations.

As a result of our acquisitions of ZN, TDT and Imaging Automation, goodwill and other intangible assets have been created. The values we may record for goodwill and other intangible assets will represent fair values calculated by independent third-party appraisers. Such valuations require us to provide significant estimates and assumptions, which are derived from information obtained from the management of the acquired businesses and our business plans for the acquired businesses or intellectual property. If estimates and assumptions used to initially value goodwill and intangible assets prove to be inaccurate, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairments which will require us to record an impairment charge in the period in which we identify the impairments.

If we do not achieve the expected benefits of our acquisitions of ZN, TDT and Imaging Automation, the price of our common stock could decline.

We expect that the acquisition of ZN will enhance our leadership in face recognition technology through the combination of our technologies with those of ZN. Although the results of the initial tests of our combined technologies have been positive, the combination of such technologies might not meet the demands of the marketplace. If our technologies fail to meet such demand, customer acceptance of our face recognition solutions could decline, which would have an adverse effect on our results of operations and financial condition. In addition, we expect that the acquisition of ZN will enable us to market our systems and products on a global scale. Our face recognition customers are primarily located in the United States, and ZN s customers are primarily located in Europe. We might not be able to market successfully our products and services to ZN s customers or ZN s products and services to our customers. We expect that the acquisition of TDT will enhance our position in the market for secure credentials, particularly the U.S. government. We expect that the acquisition of Imaging Automation will provide us with a market leadership position in identity document authentication and will complement our core competencies in secure credentials and biometrics. We expect that this addition to our product portfolio will extend our reach into our current markets and provide a critical component to our comprehensive offering for new markets in need of identity solutions. However, there can be no assurance that our current customers or customers in new markets will be receptive to these additional offerings. If our product offerings and services fail to meet the demands of this marketplace, our results of operations and financial condition could be adversely affected. There is also a risk that we will not achieve the anticipated benefits of the acquisitions as rapidly as, or to the extent, anticipated by financial or industry analysts, or that such analysts will not perceive the same benefits to the acquisitions as we do. If these risks materialize, our stock price could be adversely affected.

Table of Contents

The success of our strategic plan to grow sales and develop relationships in Europe may be limited by risks related to conducting business in European markets.

Although ZN has experience marketing and distributing its products and developing strategic relationships in Europe, part of our strategy will be to increase sales and build additional relationships in European markets. Risks inherent in marketing, selling and developing relationships in European markets include those associated with:

economic conditions in European markets, including fluctuations in the relative values of the U.S. dollar and the Euro;

taxes and fees imposed by European governments that may increase the cost of products and services; and

laws and regulations imposed by individual countries and by the European Union.

In addition, European intellectual property laws are different than U.S. intellectual property laws and we will have to ensure that our intellectual property is adequately protected in foreign jurisdictions and that ZN s intellectual property is adequately protected in the United States. If we do not adequately protect our intellectual property rights, competitors could use our proprietary technologies in non-protected jurisdictions and put us at a competitive disadvantage.

Our business may be impacted by changes in the local marketplace of our foreign operations and fluctuations in currency exchange rates.

As a result of our acquisitions of ZN, TDT and Imaging Automation, we expect that we will have increased exposure to foreign currency fluctuations. Net revenue and related expenses generated from our international location in Germany are denominated in euros. The results of operations and certain of our inter-company balances associated with this international location are exposed to foreign exchange rate fluctuations. As of July 3, 2005 and December 31, 2004, the cumulative loss from foreign currency translation adjustments was $2.0 million and $322,000, respectively. In addition to our German operation, we will have increased transactions with Japanese vendors supplying hardware and consumables for the delivery of the TDT contracts. These transactions will increase our exposure to foreign currency fluctuations with the yen. To the extent the U.S. dollar weakens against these foreign currencies, the translation of these foreign currencies denominated transactions results in increased net revenue, operating expenses and net income. Similarly, our net revenue, operating expenses and net income will decrease when the U.S. dollar strengthens against these foreign currencies. For the six months ended July 3, 2005, we had unrealized losses related to transactions with Japanese vendors of approximately $46,000.

If our systems and products do not perform as promised, we could experience increased costs, lower margins, liquidated damage payment obligations and harm to our reputation.

We will be required to provide complex systems that will be required to operate on an as needed basis. Although we will deploy back-up systems, the failure of our products to perform as promised could result in increased costs, lower margins, liquidated damage payment obligations and harm to our reputation. This could result in contract terminations and have a material adverse effect on our business and financial results.

Misappropriation of our intellectual property could harm our reputation, affect our competitive position and cost us money.

We believe that our intellectual property, including our methodologies, will be critical to our success and competitive position. If we are unable to protect this intellectual property against unauthorized use by third parties, our reputation among existing and potential customers could be damaged and our competitive position adversely affected. Our strategies to deter misappropriation could be undermined if:

- the proprietary nature or protection of our methodologies is not recognized in the United States or foreign countries;
- third parties misappropriate our proprietary methodologies and such misappropriation is not detected; and
- competitors create applications similar to ours but which do not technically infringe on our legally protected rights.

9

Table of Contents

If these risks materialize, we could be required to spend significant amounts to defend our rights and divert critical managerial resources. In addition, our proprietary methodologies may decline in value or our rights to them may become unenforceable.

If we fail to adequately manage our resources, it could have a severe negative impact on our financial results or stock price.

We could be subject to fluctuations in technology spending by existing and potential customers. Accordingly, we will have to actively manage expenses in a rapidly changing economic environment. This could require reducing costs during economic downturns and selectively growing in periods of economic expansion. If we do not properly manage our resources in response to these conditions, our results of operations could be negatively impacted.

Future acquisitions of companies or technologies may result in disruptions to our business.

Beyond the acquisitions of ZN, TDT and Imaging Automation, our growth strategy could include additional acquisitions of companies or technologies that complement ours. Future acquisitions could involve risks inherent in acquisitions, such as:

- challenges associated with integrating acquired technologies and the business and operations of acquired companies;
- exposure to unknown liabilities;
- diversion of managerial resources from day-to-day operations;
- possible loss of key employees, customers and suppliers;
- higher than expected transaction costs; and
- additional dilution to our existing stockholders if we use our common stock as consideration.

If we fail to manage these challenges adequately, our results of operations and stock price could be adversely affected.

The loss of key personnel could adversely affect our ability to remain competitive.

We believe that the continued service of our executive officers will be important to our future growth and competitiveness. We have entered into employment agreements with Bernard C. Bailey, our Chief Executive Officer, Bradley T. Miller, our Chief Financial Officer, Iftikhar Ahmad, our Senior Vice President, Worldwide Services, Mohamed Lazzouni, our Chief Technology Officer, and James P. Ebzery, our Senior Vice

President, Customer Solutions. These agreements are intended to provide the executives with incentives to remain employed by us. However, we cannot assure you that they will remain employed by us. In addition, we believe that the continued employment of key members of our technical and sales staff is important to us. Most of our employees are entitled to voluntarily terminate their relationship with us, typically without any, or with only minimal, advance notice. The process of finding additional trained personnel to carry out our strategy could be lengthy, costly and disruptive. We might not be able to retain the services of all of our key employees or a sufficient number of them to execute our plans. In addition, we might not be able to continue to attract new employees as required.

Our quarterly results could be volatile and may cause our stock price to fluctuate.

We have experienced fluctuations in quarterly operating results and we expect those fluctuations to continue. We expect that our quarterly results will continue to be affected by, among other things, factors such as:

- the size and timing of contract awards;
- the timing of our contract performance;
- variations in the mix of our products and services; and
- contract losses and changes in management estimates inherent in accounting for contracts.

10

Table of Contents

Certain of our stockholders have significant relationships with us, which could result in us taking actions that are not supported by unaffiliated stockholders.

Lau Technologies, or Lau, and Mr. Buddy Beck, the former sole stockholder of TDT who is now a director and Vice Chairman of our Board of Directors, beneficially own approximately 11.3% and 11.9%, respectively, of our outstanding common stock. As a result, both Lau and Mr. Beck may have a strong influence on matters requiring approval by our stockholders, including the election of directors and most corporate actions, including mergers and acquisitions. In addition, we have significant relationships with each of Lau and Mr. Beck, including:

- we acquired significant intellectual property, contracts and distribution channels through a transaction with Lau in January 2002 under which we agreed to pay Lau a 3.1% royalty on our face recognition revenues through June 30, 2014, up to a maximum of $27.5 million;

- in connection with the above transaction with Lau, we entered into consulting agreements with Joanna Lau, the President of Lau, and her spouse Denis K. Berube, the Chief Operating Officer of Lau who also serves as the Chairman of our Board of Directors, under which we will pay each of Ms. Lau and Mr. Berube $125,000 per year for ten years;

- the Chairman of our Board of Directors and his spouse own a majority of Lau s voting stock;

- in connection with the acquisition of TDT in February 2004, Mr. Beck was elected a member of our Board of Directors and appointed Vice Chairman;

- in connection with the acquisition of TDT, we entered into a consulting agreement with Mr. Beck under which we will pay Mr. Beck $300,000 per year for two years, provided that Mr. Beck devotes his full business time to developing business opportunities for us;

- an additional purchase price adjustment of $2.6 million, payable to Mr. Beck, was incurred upon TDT s selection by the U.S. Department of Defense for the production of smart cards as part of the agency s CAC program. This amount has been paid in full.

Future sales of our common stock by Lau or Mr. Buddy Beck could depress the market price of our common stock.

As of September 1, 2005, there were 48,126,672 shares of our common stock outstanding. Lau and Mr. Buddy Beck own approximately 11.3% and 11.9%, respectively, of our common stock. If either of these stockholders sell a significant number of shares of our common stock in the open market, our stock price could decline.

Table of Contents

PRICE RANGE OF COMMON STOCK

Our common stock trades on the Nasdaq National Market under the symbol VISG. The following table sets forth the quarterly range of high and low reported sale prices of the common stock on the Nasdaq National Market for the periods indicated.

Fiscal year ended December 31, 2003	High	Low
First Quarter	$ 5.40	$ 3.01
Second Quarter	5.78	3.76
Third Quarter	5.40	3.85
Fourth Quarter	4.61	3.34
Fiscal year ended December 31, 2004	**High**	**Low**
First Quarter	$ 7.48	$ 3.53
Second Quarter	14.30	6.90
Third Quarter	9.43	5.15
Fourth Quarter	9.94	5.75
Fiscal year ending December 31, 2005	**High**	**Low**
First Quarter	$ 9.18	$ 2.83
Second Quarter	5.19	2.57
Third Quarter (through September 1, 2005)	5.74	4.25

On September 1, 2005, the last reported sale price of the common stock as reported on the Nasdaq National Market was $4.32 per share. As of September 1, 2005, there were approximately 274 record holders of our common stock.

DIVIDEND POLICY

We have never declared or paid dividends on our common stock. We presently intend to retain our cash for use in the operation and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, we are prohibited from paying dividends pursuant to our lending arrangements.

USE OF PROCEEDS

The shares are being registered hereunder for resale by the selling stockholders. We will not receive any proceeds from the sale of the shares by the selling stockholders.

12

Table of Contents

SELECTED FINANCIAL DATA

The following tables provide our selected consolidated financial data, which were derived from our audited consolidated financial statements for each of the five years in the period ended December 31, 2004. The historical results presented are not necessarily indicative of future results. The data should be read in conjunction with our financial statements, related notes and other financial information as of December 31, 2004 and for each of the three years in the periods ended December 31, 2004 appearing elsewhere in this prospectus, as well as the discussions appearing in Management s Discussion and Analysis of Financial Condition and Results of Operations.

Our financial data for the six-month periods ended June 27, 2004 and July 3, 2005 were derived from our unaudited financial statements included elsewhere in this prospectus. The unaudited financial statements include all adjustments, consisting of normal recurring accruals, which we consider necessary for a fair presentation of our financial position and results of operations for those periods. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire fiscal year.

	For the Years Ended December 31,					For the Six Months Ended (1)	
						June 27,	July 3,
	2000 (2)	2001 (2)	2002 (2)	2003 (1)	2004 (1)	2004	2005
	(in thousands, except per share data)						
Statement of Operations Data:							
Revenue	$ 27,539	$ 26,280	$ 32,302	$ 37,371	$ 67,466	$ 28,535	$ 36,960
Cost of revenue	21,136	19,602	25,239	27,844	48,201	20,213	24,579
Gross Margin	6,403	6,678	7,063	9,527	19,265	8,322	12,381
Operating expenses:							
Sales and marketing	787	809	5,368	5,282	7,028	3,071	4,355
Research and development	688	2,054	4,457	3,650	4,431	1,901	3,071
General and administrative	2,489	2,500	5,069	5,110	9,838	4,355	6,544
Restructuring charges		1,639	824		2,000		
Total operating expenses	3,964	7,002	15,718	14,042	23,297	9,327	13,970
Operating Income (loss)	2,439	(324)	(8,655)	(4,515)	(4,032)	(1,005)	(1,589)
Interest expense, net	(1,637)	(1,210)	(875)	(969)	(1,771)	(969)	14
Other income (loss)				18	(235)	75	84
Income (loss) before income taxes and cumulative effect of change in accounting principle	802	(1,534)	(9,530)	(5,466)	(6,038)	(1,899)	(1,491)
Provision for income taxes				(63)	(959)	(50)	(654)
Income (loss) before cumulative effect of change in accounting principle	802	(1,534)	(9,530)	(5,529)	(6,997)	(1,949)	(2,145)
Cumulative effect of change in accounting principle (3), (5)	(277)			(12,131)			
Net Income (loss)	525	(1,534)	(9,530)	(17,660)	(6,997)	(1,949)	(2,145)

Preferred stock dividends	(327)	(5)					
Net Income (loss) applicable to common shareholders	$ 198	$ (1,539)	$ (9,530)	$ (17,660)	$ (6,997)	$ (1,949)	$ (2,145)
Basic income (loss) per share before cumulative effect	$ 0.05	$ (0.09)	$ (0.48)	$ (0.26)	$ (0.18)	$ (0.06)	$ (0.04)
Basic net income (loss) per share applicable to common shareholders (4)	$ 0.02	$ (0.09)	$ (0.48)	$ (0.82)	$ (0.18)	$ (0.06)	$ (0.04)
Weighted average basic common shares outstanding	10,460	16,265	20,046	21,445	38,664	33,603	47,973
Diluted income (loss) per share before cumulative effect	$ 0.03	$ (0.09)	$ (0.48)	$ (0.26)	$ (0.18)	$ (0.06)	$ (0.04)
Diluted net income (loss) per share applicable to common shareholders (4)	$ 0.01	$ (0.09)	$ (0.48)	$ (0.82)	$ (0.18)	$ (0.06)	$ (0.04)
Weighted average diluted common shares outstanding	14,504	16,265	20,046	21,445	38,664	33,603	47,973

Table of Contents

	December 31,						
						June 27,	July 3,
	2000 (2)	2001 (2)	2002 (2)	2003 (1)	2004 (1)	2004(1)	2005(1)
Balance Sheet Data:							
Working capital	$ 15,225	$ 38,115	$ 22,244	$ 5,887	$ 15,233	$ (3,500)	$ 17,894
Total assets	45,273	67,663	61,189	54,480	175,629	135,653	170,313
Total long-term debt	9,526	10,368	9,845	8,147	149	14,136	111
Shareholders equity	20,728	46,294	39,064	34,008	154,790	92,884	151,299

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
For the Year Ended December 31, 2003				
Revenue	$ 8,159	$ 8,789	$ 10,108	$ 10,315
Gross margin	$ 1,366	$ 1,963	$ 3,380	$ 2,818
Net loss	$ (14,496)	$ (1,376)	$ (389)	$ (1,399)
Net loss applicable to common shareholders	$ (14,496)	$ (1,376)	$ (389)	$ (1,399)
Basic and diluted net loss per share	$ (0.72)	$ (0.07)	$ (0.02)	$ (0.06)
Basic and diluted net loss per share applicable to common shareholders	$ (0.72)	$ (0.07)	$ (0.02)	$ (0.06)
For the Year Ended December 31, 2004				
Revenue	$ 12,259	$ 16,276	$ 19,907	$ 19,024
Gross margin	$ 3,353	$ 4,969	$ 5,507	$ 5,436
Net loss	$ (1,632)	$ (317)	$ 198	$ (5,246)
Net loss applicable to common shareholders	$ (1,632)	$ (317)	$ 198	$ (5,246)
Basic and diluted net loss per share	$ (0.05)	$ (0.01)	$	$ (0.11)
Basic and diluted net loss per share applicable to common shareholders	$ (0.05)	$ (0.01)	$	$ (0.11)
For the Six Months Ended July 3, 2005				
Revenue	$ 16,810	$ 20,149		
Gross margin	$ 5,770	$ 6,610		
Net loss	$ (1,642)	$ (505)		
Net loss applicable to common shareholders	$ (1,642)	$ (505)		
Basic and diluted net loss per share	$ (0.03)	$ (0.01)		
Basic and diluted net loss per share applicable to common shareholders	$ (0.03)	$ (0.01)		

(1) The results are presented in accordance with EITF 00-21 applied on a cumulative basis as of January 1, 2003.

(2) The results are presented under percentage of completion based on the cost-to-cost method of measurement.

(3) We adopted EITF 00-21 on a cumulative basis as of January 1, 2003. See Note 2 in the Notes to Consolidated Financial Statements which discusses the change in accounting principle.

(4) See Note 2 in the Notes to Consolidated Financial Statements for information concerning the computation of basic and diluted net income (loss) per share.

(5) We adopted EITF 00-27 on a cumulative basis as of January 1, 2000.

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

We are a leading provider of advanced technology identity solutions that enable governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy. Our identity solutions include secure credential provisioning systems, biometric software and systems and real-time identity databases, as well as systems design, development, integration and support services. These solutions enable our customers to manage the entire life cycle of an individual s identity for a variety of applications including civil identification, criminal identification and border management. Our customers use our solutions to help solve the following three critical problems in identity verification and management:

assurance that the identification document is authentic and has been issued to the correct person;

confidence that the person holding the identification is uniquely tied to and authorized to use the document; and

verification of the privileges the individual is entitled to at a particular point in time.

Our solutions annually produce more than 30 million secure government-issued credentials at more than 2,000 locations. We are the second largest provider of U.S. drivers licenses with a 30% market share, and we are the sole source provider of passport production capability to the U.S. Department of State. We also are a recognized leader in biometrics in the field of face recognition. In addition, we are the leader in document authentication technology with approximately 2,500 installations in 15 countries. Our customers include governments, law enforcement agencies and businesses around the world.

On August 2, 2005, the Company announced that William K. Aulet would be resigning as Chief Financial Officer, and that Bradley T. Miller would joining the Company as its new Chief Financial Officer, effective September 6, 2005.

Financial Results

We generate revenue through the sale and license of products and services for verifying and managing identities. Our revenues for the six months ended July 3, 2005 increased to approximately $37.0 million from $28.5 million in the first six months of 2004. Our net loss for the six months ended July 3, 2005 increased to $2.1 million from $1.9 million in the first six months of 2004. Our revenues increased from approximately $37.4 million and $32.3 million for the years ended December 31, 2003 and 2002, respectively, to approximately $67.5 million for the year ended December 31, 2004, due in large part to the three acquisitions we completed during 2004. Our net loss for 2004 was $7.0 million.

Capital Raising Initiatives and Repayment of Indebtedness

In August 2004, we sold approximately 7.3 million shares of our common stock in an underwritten public offering. We received net proceeds of approximately $37.4 million from the offering.

During 2004, we repaid in full a $15.3 million promissory note that we had issued to Buddy Beck, a director of Viisage and the former sole shareholder of TDT in connection with our acquisition of TDT. $14.5 million of the note was repaid in cash and the remaining $0.8 million was settled as an offset against a purchase price reduction negotiated as part of the acquisition of TDT. In addition, in 2004, we repaid in full our $4.3 million debt obligation to Lau Technologies, or Lau, one of our principal stockholders. Finally, in 2004, we repaid $7.7 million representing the outstanding principal balance under our loan agreement with Commerce Bank and Trust Company which was subsequently terminated.

In December 2004, we entered into a new loan agreement with a commercial lender which permits us to borrow up to $25,000,000, subject to certain financial covenants which may restrict the amounts borrowed. Certain of these covenants were amended in March 2005. No borrowings have been made under this agreement to date other than $2.3 million in letters of credit issued by Citizens to certain of our customers.

We expect our current capital resources to be adequate for our needs for at least the next 12 months. However, if we enter into a new drivers license contract or engage in a significant acquisition or other strategic transaction, we could be required to raise additional capital, either in the form of debt or equity.

Acquisitions

In January 2004, we acquired all outstanding shares of 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 assumed 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 options under this plan were fully vested prior to the close of the transaction.

In February 2004, we acquired all outstanding shares of TDT in exchange for 5,850,000 newly issued shares of our common stock, $5.0 million in cash and $15.3 million in notes, which have subsequently been repaid in full.

In October 2004, we completed the acquisition of iA. The purchase price for the acquisition included approximately 3.9 million shares of common stock, approximately $5.0 million in cash and the assumption of approximately $2.9 million of debt, which has subsequently been repaid in full. In addition, we issued fully vested stock options effective as of the close of the transaction to assume iA s employee stock option plans, and accordingly have reserved 565,270 shares of our common stock for issuance to the plans participants.

Litigation

In March and April 2005, eight putative class action lawsuits were filed in the United States District Court for the District of Massachusetts against us, Bernard C. Bailey, William K. Aulet and Denis K. Berube and other members of our Board of Directors. The suits allege violations of the federal securities laws by us and certain of our officers and directors arising out of purported misrepresentations in the guidance that we provided on our anticipated financial results for fiscal 2004 following the release of our 2004 second and third quarter results, which allegedly artificially inflated the price of our stock during the period May 3, 2004 through March 2, 2005. We are not able to estimate the amount of the loss allegedly suffered by members of the putative class or the amount of legal costs and internal efforts associated with defending ourselves and our officers and directors.

In December 2004, a Georgia court granted summary judgment in favor of Georgia s Department of Motor Vehicle Safety, or DMVS, in connection with litigation brought by one of our competitors in March 2003 alleging that the DMVS did not comply with its own bid process when it selected Viisage as the vendor for its new digital drivers license program. As a result of the judge s ruling, in the fourth quarter of 2004, we took a non-cash write-down of $2 million for an impairment charge to assets then on our balance sheet. Our appeal of this ruling to the Georgia Supreme Court was dismissed on procedural grounds in May 2005.

In May 2005, Viisage, Toppan Printing Co., Ltd. and Fargo Electronics, Inc. agreed to a settlement of the patent infringement lawsuit Fargo had filed against Toppan and TDT in July 2004 in a U.S. federal court in Virginia.

Segments and Geographic Information

Our business operates in one business segment, the advanced technology identity solutions segment. Our advanced technology identity solutions segment enables governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy utilizing secure credential provisioning and authentication systems, biometric technology and the creation, enhancement and/or utilization of identity databases.

During the fourth quarter of 2004 we realigned our net product and services revenues into three main categories identified by the markets which they serve: State and Local, Federal, and Commercial/Emerging Markets. Our Chief Executive Officer is the chief operating decision maker who evaluates performance based on revenues and total consolidated operating expenses of identity solutions products and services across all markets and geographic regions.

Revenues by market for the years ended December 31, 2002, 2003, and 2004 as well as six months ended June 27, 2004 and July 3, 2005 , respectively are disclosed in the following table (in thousands):

				Six Months Ended	
	2002	2003	2004	June 27, 2004	July 3, 2005
State and Local	$ 30,076	$ 34,064	$ 40,916	$ 19,299	$ 17,999
Federal	1,630	2,561	25,760	8,818	16,583
Emerging Markets	596	746	790	418	2,378
	$ 32,302	$ 37,371	$ 67,466	$ 28,535	$ 36,960

Table of Contents

Our operations outside the United States include a wholly-owned subsidiary in Bochum, Germany. Revenues are attributed to each region based on the location of the customer. The following is a summary of revenues by geographic areas (in thousands):

				Six Months Ended	
	2002	2003	2004	June 27, 2004	July 3, 2005
Revenue					
United States	$ 32,302	$ 36,571	$ 65,023	$ 27,308	$ 32,774
Rest of World		800	2,443	1,227	4,186
	$ 32,302	$ 37,371	$ 67,466	$ 28,535	$ 36,960

Of the total revenue for the year ended 2002, 2003, and 2004, approximately zero, $800,000 and $2.4 million was earned from export sales, respectively. Of the total revenue for the six months ended June 27, 2004, approximately $775,000 was earned from export sales. Of the total revenue for the six months ended July 3, 2005, approximately $3.8 million was earned from export sales. The Company did not have significant international sales to individual countries for the periods presented.

Dependence on Significant Customers

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. Customers who accounted for more than 10% of our total revenues are as follows:

for the year ended December 31, 2002, two customers accounted for an aggregate of 22.0%;

for the year ended December 31, 2003, two customers accounted for an aggregate of 26.0%;

for the year ended December 31, 2004, two customers accounted for an aggregate of 31.0%;

for the six-month period ended June 27, 2004, one customer accounted for an aggregate of 18.9%; and

for the six-month period ended July 3, 2005, one customer accounted for an aggregate of 32.8%.

Critical Accounting Policies and Significant Estimates

We prepare our financial statements in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. Consistent with U.S. GAAP, we have adopted accounting policies that we believe are most appropriate given the facts and circumstances of our business. The application of these policies has a significant impact on our reported results. In addition, some of these policies require management to make estimates. These estimates, which are based on historical experience and analysis of current conditions, have a significant impact on our reported results and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. If actual results differ significantly from these estimates, there could be a material effect on our financial statements.

Table of Contents

Valuation of Goodwill and Other Long-Lived and Intangible Assets

Our long-lived assets include property, plant and equipment, other intangible assets and goodwill. As of July 3, 2005, the balances of property, plant and equipment, other intangible assets and goodwill, net of accumulated depreciation and amortization, were $18.6 million, $22.6 million, and $92.5 million, respectively. As of December 31, 2004, the balances of property, plant and equipment, other intangible assets and goodwill, net of accumulated depreciation and amortization, were $19.9 million, $26.0 million and $93.5 million, respectively. As of December 31, 2003, the balances of property, plant and equipment and other intangible assets, net of accumulated depreciation and amortization, were $25.1 million and $2.7 million, respectively. As of December 31, 2002, the balances of property, plant and equipment and other intangible assets, net of accumulated depreciation and amortization, were $16.6 million and $3.1 million, respectively.

Where we believe that property, plant and equipment and intangible assets have finite lives, we depreciate and amortize those assets over their estimated useful lives. For purposes of determining whether there are any impairment losses, as further discussed below, our management has examined the carrying value of our identifiable long-lived tangible and intangible assets, including their useful lives where we believe such assets have finite lives, when indicators of impairment are present. For all long-lived tangible and intangible assets, if an impairment loss were identified based on the fair value of the asset, as compared to the carrying value of the asset, the excess carrying value over fair value would be charged to expense in the period we identify the impairment. Furthermore, based on our review of the carrying values of the long-lived tangible and intangible assets with finite lives, we may determine that shorter estimated useful lives are more appropriate. In that event, we will be required to record depreciation and amortization over fewer future periods, which will reduce our earnings.

Factors we generally consider important which could trigger an impairment review on the carrying value of other long-lived tangible and intangible assets include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of acquired assets or the strategy for our overall business;
- underutilization of our tangible assets;
- discontinuance of product lines by ourselves or our customers;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- significant decline in our market capitalization relative to net book value.

We have evaluated the assumptions used in our assessment of goodwill impairment as of December 31, 2004 and have determined that the estimates used in the independent valuation of goodwill at that date have not materially changed after considering the above triggering events for an impairment review during the three months ended July 3, 2005. Although we believe that the carrying values of our long-lived tangible and intangible assets were realizable as of July 3, 2005 and December 31, 2004, future events could cause us to conclude otherwise.

In the fourth quarter of 2004, we recorded an impairment charge of $2.0 million related to a write-down of certain system assets associated with our contract to produce drivers licenses in the state of Georgia. This impairment was the result of a Georgia court s grant of summary judgment, during that quarter, in favor of Georgia s Department of Motor Vehicle Safety, or DMVS, in connection with litigation brought by one of our competitors in March 2003 alleging that the DMVS did not comply with its own bid process when it selected Viisage as the vendor for its new digital drivers license program. The summary judgment negated a prior settlement between us and the state that would have provided us with a payment of $2.0 million upon the cancellation of its contract. Due to the uncertainty of the cash settlement as a result of the judge s ruling and the uncertainty of future cash flows from this contract to support the book value of certain system assets installed, we have identified $2.2 million of assets deployed within the state that we have deemed to have no alternative use. We reduced the recorded value of these assets from approximately $2.2 million to their estimated fair value of approximately $200,000 based on our estimate of realizable value from liquidation of these assets, which resulted in a $2.0 million charge in the fourth quarter of 2004. We also have evaluated for impairment the remaining $2.9 million in assets being retained by us from the Georgia contract. These consist of approximately $1.1 million of assets that we anticipate using in Georgia if we win the contract based on the new request for proposals, approximately $150,000 of assets that we anticipate could either be used in Georgia under a new contract or used in other projects, and approximately $1.6 million of assets constituting our central production facility in Georgia. Based upon our current probability-weighted estimate of cash flows, we have determined that these assets are not currently impaired. While we believe we can utilize these assets either in Georgia, if we win the new contract, or on alternative projects, to the extent that we are unable to utilize these assets or realize value through a sale of these assets or reach a new settlement with DMVS regarding these assets, we would be required to take a further charge to earnings.

Due to our three acquisitions in 2004, goodwill and other intangible assets were created as a result of the allocation of the purchase price of the acquired businesses. The values recorded for goodwill and other intangible assets represent estimates of fair values calculated by independent third-party appraisers and are subject to further review and finalization. Such valuations require us to provide significant estimates and assumptions, which are derived from information obtained from the management of the acquired businesses, and our business plans for the acquired businesses or intellectual property. Critical estimates and assumptions used in the initial valuation of goodwill and other intangible assets include, but are not limited to:

- future expected cash flows from product sales, customer contracts and acquired developed technologies and patents;
- expected costs to complete any in-process research and development projects and commercialize viable products and estimated cash flows from sales of such products;
- the acquired companies brand awareness and market position;
- assumptions about the period of time over which we will continue to use the acquired brand; and
- discount rates.

These estimates and assumptions may be incomplete or inaccurate because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be inaccurate, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairment which will require us to record an impairment charge in the period in which we identify the impairment.

We follow Statement of Financial Accounting Standards No. 142, or SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires us to test goodwill for impairment on an annual basis, and between annual tests in certain circumstances, and to write down goodwill when impaired. These events or circumstances generally would include the occurrence of operating losses or a significant decline in earnings associated with the asset. We evaluate goodwill for impairment using the two-step process as prescribed in SFAS No. 142. The first step is to compare the fair value of the reporting unit to the carrying amount of the reporting unit. If the carrying amount exceeds the fair value, a second step must be followed to calculate impairment. Otherwise, if the fair value of the reporting unit exceeds the carrying amount, the goodwill is not considered to be impaired as of the measurement date. We performed the initial step by comparing the fair value of our reporting units as determined by considering a number of factors, including an independent valuation that assessed the fair value of Viisage based on a comparison of us to comparable firms using the guideline company method and comparable transaction method. We also considered future discounted cash flows as compared to the carrying amount to assess the recoverability of the goodwill asset. Based upon these tests, we determined that the fair value exceeded the carrying amount resulting in no impairment. If impairment had occurred, any excess of carrying value over fair value would have been recorded as an impairment charge.

Revenue and Cost Recognition

We deliver document issuance solutions primarily to federal and state government customers. We recognize revenue when persuasive evidence of a sales arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectibility is reasonably assured.

Product revenue on contracts where title to the products passes to the customer mainly consists of sales of printing system components and consumables including printers, secure coating, ribbon, film, document authentication products and other parts. Revenue on products is recognized when the products are accepted by the customer. Services revenue under these contracts consists of maintenance services on our installed base of printing systems and document authentication products. We also provide on-site technical support and consulting services to customers primarily in the federal government marketplace. Revenue on fixed price services is recognized over the service period and approximates the timing of the services rendered. Revenue on time and material services is recognized as the services are rendered. Expenses on all services are recognized when the costs are incurred.

Table of Contents

During the third quarter of 2003, we adopted the provisions of Emerging Issues Task Force 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, (EITF 00-21), on a cumulative basis as of January 1, 2003. EITF 00-21 governs how to determine whether separate units of accounting exist in a revenue arrangement with multiple deliverables and, if so, how the arrangement consideration should be allocated among separate units of accounting. The operating results for the year ended December 31, 2003 reflect the cumulative effect of this change in accounting principle in 2003 which was a non-cash charge of $12.1 million. When elements such as products and services are contained in a single arrangement, or in related arrangements with the same customer, we allocate revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The price charged when the element is sold separately generally determines fair value.

We have contracts, generally with state governments for the production of drivers licenses and other identification credentials, where we have determined that we have multiple elements and where the title to equipment installed to produce these credentials does not pass to the customer. Under these contracts, the first element consists of hardware, system design, implementation, training, consumables management, maintenance and support which is accounted for as equipment and related executory services under lease in accordance with SFAS No. 13. The second element consists of customized software which is accounted for as a long term contract in accordance with AICPA Statement of Position 97-2, *Software Revenue Recognition*, (SOP 97-2), and Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, (SOP 81-1), on a units of delivery method of measurement.

Costs related to the hardware element of these contracts are capitalized on the balance sheet and are depreciated over the contract term beginning when the system goes into service. The delivery of these credentials typically requires us to customize, design, and install equipment and software at customer locations, as well as perform training, supply consumables, maintain the equipment and provide support services. Nonperformance of training, consumables management, maintenance and support services would prevent receipt of payment for the costs incurred in the customization, design and installation of the system. EITF 00-21 limits the amount of revenue allocable to the customization, design and installation of the system to the amount that is not contingent upon the production of credentials. Revenue on these contracts under EITF 00-21 is earned based on, and is contingent upon, the production of credentials from the system. Due to the contingent performance of credential production in secure credentials contracts, we defer revenue recognition for the system design and installation phase of such contracts, including customized software and equipment, and recognize revenue as credentials are produced.

Costs related to the customized software used in drivers license contracts are capitalized on the balance sheet during the period in which we are designing and installing the system and are amortized over the contract term beginning when the system goes into service. Revenue related to our drivers license contracts are recorded as credentials are produced by the system.

Our contracts related to the delivery of drivers licenses and identification credentials typically provide that the state department of transportation, or similar agency, will pay a fixed price per credential produced utilizing a system we design, implement and support. Our fixed pricing includes charges for the use of the system, materials and the data that is stored on the credentials. Prices under these contracts vary depending on, among other things:

- design and integration complexities;
- nature and number of workstations and sites installed;
- projected number of secure credentials to be produced;
- size of the database;

level of post-installation involvement that will be required of us; and

competitive environment.

Other identity solutions contracts typically provide for the development, customization and installation of face recognition systems for government agencies, law enforcement agencies and businesses. These contracts are

19

Table of Contents

generally on a fixed price basis, and include milestones and acceptance criteria for the various deliverables under the contract. Contract prices vary depending on, among other things, design and integration complexities, the nature and number of workstations and sites, the size of the database, the level of post-installation support and the competitive environment. In certain cases, we provide licenses of off-the-shelf versions of its face recognition software on a per-user basis.

We recognize revenue under these contracts using the percentage-of-completion methodology in accordance with SOP 81-1. We uses the percentage-of-completion methodology to account for revenue under these contracts because:

- a high level of certainty exists regarding expected cash flows from these contracts; and
- a reliable basis exists for estimating the percentage of the contract that will be completed at the end of the accounting period.

We measure the percentage complete as costs are incurred or based on milestones. These milestones are specific events or deliverables clearly identified in the contract and can include customized systems, installation and services as defined by the contract. When milestone measures are used, billings occur and revenue is recognized when scheduled performance milestones and customer acceptance criteria have been achieved. We recognize revenue based on the total milestone billable to the customer less revenue related to any future maintenance requirements. Billings occur under these contracts when the milestone is delivered and accepted by the customer. On contracts where milestones are not used, we generally recognize revenue on a cost-to-cost basis using direct labor dollars as the method of measurement.

We record costs and estimated earnings in excess of billings under these contracts as current assets. When elements such as products and services are contained in a single arrangement, or in related arrangements with the same customer, we allocate revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The price charged when the element is sold separately generally determines fair value.

Revenue related to software licenses of off-the-shelf face recognition software is recognized in accordance with SOP 97-2. For these software licenses we recognize revenue when:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the sales price is fixed or determinable;
- collection is probable; and
- post delivery obligations have established fair values.

On identity solutions contracts where the arrangement consists of build-to-suit software and solution design during the installation phase of the project, as well as ongoing services under a long-term contract, we apply the criteria in EITF 00-21 to separate the SOP 81-1 deliverables, the installation services, from the non SOP 81-1 deliverables, ongoing maintenance and support services. On these contracts we allocate revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The price charged when the element is sold separately generally determines fair value.

Income Taxes

We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using currently enacted tax rates. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Due to the uncertainty surrounding the realization of net deferred tax assets, we have provided a full valuation allowance against this amount.

20

Table of Contents

We had a deferred income tax provision for the six months ended July 3, 2005 of approximately $554,000 and for the six months ended June 27, 2004 there was no provision. For the year ended December 31, 2004 a provision was made of $859,000 to record the deferred tax liability related to tax deductible amortization of certain goodwill. This deferred tax liability is created by taxable temporary differences related to certain goodwill for which the period the difference will reverse is indefinite. Following the adoption of SFAS 142, taxable temporary differences creating deferred tax liabilities as a result of different treatment of goodwill for book and tax purposes cannot offset deductible temporary differences that create deferred tax assets in determining the valuation allowance. In the fourth quarter of 2004, we made an election under Internal Revenue Tax Code Section 338(h)(10) to treat the acquisition of TDT as an asset transaction for tax purposes. This election resulted in tax deductible amortization expense related to certain goodwill for tax purposes. As a result, a deferred tax provision was required to record the deferred tax liability of tax deductible goodwill amortization. There was no provision for Federal income taxes for the years ended December 31, 2003 or 2002 due to the net losses in those years.

Comprehensive Income (Loss)

In accordance with SFAS No. 130, *Reporting Comprehensive Income,* we report accumulated other comprehensive income (loss) in our Consolidated Balance Sheets. Comprehensive income (loss) includes net income (loss) and other comprehensive income (loss), which includes current period foreign currency translation adjustments. The accumulated other comprehensive income (loss) consists of unrealized translation losses in accordance with SFAS No. 52, *Foreign Currency Translations*. We had $2 million of accumulated other comprehensive loss as of July 3, 2005. We had $322,000 of accumulated other comprehensive loss as of December 31, 2004. There were no components of other comprehensive income (loss) for the years ended December 31, 2003 and 2002.

Stock-Based Compensation

We account for our employees stock-based compensation plans under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, utilizing the intrinsic value method. SFAS No. 123, *Accounting for Stock-Based Compensation*, established a fair value based method of accounting for stock-based compensation plans. The Company has adopted the disclosure only alternative under SFAS No. 123 for its employees stock-based compensation awards, which requires disclosure of the pro forma effects on net loss and net loss per share as if SFAS No. 123 had been adopted as well as certain other information.

Derivative Instruments and Hedging Activities

In 2005, we began to utilize foreign currency forward contracts. We elected not to use hedge accounting and all gains and losses resulting from the change in fair value of the derivatives are recorded in earnings. None of the contracts was terminated prior to settlement. As of July 3, 2005, the Company had committed to seven foreign currency forward contracts to purchase approximately 201,000,000 Japanese Yen for $1,854,000. The fair value of these contracts at July 3, 2005 was a liability of approximately $46,000. All of these contracts will be settled before October 2, 2005.

Results of Operations

Comparisons of 2002 through 2004 and of six months ended June 27, 2004 and July 3, 2005

Revenue

	For the Years Ended December 31,					Six Months Ended		
	2002	Percent Change	2003	Percent Change	2004	June 27, 2004	Percent Change	July 3, 2005
Services revenue	$ 32,302	15.7%	$ 37,371	22.9%	$ 45,915	$ 22,338	-6.1%	$ 20,978
Product revenue		0.0%		100.0%	21,551	6,197	157.9%	15,982
Total revenue	$ 32,302	15.7%	$ 37,371	80.5%	$ 67,466	$ 28,535	29.5%	$ 36,960

Table of Contents

Revenues in the state and local market of our business are derived principally from multi-year contracts for systems implementation, credential production and related services. Secondarily we derived state and local revenues from the sale of our document authentication products and services which were acquired from Imaging Automation, Inc., or iA, in October 2004. Revenues from our federal market are derived principally from products and solutions delivered to the Department of State and the Department of Defense. Revenues for the six-month period ending July 3, 2005 increased 29.5%, from approximately $28.5 million for the six-month period ending June 27, 2004 to approximately $37.0 million for the six-month period ending July 3, 2005.

For the six months ended July 3, 2005, our state and local revenue decreased by approximately $1.3 million to $18.0 million from $19.3 million for the six months ended June 27, 2004. This decrease was the result of revenue decreases in New York, Maryland, Florida, and Ohio of approximately $1.8 million for the first six months of 2005 compared to the prior year. The New York and Ohio contracts ended in the first quarter of 2005 and the Florida contract will end in the third quarter of 2005. We also experienced a decrease in revenue in our contract with Massachusetts of approximately $300,000 for the six-month period where our contract to produce welfare cards is ending in 2005. We also entered the maintenance phase on contracts in three states which resulted in a revenue decrease of approximately $1.1 million. The decreases in the state and local market for the six months ended July 3, 2005 compared to the six months ended June 27, 2004 were offset by sales of document authentication product, contributed by our acquisition of Imaging Automation in October 2004, of approximately $1.2 million into this market. In addition, card volume increases and new card production on other contracts contributed approximately $500,000 of additional revenue for the six month period. Revenue in the federal market increased by approximately $7.8 million to $16.6 million for the six months ended July 3, 2005 from $8.8 million for the six months ended June 27, 2004. Approximately $6.5 million of this increase for the six month period was related to additional sales of products and services to the Department of State. The remaining $1.3 million increase was the result of an increase in document authentication and biometric products and services to government customers internationally. Revenue in the commercial / emerging markets increased by approximately $2.0 million for the six months ended July 3, 2005 compared to the comparable periods in the prior year. This increase was related to additional sales of document authentication products into this market in the second quarter of 2005. Revenue for the six months ended July 3, 2005 includes two full quarters of sales of document authentication products and services acquired from Imaging Automation of approximately $3.0 million compared to zero in the prior year. For the six months ended July 3, 2005, revenue includes six months of Imaging Automation, TDT, and ZN. Revenue compared to zero months, five months and five months of revenue from these entities in the prior year, respectively.

Our revenues increased from approximately $37.4 million for the year ended December 31, 2003 to approximately $67.5 million for the year ended December 31, 2004, which includes increases resulting from the ZN, TDT and iA acquisitions. The increase was the result of:

approximately $14.0 million related to our delivery under our contract to deliver passports to the U.S. Department of State and other services contracts;

Table of Contents

approximately $10.6 million from the U.S. Department of Defense procurement of printing systems and consumables for its common access card, or CAC, program;

approximately $4.5 million from new contracts won to deliver solutions to state government customers as well as technology upgrades to installed systems in some states and credential volume increases in many states where we produce drivers license licenses;

approximately $3.2 million from the delivery of new biometrically-enabled identity solutions projects to primarily state government customers;

approximately $1.4 million related to international sales of face recognition solutions; and

approximately $700,000 from document authentication product and services sales.

We experienced increases in card volume in ten states resulting in approximately $3.3 million of additional revenue in 2004. We also signed extensions in two states contributing an additional $1.2 million of revenue and completed technology upgrades in three states for an additional $630,000 of revenue in 2004. These increases related to our deployed drivers license solutions were offset by reduced revenue in four states of approximately $600,000 related to price decreases and reduced card volume. The system deliveries related to the CAC procurement were substantially complete by December 31, 2004 and we expect to provide consumables and support services in the future.

Other identity solutions revenue was offset by legacy contracts entering the maintenance phase resulting in a decrease in revenue of approximately $2.7 million from the prior year. In addition, we generated $1.5 million less revenue from one federally funded face recognition contract in 2004.

Revenue for the year ended December 31, 2003 increased 19.6% to $37.4 million from $32.3 million in 2002 after adjusting the 2002 results on a pro forma basis for the impact of the accounting change. The increase was the result of credential volume increases in five states generating additional revenue in those states of approximately $3.3 million. Volume increases in two states resulted from the addition of new types of credentials or from normal fluctuations in credential issuances. Volume increases under our contracts with the Connecticut Department of Motor Vehicles and the State of Rhode Island, Division of Motor Vehicles were due to a full year of card production in 2003, in addition we began card production in Oklahoma in 2003. In addition to the volume increases, revenue under our contract serving the Maryland Department of Transportation and Motor Vehicle Administration increased $1.3 million in 2003 due to a full year of delivery on that contract. We also experienced an increase in revenue of approximately $300,000 due to net price per credential increases on contract extensions signed in 2003. These increases, were offset by volume decreases under drivers license contracts in two states, which resulted in a decrease in revenue of approximately $386,000. These increases, in revenue for 2003 were also offset by decreases in revenue of approximately $260,000 under our contracts with Arizona Department of Transportation and New Mexico Department of Taxation and Revenue as a result of the expiration of those contracts in 2002. Other increases related to the inclusion of a full year of revenue derived from our Pinellas County contract signed in October 2002. We also delivered face recognition solutions to the United Arab Emirates for the Dubai International Airport and to Alberta, Canada in mid-2003, which contributed approximately $800,000 of additional revenue combined.

Gross Margin

	For the Years Ended December 31,	Six Months Ended

	2002	Percent Change	2003	Percent Change	2004	June 27, 2004	Percent Change	July 3, 2005
Services gross margin	$ 7,063	34.9%	$ 9,527	-37.4%	$ 5,966	$ 6,701	-10.1%	$ 6,025
Product gross margin		0.0%		100.0%	13,299	1,621	292.1%	6,356
Total gross margin	$ 7,063	34.9%	$ 9,527	102.2%	$ 19,265	$ 8,322	48.8%	$ 12,381

Table of Contents

Gross margin increased to 33.5% for the first six months of 2005 compared to 29.2% for the same period in 2004. The increase in our gross margin for the first six months are both related to a change in the mix of products and solutions that we are delivering to our customers. For the six months ended July 3, 2005, we delivered additional products and services to our federal customers of approximately $7.8 million, respectively compared to the prior year period. The products and services delivered to these customers carried gross margins in excess of 35% which contributed to a higher average margin for each period. For the six months ended July 3, 2005 we generated less revenue from state and local customers of approximately $1.3 million, respectively compared to the prior year period. We generated revenue in the state and local market primarily from drivers license contracts which, due to the competitive nature of that market, have historically carried margins on products and services below 25%.

Gross margin improved by 3.1% to 28.6% for the year ended December 31, 2004 compared to 25.5% for the prior year. The improvement in gross margin is attributable to the introduction of higher margin products and solutions to our product mix through acquisitions and new contracts. Our international sales contributed revenue with gross margins of between 40% and 50% for 2004. Our U.S. federal contracts contributed revenue with gross margins in excess of 35% related to its contracts which includes in its cost of goods sold the significant amortization of intangible asset expense described in the next paragraph. Document authentication products, starting in the fourth quarter of 2004, contributed revenue with gross margins of approximately 50%. In addition to the change in product mix related to our acquisitions of ZN, TDT and iA, the increase in card volume in many states and our sales of technology upgrades to some of our drivers license customers in 2004, as well as improved cost management in executing these contracts, resulted in gross margin improvement of approximately 3.0% from this customer base. In 2005, we believe that by changing our product mix to include more sales of higher margin products, services and solutions, we will be able to further improve our gross margin performance.

For the year ended December 31, 2004, we have allocated approximately $2.7 million of amortization expense for the TDT acquisition to cost of sales due to the fact that a majority of the identified intangible assets were attributed to contracts that are generating significant revenue. For the year ended December 31, 2004, we have allocated approximately $35,000 of expense to cost of goods, representing amortization expense in the fourth quarter of 2004 from the iA acquisition related to acquired contracts and technology preliminarily identified as intangible assets in that transaction. Non-cash amortization expense related to identified intangible assets from these transactions will be continue to be allocated to cost of sales which we expect will continue to negatively impact our gross margins in the future.

Gross margins increased to 25.5% for the year ended December 31, 2003 compared to 17.3% for 2002 after adjusting the 2002 results on a pro forma basis for the impact of accounting changes. We expect gross margins on our drivers license contracts to fluctuate based on changes in period cost of sales as a result of our adoption of EITF 00-21 due to the fact that in 2003 and in the future we will effectively recognize revenue on a fixed price per credential produced by our customers. If we successfully achieve cost saving measures in the delivery process, we will realize higher gross margins in those periods where the cost savings measures are achieved. Alternatively, in periods where our delivery costs are higher due to service and maintenance requirements, we expect gross margins to decrease for those periods.

We achieved margin increases on 10 of our 18 active drivers license contracts in 2003. Those contracts represented approximately 66.7% of the total revenue in that segment for the year. The margin increases were attributable to our commitment to minimize period costs during the card production phase on all of our drivers license contracts. We were able to achieve some of these costs savings by minimizing overtime labor charges through better resource management of field service technicians. In addition, we installed inventory management software in multiple states in 2003, which allows us to better control consumables scrap thus reducing our materials costs. In addition to these cost savings initiatives, we signed contract extensions in five states and began card production in two additional states during 2003, both of which resulted in margin increases for those states. These increases were offset by gross margin decreases in other states due primarily to decreases in credential volume during the year.

Table of Contents

Sales and Marketing Expenses

	For the Years Ended December 31,					Six Months Ended		
	2002	Percent Change	2003	Percent Change	2004	June 27, 2004	Percent Change	July 3, 2005
Sales and Marketing Expenses	$ 5,368	-1.6%	$ 5,282	33.1%	$ 7,028	$ 3,071	41.8%	$ 4,355
As a percentage of net revenues	16.6%		14.1%		10.4%	10.8%		11.8%

Sales and marketing expenses increased by approximately $561,000, from $1.6 million in the second quarter of 2004 to $2.1 million in the second quarter of 2005. Approximately $552,000 of this increase was related to personnel and resources from the three acquisitions that we completed in 2004. In addition, we continue to invest in sales and marketing to support our products organization and our federal government sales initiatives in 2005. For the six months ended July 3, 2005, sales and marketing expenses increased by approximately $1.3 million to $4.4 million from $3.1 million for the same period in the prior year. Acquisitions accounted for approximately $1.1 million of the increase during this period. As a percentage of revenue, sales and marketing expenses increased from 9.7% in the second quarter of 2004 to 10.6% in the second quarter of 2005 and from 10.8% for the first six months of 2004 to 11.8% in the first six months of 2005. The ZN and TDT acquisitions which were both closed in the first quarter of 2004 represented a partial quarter of expense. We expect that we will continue to invest in sales and marketing resources primarily in the federal market and in commercial/emerging markets in 2005.

Sales and marketing expenses increased approximately $1.7 million, from $5.3 million in for the year ended December 31, 2003 to $7.0 million for the year ended December 31, 2004. The increase is primarily due to sales and marketing expenses related to the 2004 acquisitions of approximately $1.6 million. The remaining increase related to our investment in pursuing opportunities to deliver solutions that incorporate our total identity solutions capabilities to our customers with a heightened focus on federal programs. As a percentage of revenue, sales and marketing expenses decreased from 14.1% for the year ended December 31, 2003 to 10.4% for the year ended December 31, 2004. In 2005 we expect sales and marketing expenses to increase as a percentage of sales as we continue to target opportunities in both the federal and state marketplaces. Associated with the acquisition of iA in 2004, we have increased our focus on product management and anticipate that these additional product development and product management resources will help to expand our product offerings and product sales in 2005 and beyond.

Sales and marketing expenses decreased approximately $86,000, to $5.3 million for the year ended December 31, 2003 from $5.4 million in 2002. As a percentage of revenue, sales and marketing expenses decreased to 14.1% in 2003 from 17.2% in 2002 after adjusting the 2002 results on a pro forma basis for the impact of accounting changes. The decrease is primarily due to a decrease in the number of drivers license contracts coming up for bid in 2003 within the secure credentials segment as a result of delays within certain states due to budgetary constraints. The bid and proposal process related to the secure credentials contracts for state drivers license contracts generally requires the involvement of our technology personnel as we devise the system architecture during this phase that satisfies the states requirements in the proposal. As proposal volume was down in 2003, there was increased focus of these resources in other areas, specifically on the delivery of the systems that were contracted in 2002.

Research and Development Expenses

	For the Years Ended December 31,			Six Months Ended
	2002	2003	2004	

		Percent Change		Percent Change		June 27, 2004	Percent Change	July 3, 2005
Research and Development Expenses	$ 4,457	-18.1%	$ 3,650	21.4%	$ 4,431	$ 1,901	61.5%	$ 3,071
As a percentage of net revenues	13.8%		9.8%		6.6%	6.7%		8.3%

Research and development expenses increased by approximately $608,000, from $942,000 in the second quarter of 2004 to $1.6 million in the second quarter of 2005. Approximately $492,000 of this increase was related

Table of Contents

to personnel and resources from the three acquisitions that we completed in 2004. For the six months ended July 3, 2005, research and development expenses increased by approximately $1.2 million to $3.1 million from $1.9 million for the same period in the prior year. Acquisitions accounted for approximately $1.0 million of the increase during this period. We continue to invest in biometric technologies and new product development to broaden our product offerings of advanced technology identity solutions. This investment included enhancing existing products as well as contributing new products with the intellectual property and product offerings that were acquired through our acquisitions in 2004. As a percentage of revenue, research and development expenses increased from 5.8% in the second quarter of 2004 to 7.7% in the second quarter of 2005 and from 6.7% for the first six months of 2004 to 8.3% in the first six months of 2005. We expect to continue to invest in research and development in order to add functionality to our current advanced technology identity solutions offerings, as well as to develop new offerings in 2005.

Research and development expenses increased by approximately $781,000, from $3.7 million for the year ended December 31, 2003 to $4.4 million for the year ended December 31, 2004. The acquisitions of ZN, TDT and iA contributed additional research and development expense of approximately $2.7 million in 2004. This increase in expense from the prior year was offset by billable labor hours of approximately $500,000, headcount reductions resulting in approximately $250,000 in cost savings, capitalized software development costs of approximately $185,000 and a reduction in research and development activity from our services organization of approximately $1.0 million. In addition to the revenue generating funded research provided by our research and development organization, we also had operating expense offsets from reimbursed research and development costs in Germany of approximately $600,000. We expect to continue to generate billings and expense reimbursements related to our funded research and development activity in 2005. As a percentage of revenue, research and development expenses decreased from 9.8% for the year ended December 31, 2003 to 6.6% for the year ended December 31, 2004. We expect research and development expenses to increase as a percentage of revenue in 2005 as we continue to support our product development strategy. We believe that our products organization, through its focus on the success of our customers, will continue to generate a robust pipeline of product offerings that will ultimately drive our development plan.

Research and development expenses decreased approximately $807,000, to $3.7 million for the year ended December 31, 2003 from $4.5 million in 2002. As a percentage of revenue, research and development expenses decreased to 9.8% from 14.3% in 2002 after adjusting the 2002 results on a pro forma basis for the impact of accounting changes. These decreases are the result of a restructuring and workforce reduction in the fourth quarter of 2002, as well as a decrease in our internal investment in research and development during 2003 anticipating the contribution that the ZN acquisition will bring to our research and development initiatives in the future. Development costs that benefited specific projects were recorded as cost of revenues and costs that did not benefit specific projects were recorded as research and development expenses. Software development costs we have capitalized subsequent to achieving technological feasibility have not been material.

General and Administrative Expenses

	For the Years Ended December 31,					Six Months Ended		
	2002	**Percent Change**	**2003**	**Percent Change**	**2004**	**June 27, 2004**	**Percent Change**	**July 3, 2005**
General and Administrative Expenses	$ 5,069	0.8%	$ 5,110	92.5%	$ 9,838	$ 4,355	50.3%	$ 6,544
As a percentage of net revenues	15.7%		13.7%		14.6%	15.3%		17.7%

General and administrative expenses increased by approximately $902,000, from $2.2 million in the second quarter of 2004 to $3.1 million in the second quarter of 2005. The increase in general and administrative expenses was the result of increases in accounting and legal fees of approximately $744,000 in the second quarter of 2005 compared to the comparable period in the prior year, and increases in salary and related costs of approximately $93,000 from new headcount additions in information technology, finance and accounting. The remaining increase of approximately $65,000 resulted from resources and other general and administrative costs from the acquisitions in 2004. For the six months ended July 3, 2005, general and administrative expenses increased by $2.1 million to $6.5 million from $4.4 million for the same period in the prior year. The increase during this six month period was primarily attributed to headcount additions in administrative functions, compliance consulting fee increases,

Table of Contents

accounting and legal fees increases, and additional costs from acquisitions. As a percentage of revenue, general and administrative expenses increased from 13.6% in the second quarter of 2004 to 15.5% in the second quarter of 2005 and from 15.3% for the first six months of 2004 to 17.7% in the first six months of 2005.

General and administrative expenses increased approximately $4.7 million, from $5.1 million for the year ended December 31, 2003 to $9.8 million for the year ended December 31, 2004. The 2004 acquisitions contributed approximately $1.4 million of additional general and operating expenses from the prior year. In 2004, legal costs increased by approximately $1.3 million primarily related to the litigation involving our contract with the state of Georgia. Compliance costs for consultants and auditors related to our Sarbanes-Oxley compliance requirements in 2004 contributed an additional $850,000 of general and administrative expense. Other expense increases in 2004 related to an increase in corporate strategy consulting costs of $360,000, move related costs and accelerated amortization of leasehold improvements for abandoned property of $312,000, an increase in expenses for investor relations, insurance and listing fees due to company growth of $265,000, and severance and other personnel costs of $200,000. As a percentage of revenue, general and administrative expenses increased from 13.7% for the year ended December 31, 2003 to 14.6% for the year ended December 31, 2004. In 2005, we do not anticipate any costs related to moving our corporate headquarters, but we do expect that other general and administrative expenses related to insurance, investor relations and listing fees may increase as we continue to grow. In addition, we expect to add resources to our financing and accounting organization in 2005 that will increase our general and administrative expenses. We expect these additional costs may be offset by a decrease in consulting expenses.

General and administrative expenses remained relatively flat, increasing by approximately $41,000, to $5.1 million for the year ended December 31, 2003 from $5.1 million in 2002. As a percentage of revenue, general and administrative expenses decreased to 13.7% in 2003 from 16.2% in 2002 after adjusting 2002 results on a pro forma basis for the impact of accounting changes. The slight increase in general and administrative expenses was due to the logistical support required to grow our business through acquisitions while continuing to meet the financing requirements created by our expanding operations. The benefits that we experienced related to the restructuring in 2002 and other cost savings initiatives were offset by additional expenses related to new strategic actions taken in 2003. Additional general and administrative expenses related to these actions included $725,000 of expense related to new strategic hires, $200,000 of expenses related to additional employee terminations in 2003, $150,000 of expenses related to pursuing new financing opportunities and $285,000 of additional professional fees related to our contract in Georgia.

Interest Income and Expense

	For the Years Ended December 31,					Six Months Ended		
	2002	Percent Change	2003	Percent Change	2004	June 27, 2004	Percent Change	July 3, 2005
Interest income	$ 196	-49.5%	$ 99	63.6%	$ 162	$ 41	65.9%	$ 68
Interest expense	(1,071)	0.3%	(1,068)	81%	(1,933)	(1,010)	-94.7%	(54)
Net Interest Income and Expense	$ (875)	10.7%	$ (969)	82.8%	$ (1,771)	$ (969)	-101.4%	$ 14
As a percentage of net revenues	-2.7%		-2.6%		-2.6%	-3.4%		0.0%

Interest income for the six months ended July 3, 2005 increased by $27,000 to $68,000 from $41,000 for the six months ended June 27, 2004. These increases in interest income are related to a higher average cash balance during the first six months of 2005 compared to the comparable period in 2004. Interest expense for the six months ended July 3, 2005 decreased by approximately $956,000 to $54,000 from $1.0 million for the six months ended June 27, 2004. These decreases in interest expense are related to our repayment during 2004 of approximately $31.4 million of debt that was on our balance sheet as of June 27, 2004.

Table of Contents

Interest expense, net of interest income of approximately $162,000 and $99,000 for the years ended December 31, 2004 and 2003, respectively, increased approximately $800,000 from $969,000 for the year ended December 31, 2003 to approximately $1.8 million for the year ended December 31, 2004. This increase was primarily due to $750,000 of interest on the $15.3 million note used to purchase TDT.

Interest expense, net of approximately $99,000 and $196,000 of interest income in 2003 and 2002, respectively, increased approximately $94,000 for the year ended December 31, 2003 to $969,000 from $875,000 in 2002. The increase in interest expense reflects the additional debt financing required to support contract delivery in 2003.

Income Taxes

	For the Years Ended December 31,					Six Months Ended		
	2002	Percent Change	2003	Percent Change	2004	June 27, 2004	Percent Change	July 3, 2005
Income Taxes	$	-100.0%	$ (63)	1422.2%	$ (959)	$ (50)	1208.0%	$ (654)
As a percentage of net revenues	0.0%		-0.2%		-1.4%	-0.2%		-1.8%

The deferred income tax provision for the six-month period ended July 3, 2005 includes $554,000 to increase the deferred tax valuation allowance. This deferred tax liability is created by taxable temporary differences related to certain goodwill for which the period the difference will reverse is indefinite. Following the adoption of SFAS 142, taxable temporary differences creating deferred tax liabilities as a result of different treatment of goodwill for book and tax purposes cannot offset deductible temporary differences that create deferred tax assets in determining the valuation allowance. In the fourth quarter of 2004, the Company made an election under Internal Revenue Tax Code Section 338(h)(10) to treat its acquisition of TDT as an asset transaction for tax purposes. This election resulted in future tax deductible amortization expense for tax purposes. As a result, a deferred tax provision is required to increase the Company s valuation allowance. No current provision for federal income taxes was made for the six-month periods ended July 3, 2005 and June 27, 2004. The provision for state income taxes for the six-month period ended July 3, 2005 was approximately $94,000. The provision for state income taxes for the six months ended June 27, 2004 was $50,000.

For the year ended December 31, 2004, we had a provision for federal income taxes of approximately $859,000 which resulted from our election to treat the acquisition of TDT as an asset transaction for tax purposes. This election created a deferred tax liability for tax deductible amortization of certain goodwill and a related non-cash tax expense. There was no provision for federal income taxes for the year ended December 31, 2003. The provision for state income taxes for the year ended December 31, 2004 was approximately $100,000 compared to $63,000 for the year ended December 31, 2003.

No provision for federal income taxes has been made for the years ended December 31, 2003 and 2002 due to the net loss in both periods. For the year ended December 31, 2003, the provision for state income taxes was approximately $63,000. There was no provision for state income taxes for the year ended December 31, 2002.

Consolidated Performance

Net loss for the year ended December 31, 2004 was $7.0 million or $.18 per basic and diluted share compared to $17.7 million or $0.82 per basic and diluted share for the prior year, including the one-time charge of $12.1 million in connection with our change in accounting principle as of January 1, 2003. The increase in net loss from the prior year, excluding the impact of the cumulative effect of the change in accounting principle, was primarily attributable to the write-down of $2 million for an impairment charge to assets related to our Georgia drivers license contract, other expense related to foreign currency losses of $235,000, increases in interest expense of $802,000 and tax expenses of approximately $959,000, as we experienced a decrease in our loss from operations for the year ended December 31, 2004 of approximately $483,000 or an operating loss of $4.0 million compared to $4.5 million for the year ended December 31, 2003. In 2005 we anticipate that improved margins and continued focus on controlling operating costs will improve our operating results. We plan to implement strategies to continue to monitor our operating expenses and to reduce other losses from foreign currency transactions which we expect will improve our operating results.

Table of Contents

Impairment of Long-Lived Asset

In December 2004, the superior court for Fulton County, Georgia granted summary judgment in favor of Georgia s Department of Motor Vehicle Safety, or DMVS, in connection with litigation brought by Digimarc ID Systems, LLC in March 2003 alleging that DMVS did not comply with its own bid process when it selected Viisage as the vendor for its new digital drivers license program. In July 2003, the court had issued a preliminary injunction prohibiting DMVS from continuing to work with us to install the State s new drivers license system. In July 2004, we reached a settlement agreement with the State pursuant to which DMVS terminated the contract for convenience and agreed to pay us $2.0 million in cash and the State agreed to purchase certain equipment from us for $500,000. In its December 2004 ruling, the Georgia court authorized DMVS to issue a new request for proposals for a digital drivers license system, but disallowed the $2.0 million cash payment described above. Due to the uncertainty of the cash settlement as a result of the judge s ruling and the uncertainty of future cash flows from this contract to support the book value of certain system assets installed, we have identified $2.2 million of assets deployed within the state that we have deemed to have no alternative use. We reduced the recorded value of these assets from approximately $2.2 million to their estimated fair value of approximately $200,000 based on our estimate of realizable value from liquidation of these assets, which resulted in a $2.0 million charge in the fourth quarter of 2004. We also have evaluated for impairment the remaining $2.9 million in assets being retained by us from the Georgia contract. These consist of approximately $1.1 million of assets that we anticipate using in Georgia if we win the contract based on the new request for proposals, approximately $150,000 of assets that we anticipate could either be used in Georgia under a new contract or used in other projects, and approximately $1.6 million of assets constituting our central production facility in Georgia. Based upon our current probability-weighted estimate of cash flows, we have determined that these assets are not currently impaired. While we believe we can utilize these assets either in Georgia, if we win the new contract, or on alternative projects, to the extent that we are unable to utilize these assets or realize value through a sale of these assets or reach a new settlement with DMVS regarding these assets, we would be required to take a further charge to earnings.

Other Income (Expense), Net

Other expense of approximately $235,000 for the year ended December 31, 2004 was primarily the result of realized and unrealized losses related to foreign currency fluctuations on purchases that we made in Japanese Yen in 2004. For the year ended December 31, 2003 we had $18,000 of other income related to gains on disposal of assets in that year. We plan to implement strategies to minimize losses from foreign currency transactions in 2005.

For the year ended December 31, 2003 we had other income of $18,000 related to a gain on the sale of certain card printer assets. There was no other income recognized for the year ended December 31, 2002.

Other Comprehensive Loss

Other comprehensive loss primarily results from translation adjustments with our German operations. Net revenue and related expenses generated from our international location in Germany are denominated in euros. The results of operations and certain of our intercompany balances associated with this international location are exposed to foreign exchange rate fluctuations. As of July 3, 2005 and December 31, 2004, we had cumulative translation adjustments related to our Germany operations of approximately $2.0 million and $322,000, respectively. To the extent the U.S. dollar weakens against these foreign currencies, the translation of these foreign currencies denominated transactions results in increased net revenue, operating expenses and net income. Similarly, our net revenue, operating expenses and net income will decrease when the U.S. dollar strengthens against these foreign currencies.

29

Table of Contents

Cumulative Effect of Change in Accounting Principle

For the year ended December 31, 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 EITF 00-21 on a cumulative basis as of January 1, 2003.

Liquidity and Capital Resources

	For the Years Ended December 31,			Six Months Ended	
				June 27,	July 3,
	2002	2003	2004	2004	2005
Consolidated Cash Flow Data:					
Net cash provided by (used in):					
Operating activities	$ (3,111)	$ 4,440	$ 4,135	$ 2,339	$ 790
Investing activities	(16,827)	(8,712)	(12,992)	(3,299)	(1,314)
Financing activities	1,488	8,726	13,504	3,797	(110)
Effect of exchange rates on cash and cash equivalents			(4)		(22)
Net increase (decrease) in cash and cash equivalents	$ (18,450)	$ 4,454	$ 4,643	$ 2,837	$ (656)

Cash was approximately $10.7 million at July 3, 2005. As of July 3, 2005, there were no restrictions on the Company s cash. Cash at December 31, 2004 was approximately $11.3 million.

In the six month period ended July 3, 2005, cash provided in operating activities was approximately $790,000, which resulted from our net loss of approximately $2.1 million, offset by non-cash charges for depreciation and amortization of approximately $5.9 million, $135,000 for expenses paid in common stock and deferred tax liability of $554,000, and cash used by the net change in operating assets and liabilities of approximately $3.7 million.

Accounts receivable increased approximately 4.4% from $17.1 million at December 31, 2004 to $17.8 million at July 3, 2005. The increase of approximately $751,000 was primarily due to product sales at the end of the quarter offset by an improvement of our overall days sales outstanding.

Inventories and other costs and estimated earnings in excess of billings increased approximately 25.3% from $3.4 million at December 31, 2004 to $4.2 million at July 3, 2005. This increase of approximately $857,000 was primarily due to additional inventory of document authentication products for delivery on future contracts.

Accounts payable and accrued expenses decreased approximately 18.3% from $15.3 million at December 31, 2004 to $12.5 million at July 3, 2005. This decrease was the result of payments to certain vendors related to our federal government contracts as well as payments made prior to the end of the quarter for professional services fees.

On December 14, 2004, we entered into a Loan and Security Agreement with Citizens Bank of Massachusetts. The Loan and Security Agreement permits us to borrow up to $25,000,000, subject to certain financial covenants which may restrict the amounts borrowed. As of July 3, 2005, we estimate that the amount available to us under the Loan and Security Agreement was approximately $5.7 million based on the financial covenants. Any amounts borrowed under the Loan and Security Agreement bear interest at the rate of Citizens prime rate minus 0.25% or the London Interbank Offered Rate (LIBOR) plus 2.5%, at our option, and must be repaid on or before May 30, 2007. In March 2005, we entered into an amendment to the Loan and Security Agreement to modify the financial covenants and make certain other changes. We are in compliance with the amended financial covenants for the quarter ended July 3, 2005. If we do not remain in compliance with the applicable covenants, Citizens could refuse to lend funds to us and could require repayment of any amounts outstanding at the time that we are not in compliance with such covenants. Currently, there are no borrowings outstanding under the Loan and Security Agreement other than a commitment of $2.3 million in letters of credit issued by Citizens to certain of our customers.

As of December 31, 2004, Viisage was not in compliance with the earnings before interest, taxes, depreciation and amortization (EBITDA) covenant under the Loan and Security Agreement. The Company received a waiver for the quarter ended December 31, 2004 from Citizens.

During 2004, we repaid in full our $4.3 million debt obligation to Lau Technologies, or Lau, one of our principal stockholders. During 2004, we also repaid in full a $15.3 million promissory note that we had issued to Buddy Beck, a director of Viisage and the former sole shareholder of TDT in connection with our acquisition of TDT. $14.5 million of the note was repaid in cash and the remaining $0.8 million was settled as an offset against a purchase price reduction negotiated as part of the acquisition of TDT. In addition, we repaid $7.7 million representing the outstanding principal balance under our loan agreement with Commerce Bank and Trust Company which was subsequently terminated.

In April 2003 we entered into an arrangement for approximately $1.5 million of equipment financing with three of our suppliers. These project lease arrangements are accounted for as capital leases. There are no financial covenants associated with these leasing arrangements. As of July 3, 2005 we had outstanding approximately $158,000 under these arrangements. The interest rates on these capital leases are between 6% and 8% and are fixed. The terms of these leases range from 12 months to 60 months. In August 2003 we entered into an arrangement for financing of database licenses with another vendor. As of July 3, 2005, we had outstanding approximately $33,000 under this arrangement.

In the first quarter of 2004, we purchased an asset totaling $800,000 which is payable in installments over four years. As of July 3, 2005, $368,000 is included in other liabilities which represent the unpaid principal balance net of imputed interest. Total remaining installment payments due total $400,000.

In January 2004, we sold 456,007 shares of our common stock at $3.775 per share in a private sale to certain institutional investors to which we had previously sold shares in a private sale in September 2003.

On February 14, 2004, we funded the acquisition of TDT with $5.0 million of available cash and executed a promissory note for an additional $15.3 million in addition to the issuance of new stock. The note bore interest at a rate of 8.5% per year and was payable in equal installments of principal and interest on December 1, 2004, May 1, 2005 and December 1, 2005. This debt was offset by approximately $750,000 of identified purchase price adjustments related to certain provisions in the stock purchase agreement. As of December 31, 2004, all principal and interest on this note was paid in full.

An additional purchase price adjustment of $2.6 million, payable to the former sole shareholder of TDT, was incurred based upon TDT s selection by the U.S. Department of Defense for the production of smart cards as part of the agency s common access card (CAC) program. As of December 31, 2004, this related party payable was paid in full.

In August 2004, we sold 7,309,666 shares of our common stock at $5.50 per share in an underwritten public offering. Net proceeds from these sales were approximately $37.4 million.

On October 5, 2004, we funded the acquisition of iA with approximately $5.0 million of available cash and assumed indebtedness of iA in the amount of approximately $2.9 million, all of which indebtedness was repaid in full from available cash concurrently with the closing of the merger.

We believe that our existing cash balances and anticipated cash flows from operations will be sufficient to meet our operating and debt service requirements for the next 12 months. However, if we cannot achieve our operating goals in 2005 or if we win additional drivers license contracts in 2005, we may be required to seek additional financing. There can be no assurance that such financing will be available on commercially reasonable terms, or at all. Our ability to meet our business forecast is dependent on a number of factors, including those described in the section of this report entitled Factors that May Affect Future Results.

Contractual Obligations

The following table sets forth our contractual obligations as of July 3, 2005 (in thousands).

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Capital Lease Obligations	$ 191	$ 80	$ 111	$	$
Operating Lease Obligations	$ 3,141	$ 339	$ 1,416	$ 1,104	$ 282

As of July 3, 2005, we had standby letters of credit issued by Citizens Bank for approximately $2.3 million to certain of our customers.

Commitments

We have employment and noncompetition agreements with certain officers. Such agreements provide for employment and related compensation, and restrict the individuals from competing, as defined, with us during the terms of their respective agreements and for up to two years thereafter. The agreements also provide for the grant of stock options under our stock option plan and for severance payments upon termination under circumstances defined in such agreements.

We have outstanding standby letters of credit with Citizens Bank of approximately $2.3 million. These letters of credit are required on certain of our customer contracts.

In addition, in May 2005, we made certain purchase commitments of $1.0 million with respect to printer purchases from a vendor.

Inflation

Although some of our expenses increase with general inflation in the economy, inflation has not had a material impact on our financial results to date.

Recent Accounting Pronouncements

In December 2004, the FASB issued FASB Staff Position, or FSP, No. 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. FSP No 109-1 states that the impact of this deduction should be accounted for as a special deduction rather than a rate reduction. It was effective immediately and has no impact on our 2004 consolidated financial statements.

In December 2004, the FASB issued FSP No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision with the American Jobs Creation Act of 2004.* FSP No. 109-2 grants a waiver to SFAS No. 109 requirement to account for the impacts of new legislation in the period of enactment. It was effective immediately and had no impact on our 2004 consolidated financial statements.

In December, 2004, the FASB issued SFAS No. 153, *Exchange of Nonmonetary Assets, an Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions.* SFAS No. 153 is based on the principle that exchange of nonmonetary assets should be measured based on the fair market value of the assets exchanged. SFAS No. 153 eliminates the exception of nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS 153 is effective for nonmonetary asset exchanges in fiscal periods beginning after June 15, 2005. We are currently evaluating the provisions of SFAS No. 153 and do not believe the adoption of SFAS No. 153 will have a material impact on our financial condition, results of operations and liquidity.

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment (SFAS 123R), which replaces SFAS 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion no. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. In April 2005, the Securities and Exchange Commission (the SEC) postponed the effective date of SFAS 123R until the issuer s first fiscal year beginning after June 15, 2005. Under the current rules, the Company will be required to adopt SFAS 123R in the first quarter of fiscal 2006.

Table of Contents

Under SFAS 123R, pro forma disclosures previously permitted will no longer be an alternative to financial statement recognition. The Company must determine the appropriate fair value model to be used for valuing share-based payments to employees, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include modified prospective and retrospective adoption options. Additionally, SFAS 123R clarifies the timing for recognizing compensation expense for awards subject to acceleration of vesting on retirement and also specifies the treatment of excess tax benefits associated with stock compensation. The adoption of SFAS No. 123R is expected to have a significant impact on our consolidated financial statements. The impact of adopting SFAS No. 123R cannot be accurately estimated at this time, as it will depend on the market value and the amount of share-based awards granted in future periods.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123R and the valuation of share-based payments for public companies. The Company is evaluating the requirements of SFAS 123R and SAB 107 and expects that the adoption of SFAS 123R will have a material impact on the consolidated results of operations and earnings per share. The Company has not yet determined the method of adoption or the effect of adopting SFAS 123R, and it has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs (SFAS 151), an amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4, Inventory Pricing . SFAS 151 amends previous guidance regarding treatment of abnormal amounts of idle facility expense, freight, handling costs, and spoilage. This statement requires that those items be recognized as current period charges regardless of whether they meet the criterion of so abnormal which was the criterion specified in ARB No. 43. In addition, this Statement requires that allocation of fixed production overheads to the cost of the production be based on normal capacity of the production facilities. This pronouncement is effective for the Company for fiscal periods beginning October 1, 2005. The Company is currently evaluating the effect that the adoption of SFAS 151 will have on its consolidated results of operations and financial condition, but does not expect it will have a material impact.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154) which replaces APB Opinions No. 20 Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements An Amendment of APB Opinion No. 28. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2006. The Company is currently evaluating the effect that the adoption of SFAS 154 will have on its consolidated results of operations and financial condition, but does not expect it will have a material impact.

Quantitative and Qualitative Disclosures about Market Risk

Since our January 2004 acquisition of ZN, our international operating results from transactions by our German operations have been denominated in euros. As of July 3, 2005, the cumulative loss from foreign currency translation adjustments was approximately $2.0 million. Hardware and consumables purchases related to contracts associated with the TDT acquisition are denominated in Japanese yen. We mitigate exchange rate volatility by utilizing foreign currency forward contracts. Prior to 2005, we did not hedge foreign currencies using derivative instruments. Subsequent to year end, we entered into derivatives contracts as cash flow hedges to mitigate exchange risk associated with our Japanese yen purchases. For the quarter ended July 3, 2005, we had unrealized losses related to transactions with Japanese vendors of approximately $46,000. Our international operations and transactions are subject to risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions and foreign currency exchange rate volatility. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Table of Contents

BUSINESS

Overview

Viisage Technology, Inc. was formed as a division of Lau Technologies in 1992. In 1996, we were incorporated as a Delaware company, just prior to the completion of our initial public offering of common stock. Our principal executive offices are located at 296 Concord Road, Billerica, MA 01821 Tel. 978.932.2200. When we refer to we , our and Viisage in this Prospectus, we mean Viisage Technology, Inc. as well as all of our consolidated subsidiaries, unless the context otherwise requires.

We are a leading provider of advanced technology identity solutions that enable governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy. Our solutions are specifically designed for the identification of people and include secure credentialing, biometrics, automated document authentication and real-time identity databases, as well as systems design, development, integration and support services. These identity solutions enable our customers to manage the entire life cycle of an individual s identity for a variety of applications including civil identification, criminal identification and border management. Our customers use our solutions to help solve the following three critical problems in identity verification and management:

- assurance that the identification document is authentic and has been issued to the correct person;
- confidence that the person holding the identification is uniquely tied to and authorized to use the document; and
- verification of the privileges the individual is entitled to at a particular point in time.

Our solutions annually produce more than 30 million secure government-issued credentials at more than 2,000 locations. We are the second largest provider of U.S. drivers licenses with a 30% market share, and are the sole source provider of passport production capability to the U.S. Department of State. We also are a recognized leader in biometrics in the field of face recognition. In addition, we are a leader in automated document authentication technology with approximately 2,500 installations in 15 countries. Our customers include governments, law enforcement agencies and businesses around the world.

Our business consists of one segment, the advanced technology identity solutions segment. See Note 12 to the Consolidated Financial Statements. As our market has become increasingly complex and more frequently requires the integration of various technologies and capabilities, we have established ourselves as a provider of end-to-end identity solutions. In January 2004, we acquired ZN Vision Technologies AG, or ZN, which solidified our leadership position in face recognition technology. In February 2004, we acquired Trans Digital Technologies Corporation, or TDT, which provided us with a significant presence in the U.S. federal government market and strengthened our capability and credibility in the border management market worldwide. And most recently, in October 2004, we acquired Imaging Automation, Inc., or iA, significantly adding breadth to our proprietary product portfolio with world-class document authentication products. The iA acquisition also supplemented our installed customer base, provided significant expansion in our distribution channels, particularly in Europe, the Middle East and Africa, and provided Viisage with a high value entrée into new markets.

We believe that our installed base of customers together with our leading face recognition and document authentication technologies provides us with a competitive advantage in delivering unified identity solutions for both the physical and digital domains.

Industry Overview

Markets

The ability to confirm an individual s identity is playing an increasingly important role in national and international security, personal privacy and commerce. Failure to provide adequate identification can lead to breaches of security and identity theft, the consequences of which can range from national security threats and loss of life to significant economic loss. Within this context, we believe that there is increasing pressure on governments and businesses to accelerate the adoption of advanced technology identity solutions. The concern over homeland security, in which identity solutions play a part, is exemplified by the size of the budget for the U.S. Department of Homeland Security, which is projected to be approximately $38.5 billion for the U.S. federal government s fiscal year ending September 30, 2005, an 8% increase over the previous fiscal year, and projected to be approximately $41.1 billion for the fiscal year ending September 30, 2006. Furthermore, identity theft is the nation s fastest growing crime, and the Federal Trade Commission has estimated that its total cost now exceeds $50 billion per year.

Government-issued credentials serve as the primary means for confirming the physical identity of an individual. The effectiveness, however, of these credentials is impaired by the following issues:

- the credential can be counterfeited or altered;
- the credential can be issued under false pretenses; and
- the credential rarely is linked to an identity database.

To address counterfeiting and alteration, identity credentials such as passports and drivers licenses increasingly are incorporating more sophisticated security features. For example, pigment ink printing, security laminates, holograms, ultra violet printing, microprinting, security fonts, half tone portraits, physical or digital watermarks and 2D barcodes have become common security features for passports and drivers licenses. Smart technologies are also expected to play a significant role in securing these credentials. We believe that issuing authorities will continue to upgrade their security features in order to overcome new means of counterfeiting and alteration. Furthermore, we believe that monitoring authorities at places like border entry points will increasingly embrace the use of automated document authentication technology to confirm the authenticity of presented credentials.

Moreover, although identity credentials are becoming more secure, the ability to obtain them under false pretenses continues to be a major weakness of the credential issuing process. As a result, issuing authorities are now focusing on improving their ability to verify the identity of a person requesting an identification credential prior to issuing that credential. As part of this effort, many authorities have also recognized the need to have secure and accurate audit trails of the issuance process and supporting documents for each credential. In addition, issuing authorities are increasingly incorporating biometrics to verify personal identities and deter fraud. Biometrics is a means of identifying a person using biological features unique to that individual. Biometric identifiers include facial images, fingerprints, iris scans, retinal scans, voice data and hand geometry.

Finally, as secure identity credentials, automated document authentication and biometrics become more prevalent, we believe the additional security generated by cross-checking the credential to a readily accessible identity database will grow in importance. This capability allows a higher level of identity assurance and real-time privilege management. With recent events surrounding the security of these source databases, we expect the standards for collecting and handling identity data to become more rigorous.

Market drivers and trends

We believe the global market for advanced technology identity solutions is driven by the following key trends:

Growth in government-initiated security programs. We believe that government agencies will continue to be key drivers for the growth and development of the market for advanced technology identity solutions through such programs as:

- the U.S. Visitor and Immigrant Status Indicator Technology program, or U.S. VISIT, which uses biometric data as part of new screening procedures for non-U.S. citizens entering the United States;

- the Transportation Workers Identification Credential, or TWIC, which is a credentialing program that may eventually cover an estimated 12 million national transportation workers;

- the U.S. Department of State s planned introduction of contactless chips in passports, which are electronic chips that hold the bearer s biographic and photographic data;

Table of Contents

Homeland Security Presidential Directive 12 (HSPD-12), which mandates that a common identification card be utilized by all Federal government employees and contractors; and

the REAL ID Act, signed into law in May 2005, which mandates authentication of a person s identity before they are issued a driver s license.

Development of industry standards and requirements. Several organizations responsible for standards in a number of our markets have implemented requirements for the use of face recognition biometrics. For example, in May 2003 the International Civil Aviation Organization, which sets recommended travel document standards for its member states, selected face recognition as the biometric to be used in passport documentation. Moreover, in February 2003, the National Institute for Standards and Testing, which is part of the U.S. Department of Commerce, recommended that a dual system of fingerprint and face recognition technology be used to verify the identities of visa holders at points of entry in the United States.

Growing use of biometrics. Governments are increasingly mandating biometrics as an integral component of identity solutions. According to the International Biometrics Group, spending on biometric security solutions is expected to grow at an approximately 40% compound annual rate from approximately $1.2 billion in 2004 to approximately $4.6 billion by 2008.

Increasing cost of identity theft and financial fraud. The growing direct and indirect cost of identity theft and financial fraud is increasing the pressure on businesses and individuals to accelerate the adoption of advanced technology identity solutions. Identity theft is the nation s fastest growing crime. The Federal Trade Commission has estimated that the total cost of identity theft exceeds $50 billion per year.

Statutory mandates for secure document authentication. The U.S. Federal Government is increasingly recommending, and in some cases mandating, the use of secure document authentication as a key component of identity verification. For example, the U.S. VISIT program specifically requires technology to be installed at all ports of entry that allow for biometric comparisons and document authentication of all U.S. visas and other travel documents. In addition, in 2004, the U.S. Federal Government issued the Federal Information Processing Standard for Personal Identity Verification of Federal Employees and Contractors as part of Homeland Security Presidential Directive 12 (HSPD-12). HSPD-12 includes a requirement for document authentication in connection with the issuance of secure credentials to federal government employees.

Convergence of physical and logical security systems. We believe that there is a growing need for governments and businesses to provide a highly secure, unified system for user authentication to access both physical assets, such as buildings, and digital assets, such as computer networks. For example, the U.S. Department of Defense s, or DoD, Common Access Card smart card program provides identity verification for approximately four million DoD employees and military personnel to enable access to military property and DoD computer networks. We believe that this program represents the model for identity solutions that will be implemented by governments and businesses in the future.

Our Identity Solutions

Our identity solutions include secure credential systems, automated document authentication systems, biometrics, database technologies and services. These solutions enable governments and businesses to issue credentials and verify and manage identities throughout the entire identity life cycle.

Table of Contents

Proofing. Our solutions provide verification of a person s claimed identity by authenticating breeder documents, such as drivers licenses, passports, INS cards, and national identification cards, and using biometrics to link the person to those breeder documents. In addition, we provide customers with the ability to perform identity verification on re-issuance of credentials and to submit queries to local and external proofing databases, as well as to perform duplicate analysis and verification using our face recognition technology.

Enrollment. Our solutions enable the digital capture and automatic storage of multiple pieces of data such as demographics, digital images, signatures and biometric data. Furthermore, our solutions enable the operator to rapidly import existing data without having to recreate it, thereby improving productivity and accuracy of the data by more effectively leveraging the existing database. Our enrollment solutions are designed to comply with a range of industry standards. In addition, our solutions create an audit trail of credentials, which includes information about the issuing operator as well as supporting breeder documents.

Issuance. Our solutions include state-of-the-art technologies for producing authentic and tamper-proof identification credentials. We offer turnkey solutions that include the hardware, software and consumables necessary to produce credentials, including static credentials and smart credentials using paper or plastic substrates. Credentials can be produced on-site (over-the-counter), off-site (central production) or through a hybrid of these two methods.

Usage. Our solutions can be used to verify the identities of individuals in a variety of settings, including on a one-to-one basis, such as to verify a claimed identity at a border checkpoint, or on a one-to-many basis, such as to establish an individual s identity when he or she does not reveal his or her true identity. In addition, our secure identity solutions can be used to address physical security needs such as border access and digital security needs such as computer network access.

We offer the following key components as part of our identity solutions:

Secure credential capabilities. We provide the necessary hardware, software and systems to enable our customers to produce secure and virtually tamper-proof credential documents that can be used for a variety of applications and settings. Our solutions are designed to integrate into our customers credential provisioning processes and conform to regulatory standards and requirements. We offer a range of tamper-resistant features, including biometric data contained in bar codes or chips, holographic overlays, ghost imaging, ultraviolet printing and microprinting. As a result, our customers can create highly secure and durable credentials that not only have embedded security features, but also link the credential to the issuing agency location, operator and material used.

We offer two types of credential systems. The first is an instant issuance or over the counter system that enables our customers to produce identification credentials on location in minutes. The second is a central production system that receives the information electronically from the point of capture, and enables our customers to produce credentials from a secure off-site processing location. Our secure credentials systems software is

Table of Contents

designed to integrate with a variety of third party software, and to support standard operating systems, network protocols and database products. In addition, we incorporate third party hardware, such as digital cameras and printers, into our systems, which enables us to offer configurations that meet our customers requirements and take advantage of advances in technology.

As part of our secure credential offerings, we provide automated document authentication systems. Automated document authentication is the process of verifying that a document is genuine (i.e., has not been altered, counterfeited, or otherwise changed or compromised). Our solutions enable our customers to authenticate documents using sophisticated electronic analysis employing advanced forensic techniques that use multi-spectral lighting, pattern matching, and other cutting edge technology. True authentication is achieved by comparing forensics examination results to expected results stored in one or more electronic document databases. Additional components are available that provide a unique and comprehensive database of document profiles or specifications, including drivers licenses from all 50 U.S. states and all Canadian provinces. Our iA-thenticate security software can test all documents that conform to the standards of the International Civil Aviation Organization, or ICAO, for machine readability. This includes hundreds of passports, visas, identification cards and other documents created by more than 250 issuing authorities worldwide, These databases are important enablers to automating the authentication process, making the technology suitable for deployments without requiring users to have any specific forensic knowledge of document security features. Additional advantages of our document authentication capabilities include:

- the ability to automatically authenticate identification documents such as passports, visas, INS immigration cards, drivers licenses, and military identification cards;
- the ability to read document data and capture full-page document images;
- our patented authentication process that performs security checks automatically in seconds; and
- incorporation into our Viisage PROOF product to create a consolidated system for the verification of an applicant s identity.

Biometric capabilities. In designing our identity solutions, we have developed a software platform upon which multiple biometrics can be integrated. The platform is designed to be independent of specific biometric technologies, thereby enabling customers to integrate one or several biometric identifiers as needed.

In addition to providing this independent platform, we have developed and invested in proprietary face recognition technology, including the ZN acquisition. We believe that face recognition will continue to grow as an important biometric for the following reasons:

- facial images do not reveal information that the person does not routinely disclose to the general public;
- facial images are already collected, stored and verified in large legacy databases as a part of most identity verification processes;
- facial image capture is non-intrusive and does not require the user to touch or interact with a physical device for a substantial timeframe to be enrolled;
- face recognition does not require new and costly enrollment procedures to be introduced;

- facial images can be captured from endorsed photographs which eliminates the need for the person to be physically present;
- facial images are culturally accepted internationally as a means of identification; and
- face recognition is the only biometric that can be easily verified by a person without special training.

We believe that we are a market leader in face recognition technology. Our face recognition systems are highly scaleable, as evidenced by our deployment in the State of Illinois, with approximately 18 million enrolled images, and our deployment with the Pakistan National Database and Registration Authority, which is expected to grow from ten million enrolled images to 40 million enrolled images in the next year. Our face recognition products have the following advantages:

- they provide the ability to search large-scale image databases containing millions of records on a real-time basis;

Table of Contents

they enable customers to rapidly enroll existing image databases;

they combine two face recognition technologies which results in increased speed and accuracy; and

they are designed to easily enable the addition of other face recognition technologies and product updates.

Systems Design, Development, Integration and Support. Our systems design, development, integration and support services are key components of our identity solutions. Our direct services organization supports our direct sales staff early in the sales cycle to help our customers identify their needs and design systems that will address these needs. Our software design and systems integration capabilities enable us to accommodate most computing environments and customers with special requirements. These capabilities also permit us to combine our products with offerings from other vendors to create a complete solution for our clients.

We also provide extensive customer training, telephone help desk support, and ongoing maintenance services through local and centralized field service technicians. In delivering these services, our direct service and support organizations can rely on the expertise of our software and hardware engineers or external technology consultants to provide post installation customer satisfaction. We also maintain a spare parts inventory and provide storage management, distribution and repair of the products we supply.

Our Products

The following summarizes our current product offerings:

Secure Credentialing

Viisage iA-thenticate® is a document authentication system which automatically captures, analyzes, and processes travel and identity documents such as passports, visas, INS immigration cards, driver licenses, and military identification cards. It can also read document data and capture full-page document images. Viisage iA-thenticate uses a patented authentication process to perform its security checks automatically in seconds. Software applications for the Viisage iA-thenticate platform include:

Viisage iA-Examiner for resolving document review and alert events.

TextWatch® for comparing data from travel documents with a database of suspicious documents or travelers, based on fields or characteristics specified by the customer.

DL-Alert for reading, interpreting and verifying the content, sequence, and format of information encoded in the magnetic stripe and/or bar code of commonly used identity documents such as drivers licenses and military identification cards.

Viisage iA-Verify for using sophisticated database queries to validate the issuance and biographic data read from drivers licenses and other identification documents.

Viisage iA-License which is a comprehensive database of U.S. and Canadian drivers license information that resides locally or on a central database server.

Viisage iA-Passport which is a comprehensive database of passport/visa information that resides locally or on a central database server.

Viisage PROOF integrates client and back-end software, our automated document authentication reader hardware and biometric technology, as well as internal and external database queries, to create a consolidated system for the verification of an applicant s identity. Viisage PROOF evaluates aggregated information on identification documents and the most commonly used breeder documents as well as a variety of additional data points, such as social security number and address verification, to produce a proofing confidence score that aids the credential issuing agency in the final decision about whether or not the candidate is allowed to proceed to the next phase of the identity solutions process or whether additional interviewing is required. This product is based on our proprietary data analytics algorithms.

Table of Contents

Biometrics

FaceTOOLS® Software Developer s Kit is designed for application developers who want to incorporate state-of-the-art face recognition technology into their applications. Using FaceTOOLS, developers can create a variety of face recognition applications. FaceTOOLS is based on flexible template matching that incorporates a unique combination of multiple approaches to face recognition.

FaceEXPLORER® is a large image database research and mining tool that provides the ability to reduce fraud and crime by identifying duplicate images in large databases, such as licensed drivers, benefit recipients and visa holders. Additionally, law enforcement officials use FaceEXPLORER to match images and computer composites against existing image databases to identify suspects and known criminals. Customers use FaceEXPLORER to verify identities, improve customer service and reduce fraud by effectively retrieving, managing and analyzing their image databases. We have deployed FaceEXPLORER in one of the world s largest face recognition systems for the Illinois Secretary of State and State Police.

FacePASS is a verification solution designed to meet complex access control system requirements. FacePASS utilizes face recognition technology to enable the customer to verify a person s identity to permit or deny access.

FaceFINDER® is a modern surveillance identification solution that uses patented real-time video technology. FaceFINDER assists customers, such as casinos, domestic and international airports, military bases and government buildings, in identifying suspects either from long distance or from large crowds.

Customers

Our customers use our identity solutions for a variety of applications, including civil identification, criminal identification and border management. For civil identification, we are the second largest provider of drivers licenses to state departments of motor vehicles. In this market, we are increasingly incorporating our biometric systems into the credential issuing processes as we have done for the office of the Illinois Secretary of State, the North Carolina Department of Motor Vehicles, the Oklahoma Department of Public Safety and the Kentucky Transportation Cabinet. We provide production capability to the DoD for the production of secure, smart credentials as part of the agency s common access card, or CAC, program. For criminal identification, our customers include the Ohio Department of Public Safety, Pinellas County, Florida, the U.S. Army and the U.S. Secret Service. For border management, we are the sole source provider of passport production capability to the U.S. Department of State. In addition, we serve a variety of customers with our document authentication products including Australia Customs, Canada Customs and Revenue Agency, British Airport Authority, Hungarian Border Police, Finnish Frontier Guards and many others.

Historically, we have experienced minimal customer turnover. We believe this is a result of our strong product portfolio and emphasis on customer service and support. The following is a representative list of our customer base:

Civil Identification Drivers Licenses	*Criminal Identification*
Arkansas Office of Driver Services	City of New Bedford, Massachusetts Department of Police
Connecticut Department of Motor Vehicles	
Illinois Secretary of State	Jefferson County, Alabama, Sheriff s Office

Kentucky Transportation Cabinet
Maryland Department of Transportation and Motor Vehicle Administration*
Mississippi Department of Information Technology Services
North Carolina Department of Transportation
Oklahoma Department of Public Safety
Pennsylvania Department of Transportation
State of Rhode Island, Department of Administration, Division of Motor Vehicles
State of Delaware Department of Public Safety
West Virginia Division of Motor Vehicles
Wisconsin Department of Transportation

Kentucky State Police of the Commonwealth of Kentucky

Ohio Department of Public Safety
Pinellas County Sheriff s Office
U.S. Army
Washington, D.C. Department of Corrections
Wisconsin Department of Transportation

Border Management
Pakistan National Database and Registration Authority
Canada Customs and Revenue Agency
U.S. Department of State
Australia Customs
British Airport Authority

39

Table of Contents

Civil Identification Social Services
Connecticut Department of Social Services

Finnish Frontier Guards

Other
ABN AMRO Bank

Berlin Airport
Hanover Zoo
U.S. Department of Defense*
U.S. Navy
100+ Casinos

* By subcontract

For the six months ended July 3, 2005 and June 27, 2004, one customer, the U.S. Department of State, accounted for 32.8% and 18.9% of our revenue, respectively. For the year ended December 31, 2004, the U.S. Department of State accounted for 16.0% of our revenue and Telos Corporation (U.S. Department of Defense) accounted for 15.0% of our revenue. We typically enter into multi-year contracts with our customers. A majority of our contracts are with U.S. federal or state governmental agencies. Government contracts are generally subject to termination for convenience or lack of appropriation at the determination of the subject agency.

Sales and Marketing

We market our products and identity solutions through a direct sales force, strategic partnerships and alliances. Our direct sales force is responsible for marketing and selling our entire identity solutions portfolio. We have a worldwide sales force responsible for delivering customer solutions to the North American Market, Europe, the Middle East and Asia Pacific. In addition, we have established a dedicated U.S. federal sales team in Washington, D.C. responsible for marketing and selling to U.S. government agencies such as the Department of Homeland Security, the Department of State, the DoD and others. We have also established a dedicated product sales team responsible for driving product sales to our worldwide customer base. Viisage continues to have a dedicated sales and services team operating from our Bochum, Germany location, strengthening our coverage and access to the international markets for our products and identity solutions. As of September 1, 2005, we employed 37 people in our sales and marketing organization.

We continue to seek to develop strategic partnerships and distribution channels to broaden our coverage and increase the size of our market worldwide. We have established original equipment manufacturer, or OEM, distribution agreements with partners to leverage our face recognition technology. We have established channels of distribution for our document authentication products to open new markets outside of the U.S. Additionally, we work with systems integrators, solution providers and service organizations to deliver identity solutions in combination with their core capabilities to expand our access to such organizations existing relationships, marketing resources and credibility in new markets. Local agents are also utilized to expand our international access to identity solutions opportunities around the world.

Product Development

We focus our product development efforts on critical components for advanced technology identity solutions. These include proprietary software that addresses image capture, image processing, enhancement of face recognition accuracy, information retrieval from identity databases and document authentication. In addition, we focus on expanding our capabilities in solutions for the civil identification, criminal identification and border management markets. As of September 1, 2005, we employed 47 people in our product development organization.

We benefit from research and development activities conducted by the manufacturers of the components integrated into our systems such as cameras, database software and computers. Moreover, many of our customers, including the U.S. government, provide direct funding to us to assist us in our research and development efforts on their behalf. For the years ended December 31, 2004, 2003 and 2002, our customers provided research and development funding of $1.8 million, $2.5 million and $1.6 million, respectively.

For the years ended December 31, 2004, 2003 and 2002 we had time and materials contracts with the U.S. Federal Government to formulate and design possible product or process alternatives for biometrics technology. We recorded revenue of $1.0 million, $2.5 million and $1.6 million related to these contracts during 2004, 2003 and 2002, respectively. The remaining funded research of $800,000 for the year ended December 31, 2004 represents funded research and development activities that meet the requirements of SFAS No. 2. The funding associated with these contracts are recorded as an offset to research and development expenses when earned.

Table of Contents

For the years ended December 31, 2004, 2003 and 2002, research and development expense was $4.4 million, $3.7 million and $4.5 million, respectively. These amounts do not include spending for projects where our customers provide research and development funding. The costs associated with delivery of these projects are generally recorded as cost of revenues or as a contract research and development expense as appropriate.

Intellectual Property

We believe that our intellectual property is important to our advanced technology identity solutions.

Patents Our advanced technology identity solutions use patented technology and trade secrets developed or acquired by us. We have significantly expanded our portfolio of patents and trade secrets through the acquisitions of ZN and iA. We have a portfolio of 20 U.S. and foreign patents. In addition, we have 30 U.S. and foreign patent applications in process for face recognition and document authentication technologies. Our U.S. patents typically have a duration of 17 to 20 years.

Trademarks We have registered our Viisage Technology trademark, as well as trademarks for FaceEXPLORER , FaceFINDER , FaceTOOLS , iA-thenticate , iA-Passport , TextWatch , BorderGuard , FaceWatch and Sensormast with the U.S. Patent and Tr Office. We also have registered trademarks for iA-thenticate , iA-Passport , TextWatch, BorderGuard and FaceWatch in Europe and Japan. Applications are pending in the United States and Europe for the Viisage and FacePASS trademarks and in Europe for FaceEXPLORER and FaceFINDER .

Copyrights We have filed a copyright application for our SensorMast software and have made copyright filings for our BorderGuard and iA-thenticate software as well as for our Visual Inspection System and related proprietary software.

Backlog

Our backlog consists of signed contracts, subcontracts and customer commitments for which revenue has not yet been recognized and excludes phase-out or other extension opportunities included in such contracts. Backlog is only somewhat indicative of future revenue because contracts may be changed positively or negatively. Contracts included in our backlog could be cancelled at any time due to lack of performance without penalty. Contracts terminated by our customers for convenience would generally result in our recovery of all actual committed costs and profit, if any, on work performed through the date of cancellation.

At July 3, 2005, our backlog was $119 million, compared to $152 million at June 27, 2004. At December 31, 2004, our backlog was $139 million, compared to $112 million at December 31, 2003. The backlog at December 31, 2003 included approximately $19 million related to our contract to produce drivers licenses for the State of Georgia. We removed this contract from our backlog in the third quarter of 2004 in connection with litigation involving this contract. See Business Legal Proceedings below. Of the $139 million in backlog as of December 31, 2004, we expect to recognize revenue of approximately $50 million in 2005.

Competition

The market for our products and services in individual component areas of identity solutions, such as secure credentials, biometrics, and document authentication is extremely competitive and we expect this competitive environment to intensify as the market for our products continues to grow and mature. We compete on the basis of the following factors: service and support, technical excellence, price, credibility and flexibility in accommodating customer technical and business needs.

We believe that our comprehensive approach to identity solutions, our unique capabilities and our proprietary technology differentiate us from our competition. We are not aware of any company that competes with us directly on the basis of providing advanced technology identity solutions that cover the full identity life cycle.

We face competition in the document issuance systems market from companies, including Digimarc ID Systems, LLC, that, in some cases, have greater financial and marketing resources than we do. Substantially all of our sales to new customers have been the result of competitive bidding for contracts pursuant to public sector

Table of Contents

procurement rules. In some cases, we may be competing with an entity that has a pre-existing relationship with a potential customer, which could put us at a significant competitive disadvantage. In other cases, however, we have pre-existing relationships with customers, which give us an advantage relative to our competitors for that customer. As the secure identification market expands, additional competitors may seek to enter the market. There are several document authentication competitors that we encounter in the marketplace, including AssureTec, Canadian Bank Note, Smiths Heimann, and 3M/AiT. We believe that we have some of the largest customer installations in the world and we have benefited from a high level of customer satisfaction and success. We further believe that our leadership position in maintaining robust document libraries gives us a competitive advantage in this market space.

In the field of biometric technology, we compete with several face recognition providers, including Identix Inc., as well as, to a lesser extent, providers of other biometric solutions, such as fingerprint, iris and retinal scans, voice data and hand geometry. We believe that applications increasingly will require the use of multiple biometrics. Accordingly, while our face recognition technology competes with other biometrics, we have designed our identity solutions to serve as a platform for multiple biometric technologies so that we are able to provide the particular biometric required by our customers. We believe that our proprietary face recognition technology, together with our market leadership and experience integrating multiple biometrics, gives us a competitive advantage in the biometrics market.

Seasonality

Our business is not subject to seasonal fluctuations.

Working Capital Requirements

Certain contracts require significant capital to fund development and implementation. In 2004, we utilized bank borrowings and other lease financing vehicles to supplement our working capital to fund these capital requirements. In addition, in August 2004, we raised approximately $37.4 million in net proceeds through an underwritten public offering. These funds were used to repay approximately $27.3 million of indebtedness and for general corporate purposes. On December 14, 2004, we entered into a Loan and Security Agreement (the Loan Agreement) with Citizens Bank of Massachusetts which permits us to borrow up to $25.0 million, subject to certain financial covenants which may restrict the amounts available to be borrowed. Certain of these covenants were amended in March 2005. There are no special requirements in our credit facility or other lease financing vehicles that are expected to have a material adverse effect on our working capital. As discussed more fully in Management s Discussion and Analysis of Financial Condition and Results of Operations, we may raise additional capital, as needed, to fund working capital needs or growth activities.

Environmental Protection Regulations

We believe that our compliance with federal, state and local environmental regulations will not have a material adverse effect on our financial position or results of operations.

Employees

As of September 1, 2005, we had 195 full time employees and three supplemental employees. Supplemental employees are employees on our payroll who are not eligible for benefits. None of our employees are covered by collective bargaining agreements. We believe that our relations with our employees are good.

Financial Information about Foreign and Domestic Operations and Export Sales

For the six months ended July 3, 2005 and June 27, 2004, export sales were approximately $3.8 million and approximately $775,000, respectively. For the years ended December 31, 2004 and 2003, export sales were approximately $2.4 million and $800,000, respectively. We did not have any revenue related to export sales for the year ended December 31, 2002. We do not consider export sales to be material for the years ended December 31, 2004, 2003 and 2002. Foreign operations and export sales may be significant in the future due to our acquisitions of ZN and iA in 2004. See Note 12 of Notes to Consolidated Financial Statements.

Company s Internet Website

We maintain a corporate website with the address www.viisage.com. We are not including the information contained in our website, or incorporating it by reference into, this Prospectus. We make available, free of charge through our website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on

42

Table of Contents

Form 8-K, and any amendments to these reports as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. We make available on our website reports filed by our executive officers and directors on Forms 3, 4 and 5 regarding their ownership of our securities as soon as reasonably practicable after they are filed with the Securities and Exchange Commission.

Properties

Our corporate headquarters comprises approximately 32,000 square feet of space in facilities located in Billerica, Massachusetts. This space is subleased to us by eiStream, Inc. The term of this sublease runs through December 31, 2008. We use this property for corporate, administrative, research and development, customer support and other general business needs. We lease approximately 12,500 square feet of space in facilities located in Bochum, Germany. The term of this lease is indefinite, but the lease can be terminated on six months notice. This space is used for research and development and sales operations. We lease approximately 4,000 square feet of space in Arlington, Virginia. The term of this lease runs through April 2009. We use this property for our federal solutions operations. While we believe that these facilities are adequate to meet our immediate needs, it may become necessary to secure additional space in the future to accommodate any future growth. We believe that such additional space will be available as needed in the future on commercially reasonable terms.

Legal Proceedings

In March and April 2005, eight putative class action lawsuits were filed in the United States District Court for the District of Massachusetts against us, Bernard C. Bailey, William K. Aulet and Denis K. Berube and other members of our Board of Directors. A motion has been filed by the so-called Turnberry Group to consolidate these lawsuits into one action under the case name: *Darquea v. Viisage Technology, Inc. et al.*, Civil Action No. 05-10438-MLW. This motion also seeks to have the Turnberry Group designated as lead plaintiff and its counsel designated as lead counsel. The suits allege violations of the federal securities laws by us and certain of our officers and directors arising out of purported misrepresentations in the guidance that we provided on our anticipated financial results for fiscal 2004 following the release of our 2004 second and third quarter results, which allegedly artificially inflated the price of our stock during the period May 3, 2004 through March 2, 2005. We are not able to estimate the amount of the loss allegedly suffered by members of the putative class or the amount of legal costs and internal efforts associated with defending ourselves and our officers and directors. We believe that the allegations and claims made in these lawsuits are wholly without merit and intend to defend the actions vigorously. If we are unsuccessful in defending ourselves in this litigation, these lawsuits could adversely affect our business, financial condition, results of operations and cash flows as a result of the damages that we would be required to pay. It is possible that our insurance policies either may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. In April 2005, two purported shareholder derivative actions also were filed against the Company s directors, naming Viisage as a nominal defendant. The suits claim that these directors breached their fiduciary duties to the Company s shareholders and to the Company generally in connection with the same set of circumstances alleged in the class action lawsuits. The complaints are derivative in nature and do not seek relief from the Company. One of these actions was filed in Massachusetts Superior Court and the other was filed in the United States District Court for the District of Massachusetts. In July 2005, the state court action was dismissed with prejudice at the plaintiff s request. The Company s response to the federal court action is not yet due. The Company believes that the allegations and claims made in the remaining derivative lawsuit are likewise wholly without merit and intends to defend this action vigorously.

In December 2004, the superior court for Fulton County, Georgia granted summary judgment in favor of Georgia s Department of Motor Vehicle Safety, or DMVS, in connection with litigation brought by Digimarc ID Systems, LLC in March 2003 alleging that DMVS did not comply with its own bid process when it selected Viisage as the vendor for its new digital drivers license program. In July 2003, the court had issued a preliminary injunction prohibiting DMVS from continuing to work with us to install the State s new drivers license system. In July 2004, we reached a settlement agreement with the State pursuant to which DMVS terminated the contract for convenience and agreed to pay us $2.0 million in cash and the State agreed to purchase certain equipment from us for $500,000. In its December 2004 ruling, the Georgia court authorized DMVS to issue a new request for proposals for a digital drivers license system, but disallowed the $2.0 million cash payment described above. Without this payment, we believe either that the settlement agreement with DMVS is not effective and that our contract with DMVS remains in place, or that our initial claim for an $8.2 million settlement payment is revived. The State has paid us the $500,000 for the equipment in March 2005 and we appealed the disallowance of the $2.0 million settlement payment. In May 2005,

Table of Contents

the Georgia Supreme Court voted in a 4-3 decision not to hear our appeal based on procedural grounds. Due to the uncertainty of the cash settlement as a result of the judge s ruling and the uncertainty of future cash flows from this contract to support the book value of certain system assets installed, we have identified $2.2 million of assets deployed within the state that we have deemed to have no alternative use. We reduced the recorded value of these assets from approximately $2.2 million to their estimated fair value of approximately $200,000 based on our estimate of realizable value from liquidation of these assets, which resulted in a $2.0 million charge in the fourth quarter of 2004. In addition, we have removed the contract from our backlog, and we will lose up to $19.7 million in revenue that we expected to recognize over the next five and one-half years, unless the contract remains in place or we are able to win the new contract for the digital drivers license system and the revenues from such new contract are substantially similar to the prior contract. There are approximately $2.9 million of system assets remaining on our balance sheet from the Georgia contract. These consist of approximately $1.1 million of assets that we anticipate using in Georgia if we win the contract based on the new request for proposals, approximately $150,000 of assets that we anticipate could either be used in Georgia under a new contract or used in other projects, and approximately $1.6 million of assets constituting our central production facility in Georgia. We have evaluated these assets for impairment and, based upon our current probability-weighted estimate of cash flows, we have determined that these assets are not currently impaired. While we believe we can utilize these assets either in Georgia, if we win the contract, or on alternative projects, to the extent that we are unable to utilize these assets or realize value through a sale of these assets or reach a new settlement with DMVS regarding these assets, we would be required to take a further charge to earnings.

In May 2005, Viisage, Toppan Printing Co., Ltd. and Fargo Electronics, Inc. agreed to a settlement of the lawsuit Fargo had filed against Toppan and TDT in July 2004 in the U.S. District Court for the Eastern District of Virginia. The lawsuit alleged that a reverse image printer manufactured by Toppan and distributed by TDT infringed four U.S. patents owned by Fargo. The settlement agreement required Toppan to pay a settlement amount to Fargo and granted Fargo distribution rights worldwide outside Japan for the Toppan CP-400 card printer. Additionally, we and Fargo entered into a strategic distribution agreement that allows us to purchase the full line of Fargo printers, become Fargo s exclusive distributor of the Toppan CP-400 card printer to the U.S. federal government and U.S. state drivers license markets, and distribute the Toppan CP-400 printer worldwide outside Japan. As part of this arrangement, we have committed to purchase $1.0 million of products from Fargo over the next two years and will pay to Fargo a commission on future sales of the Toppan CP-400 printer and consumables for the Department of Defense Common Access Card program.

We are not aware of any other legal matters that could have a material adverse effect on our business, financial condition or results of operations.

Table of Contents

MANAGEMENT

Executive Officers and Directors of the Registrant

Set forth below is information concerning each of our directors and executive officers:

Name	Age	Position
Bernard C. Bailey	51	President and Chief Executive Officer and Director
Iftikhar Ahmad	53	Senior Vice President, Worldwide Services
Bradley T. Miller	44	Senior Vice President and Chief Financial Officer
James P. Ebzery	45	Senior Vice President, Customer Solutions
Mohamed Lazzouni	45	Senior Vice President and Chief Technology Officer
Ron van Os	45	Vice President and Chief Product Officer
Denis K. Berube	62	Chairman of Board of Directors
B.G. Beck	68	Vice Chairman and Director
Charles E. Levine	52	Director
Harriet Mouchly-Weiss	62	Director
Peter Nessen	69	Director
Paul T. Principato	51	Director
Thomas J. Reilly	66	Director
Marcel Yon	38	Director

Bernard C. Bailey joined Viisage in August 2002 as Chief Executive Officer. From January 2001 through August 2002, Mr. Bailey served as the Chief Operating Officer of Art Technology Group. Between April 1984 and January 2001, Mr. Bailey served in various capacities at IBM Corporation, including several executive positions. A graduate of the US Naval Academy, Mr. Bailey served for eight years as an officer in the US Navy.

Iftikhar A. Ahmad was appointed Senior Vice President, Worldwide Services in January 2005. Between October 2002 and December 2004, he served as Senior Vice President and General Manager of our Secure Credentials business segment. Between March 1999 and October 2002 he served as Viisage s Vice President of Engineering and Program Management. From November 1996 until March 1999, Mr. Ahmad served as a Director in our Software Engineering Department. From January 1995 to November 1996, he was a senior consultant in Lau s Systems Engineering Department, and prior to that, he held various senior engineering positions at Digital Equipment Corporation.

Bradley T. Miller joined Viisage in September 2005 as Senior Vice President and Chief Financial Officer. From May 2004 to August 2005, Mr. Miller was Vice President of Finance, Corporate Controller and Chief Accounting Officer for Sonus Networks, Inc., a provider of voice infrastructure products. From March 2000 through May 2004, Mr. Miller was with Sapient Corporation, an information technology and business consulting firm. Mr. Miller joined Sapient in March 2000 as Corporate Controller, and was appointed Vice President in August 2001 and Chief Accounting Officer in November 2002. From September 1999 until March 2000, Mr. Miller served as Vice President and Corporate Controller of JuniorNet Corporation, an Internet content provider, and from August 1996 to September 1999 was Director of Financial Reporting of Wang Global, a worldwide provider of network services. Mr. Miller previously was a member of the audit practice with Coopers & Lybrand where he earned his C.P.A. license.

James P. Ebzery was appointed Senior Vice President, Customer Solutions in January 2005. Between November 2002 and December 2004, he served as Senior Vice President of Sales and Marketing. Mr. Ebzery served as Vice President of Operations for Internet Capital Group from April 2000 to February 2002. Prior to joining Internet Capital Group, he held senior sales and marketing positions at IBM Corporation from December 1983 to April 2000. He also served as the Worldwide Solutions Executive for the IBM Supply Chain Software Business.

Mohamed Lazzouni was appointed Chief Technology Officer in January 2005 and Senior Vice President in April 2005. Between November 2002 and December 2004, he served as Viisage s Vice President of Engineering. From November 2001 to November 2002, Dr. Lazzouni was an independent consultant to Viisage in the area of secure credentials. From June 2000 to November 2001, Dr. Lazzouni was the Chief Operating Officer of Nexaweb Technologies, Inc., an enterprise Internet applications provider. Prior to that, he served as the Chief Technology Officer of the electronic commerce division of EMC Corporation and before that as the Chief Executive Officer of SIA Technology Corporation.

Ron van Os joined Viisage in October 2004 as Vice President and Chief Product Officer. Between December 2001 and October 2004, Mr. van Os was the Executive Vice President of Sales, Marketing and Business Development for Imaging Automation. Between August 2000 and October 2001 he served as Executive Vice President, Sales &

Table of Contents

Marketing of Targetbase, an Omnicom company. From March 1996 to July 2000 he held various sales management positions at American Airlines/Sabre. Prior to joining American Airlines/Sabre he was with Electronic Data Systems (EDS) from August 1982 to February 1996 where he held various international sales positions.

Denis K. Berube has been the Chairman of the Board of Directors of Viisage since the Company s incorporation in 1996. Mr. Berube is Executive Vice President and Chief Operating Officer of Lau Technologies (Lau), an investment company. Lau is one of the largest holders of Viisage Common Stock, directly owning approximately 11.4% of its issued and outstanding Common Stock. Mr. Berube has been employed at Lau since 1990.

B.G. Beck was the President and Chief Executive Officer of Trans Digital Technologies Corporation from 1998 until its acquisition by Viisage in February 2004, at which time he joined the Board of Directors of Viisage. Mr. Beck currently serves as a consultant to Viisage and also serves as a member of the Board of Directors of Cardinal Financial Corporation, a provider of comprehensive individual and corporate banking services.

Charles E. Levine has served as a director of Viisage since 1998. Mr. Levine retired in September 2002 from his position as President of Sprint PCS, cellular telephone provider, a position he had held since 2001. Mr. Levine joined Sprint PCS in January 1997 as Senior Vice President of Marketing. Before joining Sprint PCS, Mr. Levine served as Senior Vice President of Octel Services, a provider of voice systems services, from October 1994 through September 1996. Mr. Levine currently also serves as a member of the Boards of Directors of @Road, Inc., a wireless applications provider, Sierra Wireless Inc., a provider of a broad range of wireless products, including data modems, embedded modules and mobile phones, Somera Communications, a provider of telecommunications operators with equipment and deployment services, and Lexar Media, Inc., a provider of digital media such as compact flash and other flash memory products.

Harriet Mouchly-Weiss has served as a director of Viisage since its incorporation in May 1996. Ms. Mouchly-Weiss founded Strategy XXI Group, an international communications and consulting firm, in 1992 and has served as its managing partner since that time. Ms. Mouchly-Weiss currently also serves as a member of the Board of Directors of American Greetings Corporation, a company engaged in the design, manufacture and sale of everyday and seasonal greeting cards and other social expression products.

Peter Nessen has served as a director of Viisage since its incorporation in May 1996. Since July 2003, Mr. Nessen has served as the President of Nessen Associates Ltd., a non-profit consulting company. From January 2003 to July 2003, Mr. Nessen served as an adviser to the Governor of the Commonwealth of Massachusetts on education matters. Mr. Nessen has been Chairman of the Board of NCN Financial, a private banking firm, since January 1995. From June 1993 through December 1994, Mr. Nessen was Dean for Resources and Special Projects at Harvard Medical School.

Paul T. Principato has served as a director of Viisage since May 2001 and as Chief Financial Officer of Lau since its incorporation in March 1990. Prior to 1990, Mr. Principato served as Controller at Barry Wright Corp.

Thomas J. Reilly has served as a director of Viisage since its incorporation in May 1996. Mr. Reilly has been a self-employed financial consultant since December 1994. From June 1966 through November 1994, Mr. Reilly was with Arthur Andersen LLP, a public accounting firm, where he became a partner in 1975.

Marcel Yon was appointed a director of Viisage in June 2004. Mr. Yon was a founder of ZN Vision Technologies AG and served as its Chief Executive Officer from its inception in April 2000 until it was acquired by Viisage in January 2004. Mr. Yon currently serves as the Chief Executive Officer of Yon AG, a consulting firm. Prior to founding ZN, Mr. Yon advised on international mergers and acquisitions and strategy with Lazard & Co., an investment bank, in London.

Audit Committee

The Audit Committee of the Board of Directors, comprised of Peter Nessen (chair), Thomas Reilly, and Charles Levine, meets at least quarterly to review the Company s quarterly financial releases. Each member of the Audit Committee is independent within the meaning of Section 4200 of the National Association of Securities Dealers Marketplace Rules and as required pursuant to Rule 10A-3 under the Securities Exchange Act of 1934, as amended (the Exchange Act). The Board of Directors has determined that Messrs, Nessen and Reilly are each qualified as an audit committee financial expert within the meaning of applicable regulations issued under the Exchange Act. The Board of Directors has adopted a written charter for the Audit Committee.

Table of Contents

Summary Compensation Table

The table below sets forth summary information concerning the compensation awarded to our Chief Executive Officer and our four other most highly compensated executive officers who were serving as executive officers as of December 31, 2004. The individuals listed below are referred to in this annual report as our named executive officers .

Name and Principal Position	Year Ended 12/31	Annual Compensation Salary	Bonus(1)	Securities Underlying Options(2)	All Other Compensation(3)
Bernard C. Bailey,	2004	$ 326,192	$ 235,000		$ 16,634
	2003	$ 300,000	$ 135,000		$ 17,721
President and Chief Executive Officer(4)	2002	$ 101,538	$ 135,000	720,000	$ 1,350
Iftikhar Ahmad,	2004	$ 185,394	$ 40,000	20,000	$ 350
	2003	$ 175,000	$ 25,000		$ 2,625
Senior Vice President of General Manager, Secure Credentials	2002	$ 172,885	$ 32,000	60,000	$ 3,073
William K. Aulet,	2004	$ 189,058	$ 100,000		$ 365
	2003	$ 151,442	$ 20,000	200,000	$ 4,543
Senior Vice President and Chief Financial Officer(5)	2002				
James P. Ebzery,	2004	$ 228,154	$ 60,000		$ 432
	2003	$ 215,000	$ 60,000		$ 6,332
Senior Vice President, Sales and Services(6)	2002	$ 25,635		200,000	
John J. Dillon,	2004	$ 100,000	$ 67,000		$ 100,192
	2003	$ 161,539	$ 67,000	200,000	
Senior Vice President, Government Solutions(7)	2002				

(1) The Company currently maintains an Executive Incentive Compensation Plan for its executive officers and other key employees to motivate participants. Each participant in the Executive Incentive Compensation Plan may receive a bonus equal to a percentage of his or her base salary based upon the Company s and each participant s individual performance, as determined by success in meeting established goals approved by the Chief Executive Officer, for individual goals, or the Board of Directors, for Company goals. The Compensation Committee administers the plan.

(2) Options were granted under the Management Plan.

(3) Amounts include 2003 401(k) plan Company match of $6,000 for Mr. Bailey, $2,625 for Mr. Ahmad, $4,543 for Mr. Aulet, and $5,572 for Mr. Ebzery. The plan permits pre-tax contributions by participants of up to 15% of base compensation or the statutory limit. The Company may make discretionary contributions to the plan, subject to certain limits. Participants are fully vested in their contributions and vest 20% per year in employer contributions. There was no Company match in 2004. Amounts also include the dollar value of premiums paid by the Company on behalf of the individual for term life insurance under the Company s life insurance and accidental death and dismemberment plan in 2004. In connection with the termination of his employment with the Company, Mr. Dillon was paid $100,000 in severance payments in 2004.

(4) Mr. Bailey was hired in 2002.

(5) Mr. Aulet was hired in 2003 and left the Company in September 2005.

(6) Mr. Ebzery was hired in 2002.

(7) Mr. Dillon was hired in 2003 and left the Company in June 2004.

Table of Contents

Stock Options Granted During 2004

The following table sets forth information concerning individual grants of stock options made during 2004 to the Company s named executive officers.

Name	Number of Securities Underlying Options Granted(1)	% of Total Options Granted to Employees in Year	Exercise Price ($/share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2)	
					5%	10%
Iftikhar Ahmad	20,000	2.0%	$ 7.06	11/10/14	$ 79,673	$ 197,291

(1) Options were granted under the Management Plan. Total of options granted does not include shares purchased pursuant to the Employee Stock Purchase Plan. The options listed vest in equal installments on the first, second, third and fourth anniversaries of the grant date.
(2) In accordance with SEC rules, we have based our calculation of the potential realizable value on the term of the option at its time of grant, and we have assumed that:

The fair market value on the date of grant appreciates at the indicated annual rate compounded annually for the entire term of the option; and
The option is exercised and sold on the last day of its term for the appreciated stock price.

These amounts are based on 5% and 10% assumed rates of appreciation and do not represent our estimate of future stock prices. Actual gains, if any, on stock option exercises will be dependent on the future performance of the Common Stock.

Aggregated Option Exercises in the Last Fiscal Year and Fiscal Year End Option Values

The following table sets forth information concerning option exercises during 2004 and outstanding stock options held at the end of 2004 by the Company s named executive officers.

Name	Shares Acquired on Exercise	Value Realized(1)	Number of Securities Underlying Unexercised Options at 12/31/04 Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at 12/31/04 Exercisable/ Unexercisable(2)
Bernard C. Bailey			250,000/470,000	$ 1,415,000/$2,660,200
William K. Aulet			66,666/133,334	$ 310,664/$621,336
James P. Ebzery			133,332/66,668	$ 662,660/$331,340

Iftikhar Ahmad		147,429/64,873	$	487,046/$261,090
John J. Dillon	75,000			