IDENTIVE GROUP, INC.
Form 10-Q
November 10, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

September 30, 2011 For the quarterly period ended September 30, 2011

OR

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

For the transition period from to

COMMISSION FILE NUMBER: 0-29440

IDENTIVE GROUP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	**77-0444317**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**(I.R.S. EMPLOYER IDENTIFICATION NUMBER)**

1900 Carnegie Avenue, Building B

Santa Ana, California 92705

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES INCLUDING ZIP CODE)

(949) 250-8888

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller Reporting Company	x

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

At November 7, 2011, 57,613,590 shares of common stock were outstanding, excluding 618,400 shares held in treasury.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30	
	2011	Restated 2010 (A)	2011	Restated 2010 (A)
Net revenue	$ 26,752	$ 20,511	$ 74,784	$ 57,035
Cost of revenue	14,922	11,563	43,360	31,506
Gross profit	11,830	8,948	31,424	25,529
Operating expenses:				
Research and development	2,286	1,035	4,823	3,513
Selling and marketing	6,198	4,823	17,432	14,877
General and administrative	6,372	5,341	17,212	16,201
Restructuring and other charges				337
Total operating expenses	14,856	11,199	39,467	34,928
Loss from operations	(3,026)	(2,251)	(8,043)	(9,399)
Other income	25		255	
Interest expense, net	(242)	(208)	(805)	(654)
Foreign currency gains (losses), net	(622)	388	(398)	(174)
Loss from continuing operations before income taxes and noncontrolling interest	(3,865)	(2,071)	(8,991)	(10,227)
(Provision) benefit for income taxes	(54)	(39)	1,550	866
Loss from continuing operations	(3,919)	(2,110)	(7,441)	(9,361)
(Loss) income from discontinued operations, net of income taxes		(24)		69
Consolidated net loss	(3,919)	(2,134)	(7,441)	(9,292)
Less: Net loss attributable to noncontrolling interest	233	109	336	526
Net loss attributable to Identive Group, Inc.	$ (3,686)	$ (2,025)	$ (7,105)	$ (8,766)
Basic and diluted net loss per share attributable to Identive Group, Inc.:				
Loss from continuing operations	$ (0.06)	$ (0.05)	$ (0.14)	$ (0.21)
Income from discontinued operations	$	$	$	$
Net loss	$ (0.06)	$ (0.05)	$ (0.14)	$ (0.21)

Weighted average shares used to compute basic and diluted loss per share	57,579	43,279	52,478	41,901

(A) As stated in Note 20 to the Consolidated Financial Statements in its 2010 Annual Report on Form 10-K, the Company had determined that an error occurred in the recognition of revenue related to the sale of readers for the German national ID program as reported in the third quarter of 2010. Upon review of Accounting Standards Codification 605, *Revenue Recognition*, the Company had concluded that not all criteria for recognizing the sale were in fact met until the fourth quarter of 2010. As a result, revenue and cost of revenue of approximately $2.8 million and $1.6 million, respectively reported in the Company s Form 10-Q for the three and nine months ended September 30, 2010 were overstated, resulting in an impact of $1.2 million on gross profit, operating loss and net loss in such periods. The loss per share was understated by $(0.03). The amounts presented for the three and nine months ended September 30, 2010 in the table above have been restated to correct the impact of such error.

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value data)

(unaudited)

	September 30, 2011	December 31, 2010 (A)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,720	$ 10,799
Accounts receivable, net of allowances of $445 and $484 as of September 30, 2011 and December 31, 2010, respectively	14,765	15,231
Inventories, net	10,067	10,584
Income taxes receivable	166	126
Other current assets	3,160	2,088
Total current assets	45,878	38,828
Property and equipment, net	5,406	5,373
Goodwill	58,996	47,126
Intangible assets, net	37,477	33,865
Other assets	476	793
Total assets	$ 148,233	$ 125,985
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,425	$ 12,833
Mortgage loan payable to bank and bank line of credit	57	630
Debt note	829	1,040
Liability to related party	1,066	1,058
Accrued compensation and related benefits	4,104	3,694
Deferred revenue	2,907	1,244
Other accrued expenses and liabilities	6,913	8,980
Income taxes payable	181	44
Total current liabilities	26,482	29,523
Long-term earn-out liability	5,397	
Long-term liability to related party	7,390	7,615
Long-term mortgage loan payable to bank	811	840
Deferred tax liability	6,234	6,795
Long-term debt note	632	950
Long-term income taxes payable	690	458
Total liabilities	47,636	46,181
Commitments and contingencies (see Notes 11 and 12)		
Equity:		
Identive Group, Inc. stockholders equity:		
Common stock, $0.001 par value: 130,000 shares authorized; 58,232 and 48,276 shares issued and outstanding as of September 30, 2011 and December 31, 2010, respectively	58	48

Additional paid-in capital	331,255	306,203
Treasury stock, 618 shares as of September 30, 2011 and December 31, 2010	(2,777)	(2,777)
Accumulated deficit	(233,001)	(225,896)
Other accumulated comprehensive income	3,076	323
Total Identive Group, Inc. stockholders equity	98,611	77,901
Noncontrolling interest	1,986	1,903
Total equity	100,597	79,804
Total liabilities and stockholders equity	$ 148,233	$ 125,985

(A) The condensed consolidated balance sheet has been derived from the audited consolidated financial statements at December 31, 2010 but does not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE LOSS

Year Ended December 31, 2010 and Nine Months Ended September 30, 2011

(unaudited)

	Identive Group, Inc. Stockholders								
	Common Stock								
(In thousands)	Shares	Amount	Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Other Accumulated Comprehensive Income	Noncontrolling Interest	Total Equity	Comprehensive Loss
Balances, December 31, 2009	25,753	$ 26	$ 253,910	$ (2,777)	$ (216,378)	$ 3,159	$	$ 37,940	
Issuance of common stock in connection with acquisitions	17,900	18	38,758					38,776	
Fair value of stock options converted in connection with Bluehill ID acquisition			3,007					3,007	
Assumption of treasury stock in connection with Bluehill ID Acquisition				(2,880)				(2,880)	
Repurchase of treasury stock in connection with Bluehill ID acquisition			(402)	2,880				2,478	
Issuance of common shares to acquire additional noncontrolling interest in a subsidiary	88		199				(199)		
Issuance of common stock upon exercise of options	7		11					11	
Issuance of common stock in connection with stock bonus and incentive plans	99		174					174	
Issuance of common stock to affiliates for conversion of loan	181		291					291	
Issuance of common stock in connection with private placement, net of issuance costs	4,098	4	9,582					9,586	
Issuance of common stock for settlement of pre-acquisition liabilities	150		343					343	
Noncontrolling interest in connection with Bluehill ID acquisition							3,057	3,057	
Stock options compensation expense			330					330	
Comprehensive loss:									
Net loss					(9,518)		(630)	(10,148)	$ (10,148)
Foreign currency translation adjustment, net tax of nil						(2,836)	(325)	(3,161)	(3,161)
Comprehensive loss									$ (13,309)
Balances, December 31, 2010	48,276	$ 48	$ 306,203	$ (2,777)	$ (225,896)	$ 323	$ 1,903	$ 79,804	
Issuance of common stock in connection with capital raise, net of issuance costs	7,843	8	18,204					18,212	

Issuance of common stock in connection with idOnDemand acquisition	996	1	3,023					3,024	
Issuance of common stock in connection with earn-out agreements	137		316					316	
Issuance of common shares to acquire additional noncontrolling interest in a subsidiary	3		8				(8)		
Issuance of common stock in connection with stock bonus and incentive plans	550	1	1,433					1,434	
Issuance of common stock upon exercise of warrants	406		1,075					1,075	
Issuance of common stock upon exercise of options	21		57					57	
Stock options compensation expense			242					242	
ESPP compensation expense			84					84	
Stock options grants in connection with stock bonus and incentive plans			610					610	
Noncontrolling interest in connection with idOnDemand acquisition							468	468	
Comprehensive loss:									
Net loss					(7,105)		(336)	(7,441)	(7,441)
Foreign currency translation adjustment						2,753	(41)	2,712	2,712
Comprehensive loss									(4,729)
Balances, September 30, 2011	58,232	$ 58	$ 331,255	$ (2,777)	$ (233,001)	$ 3,076	$ 1,986	$ 100,597	

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, Restated 2010 (A)
Cash flows from operating activities:		
Net loss	$ (7,441)	$ (9,292)
Adjustments to reconcile net loss to net cash used in operating activities:		
Income from discontinued operations		(69)
Deferred income taxes	(2,666)	(223)
Depreciation and amortization	4,013	3,475
Accretion of interest to related party liability	563	581
Interest on debt note, bank line of credit and mortgage loan	176	56
Remeasurement of contingent consideration	254	
Stock-based compensation expense	831	1,018
Gain on disposal of fixed assets	55	
Changes in operating assets and liabilities:		
Accounts receivable	1,224	(3,053)
Inventories	1,337	(919)
Other assets	(303)	(2,463)
Income taxes receivable	(40)	(272)
Accounts payable	(2,950)	2,822
Liability to related party	(780)	(829)
Accrued expenses	(685)	1,946
Deferred revenue	514	2,785
Income taxes payable	369	(316)
Net cash used in operating activities from continuing operations	(5,529)	(4,753)
Net cash used in operating activities from discontinued operations		(778)
Net cash used in operating activities	(5,529)	(5,531)
Cash flows from investing activities:		
Capital expenditures	(897)	(638)
Net cash (paid) acquired (for) from acquisitions	(5,154)	4,881
Maturities of short-term investments		1,015
Net cash (used in) provided by investing activities	(6,051)	5,258
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	18,211	1,936
Payments on debt note and mortgage loan	(857)	(40)
Payments on bank line of credit, net	(605)	(52)
Proceeds from issuance of common stock upon options exercised	56	
Proceeds from issuance of common stock upon warrants exercised	1,076	
Net cash provided by financing activities	17,881	1,844

Effect of exchange rates on cash and cash equivalents	620	(236)
Net increase in cash and cash equivalents	6,921	1,335
Cash and cash equivalents at beginning of period	10,799	4,836
Cash and cash equivalents at end of period	$ 17,720	$ 6,171
Supplemental disclosures of non-cash investing and financing activities:		
Common stock issued in connection with business combinations	$ 3,024	$ 38,776
Conversion of stock options in connection with business combinations	$	$ 3,007
Common stock issued in connection with contingent consideration	$ 316	$
Common stock issued in connection with stock bonus and incentive plans	$ 1,434	$ 135
Stock option grants in connection with stock bonus and incentive plans	$ 610	$
Common stock issued to affiliates for conversion of loan	$	$ 291
Fair value of contingent consideration in connection with business combinations	$ 5,060	$ 298
Cash paid for interest expense	$ 739	$ 637

(A) As stated earlier, the Company had determined an error in the recognition of revenue related to the sale of readers for the German national ID program as reported in the third quarter of 2010 as not all criteria for recognizing the sale were in fact met until the fourth quarter of 2010. As a result, revenue, cost of revenue, gross profit, operating loss and net loss reported in the Company s Form 10-Q for the quarter ended September 30, 2010 was overstated, however there was no impact to the total net cash used in operating activities. The amounts presented in the table above have been restated to correct the impact of such error.

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2011

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Identive Group, Inc. (Identive or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of Company s unaudited condensed consolidated financial statements have been included. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or any future period. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The preparation of unaudited condensed consolidated financial statements necessarily requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

On April 14, 2010, the Company acquired RockWest Technology Group (RockWest), a privately held provider of identification and security solutions based in Denver, Colorado. Following the acquisition, RockWest s name was changed to Multicard U.S. The results for the acquired RockWest business are included in the Company s consolidated statements of operations since April 14, 2010. On November 19, 2010, the Company acquired FCI Smartag Pte., Ltd. (Smartag), a Singapore-based manufacturer of high frequency and ultra high frequency radio frequency identification inlays and inlay-based solutions including labels and tags used for asset tracking, cards and stickers used for e-payment and ticketing transactions, and near field communication labels used to enable secure payments with mobile devices. The results for the acquired Smartag business are included in the Company s consolidated statements of operations since November 19, 2010. On May 2, 2011, the Company acquired idOnDemand, Inc. (idOnDemand), a privately-held provider of identity management services based in Pleasanton, California. The results for the acquired idOnDemand business are included in the Company s consolidated statements of operations since May 2, 2011. On July 18, 2011, Multicard AG, a subsidiary of the Company, acquired all of the outstanding shares of polyright SA (polyright), a provider of integrated ID solutions for the Swiss education and healthcare markets. The results for the acquired polyright business are included in the Company s consolidated statements of operations since July 18, 2011. As a result of the timing of these acquisitions, the Company s operating results for the periods presented are not directly comparable.

2. Summary of Significant Accounting Policies

Recently Adopted Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-29, *ASC Topic 805, Business Combinations: Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), which provides further comparative disclosure guidance and expands the pro forma disclosure requirements under ASC Topic 805, *Business Combinations* (ASC 805). This guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. ASU 2010-29 relates to disclosure requirements only and as such does not impact the Company's consolidated results of operations or financial condition. The Company adopted the provisions of ASU 2010-29 effective January 1, 2011.

In December 2010, the FASB issued ASU No. 2010-28, *ASC Topic 350, Intangibles-Goodwill and Other: When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (ASU 2010-28), which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Company adopted the provisions of ASU 2010-28 effective January 1, 2011. The Company currently does not have any reporting units with zero or negative carrying amounts.

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In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements* (ASU 2009-13). ASU 2009-13 changes the requirements for establishing separate units of accounting in a multiple element arrangement and eliminates the residual method of allocation and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price allocation method. The relative selling price method allocates any discount in the arrangement proportionately to each deliverable on the basis of the deliverable s estimated fair value. Concurrently with issuing ASU 2009-13, the FASB issued ASU No. 2009-14, *Software (Topic 985) Certain Arrangements That Contain Software Elements* (ASU 2009-14), which amends the scope of software revenue guidance in Accounting Standards Codification (ASC) Subtopic 985-605, *Software-Revenue Recognition (ASC 985-605),* to exclude tangible products containing software and non-software components that function together to deliver the product s essential functionality. ASU 2009-14 provides that tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of the software revenue guidance in ASC 985-605 and should follow the guidance in ASU 2009-13 for multiple-element arrangements. All non-essential and standalone software components will continue to be accounted for under the guidance of ASC 985-605.

ASU 2009-13 and ASU 2009-14 are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company prospectively adopted the provisions of ASU 2009-13 and ASU 2009-14 effective January 1, 2011. The Company has assessed the effects of ASU 2009-13 and ASU 2009-14 and has concluded that the adoption of these standards had no material impact on the condensed consolidated results of operations and financial position for the three and nine months ended September 30, 2011. This was because the Company s determination of separate units of accounting in a multiple element arrangement under the previous standard (ASC 605-25, *Multiple Elements Arrangements)* is not impacted by ASU 2009-13. In addition, as stated below, the Company s revenue is derived primarily from sales of hardware products, and to a lesser extent, from the license of software products and software components in revenue arrangements that are considered non-essential and standalone. As a result, ASU 2009-14 did not have any impact during the three and nine month periods ended September 30, 2011 and revenues from such software products will continue to be recognized under the guidance of ASC 985-605. ASU 2009-13 generally does not change the units of accounting for the Company s revenue arrangements. The Company cannot reasonably estimate the effect of adopting these standards on future financial periods as the impact will vary depending on the nature and volume of new or materially modified deals in any given period.

Recent Accounting Policy Changes

Revenue Recognition

The Company derives revenue from sales of products and services, primarily from sales of hardware products, and to a lesser extent, from the license of proprietary software products and sales of service contracts. The revenue is generated from sales to direct end-users and to distributors. Revenue arrangements may include one of these single elements, or may incorporate one or more elements in a single transaction or combination of related transactions. ASU 2009-13 affects accounting and reporting for all multiple-deliverable arrangements. The Company recognizes revenue from the sale of hardware products to direct end-users and distributors pursuant to ASC Topic 605, *Revenue Recognition* (ASC 605). Accordingly, revenue from product sales is recognized upon product shipment, provided that risk and title have transferred, a purchase order has been received, the sales price is fixed and determinable and collection of the resulting receivable is probable. There are no formal customer acceptance terms or further obligations related to the sale of hardware products, outside of the Company s standard product warranty. Provisions for estimated warranty repairs and returns and allowances are provided for at the time of sale.

Certain sales of the Company s hardware products are bundled with its software products. In such arrangements, both the software and hardware products are delivered simultaneously. The Company accounts for software sales in accordance with ASC 985-605, whereby the revenue from the sale of software products is recognized at the time the software is delivered to the customer, provided all the revenue recognition criteria noted above have been met. The proprietary application software sold by the Company is not essential to the functionality of the security hardware. Therefore, in multiple-element arrangements containing hardware and software, the hardware elements are excluded from ASC 985-605 and are accounted for in accordance with ASU 2009-13. Revenue from such bundled arrangements is generally recognized upon delivery of the hardware products, assuming all other basic revenue recognition criteria are met, as both the hardware and software products are delivered simultaneously and no undelivered elements exist. Certain sales of the Company s hardware products are bundled with its installation services and maintenance contracts. For transactions entered into subsequent to the adoption of ASU 2009-13 that include multiple elements, arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy as required by ASU 2009-13. In such bundled arrangements, the revenue from hardware products is generally recognized upon delivery, assuming all other basic revenue recognition criteria are met. The revenue from installation contracts is recognized upon completion of such services, which happens within a short period after the delivery of hardware products, and the revenue from maintenance contracts is deferred and amortized ratably over the period of the maintenance contracts.

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Service revenue includes revenue from professional services and maintenance contracts. Typically professional services and maintenance contracts are sold separately from hardware sales. Professional services revenue, such as security system integration services, system migration and database conversion services, is recognized upon delivery of the services. If the professional services project includes independent milestones, revenue is recognized as milestones are met and upon acceptance from the customer. Maintenance revenue is generated from the sale of hardware maintenance contracts. Maintenance revenue is deferred and amortized ratably over the period of the maintenance contract.

ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable in revenue arrangements. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, or the Company s best estimated selling price (ESP) if neither VSOE nor TPE are available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. VSOE of fair value is based on the price charged when the element is sold separately. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. The best estimate of selling price is established considering multiple factors, including, but not limited to, pricing practices in different geographies and through different sales channels, gross margin objectives, internal costs, competitor pricing strategies and industry technology lifecycles. Some of the Company s products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality; as a result, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as the Company is unable to reliably determine what competitors products selling prices are on a stand-alone basis, the Company is not typically able to determine TPE for such products. Therefore ESP is used for such products in the selling price hierarchy for allocating the total arrangement consideration. The Company evaluates each deliverable in an arrangement to determine whether they represent separate units of accounting in accordance with the provisions of ASU 2009-13. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. Allocation of the consideration is determined at arrangement inception on the basis of each unit s relative selling price.

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles-Goodwill and Other, ASC Topic 350, Testing for Impairment* (ASU 2011-08). ASU 2011-08 amends the guidance in ASC 350-20, *Intangibles-Goodwill and Other-Goodwill*. The intent of this ASU is to simplify how entities, both public and non-public, test goodwill for impairment by allowing an entity to use a qualitative approach to test goodwill for impairment. The amendments in the ASU permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC 350-20. This guidance is effective for annual and interim tests performed in fiscal years beginning on or after December 15, 2011. Early adoption is permitted. The Company will adopt the provisions of ASU 2011-08 effective December 1, 2011 at the time of its annual goodwill impairment test.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income, ASC Topic 220, Presentation of Comprehensive Income* (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective in the first quarter of fiscal 2012 and should be applied retrospectively. The Company is currently evaluating the impact of its pending adoption of ASU 2011-05 on its consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards, ASU Topic 820, Fair Value Measurement* (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. ASU 2011-04 is effective in the first quarter of fiscal 2012 and should be applied prospectively. The Company is currently evaluating the impact of its pending adoption of ASU 2011-04 on its consolidated financial statements.

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3. Acquisitions

Acquisition of polyright

Multicard AG, a subsidiary of the Company, completed the acquisition and acquired all of the outstanding shares of polyright on July 18, 2011 (polyright acquisition date), for a combination of cash and payment of outstanding indebtedness in the aggregate amount of CHF 2.55 million (or approximately $3.1 million). The sellers included Securitas AG, Kudelski SA and members of polyright management. The sellers may receive aggregate potential earn-out payments payable in shares of the Company s common stock over the 30-month period following the closing of the acquisition, subject to achievement of specific financial and sales performance targets over such period. The number of such shares, if any, issued under the earn-out will be based on the average share price during the month preceding the date of announcement of the Company s annual results, and will be subject to a two-year lockup. polyright is a provider of identity management platforms and open-ended rights and services management solutions for higher education, healthcare and industry.

The polyright acquisition is accounted for under the acquisition method of accounting in accordance with ASC 805. Under the acquisition method of accounting, the total purchase consideration, assets acquired and the liabilities assumed is measured at fair value as of the date of acquisition when control is obtained. The fair value of the consideration transferred and the assets acquired and liabilities assumed was determined by the Company and in doing so relied in part upon a third-party valuation report to measure the purchase consideration, identifiable intangible assets acquired and obligations related to deferred revenue and earn-out payments. The following table summarizes the fair value of total consideration transferred for the polyright acquisition, the total fair value of net identifiable assets acquired at the polyright acquisition date and the resulting goodwill recorded (in thousands):

Cash consideration	$ 3,133
Fair value of contingent consideration	302
Fair value of total consideration transferred	3,435
Fair value of net identifiable assets acquired	(716)
Goodwill	$ 2,719

The fair value of the contingent consideration is based on achieving certain revenue and profit targets as defined under the acquisition agreement. These contingent payments were probability weighted and discounted to present value. An additional discount was applied to reflect the restriction on the resale or transfer of such shares. The key assumptions in calculating the fair value of contingent consideration are as follows: 21.7% discount rate and probability adjusted revenues between $2.9 million and $7.1 million. The fair value of the contingent consideration was classified as liability in accordance with ASC Topic 480, *Distinguishing Liabilities from Equity* (ASC 480). As of September 30, 2011, there were no significant changes in the range of outcomes for the contingent consideration recognized as of the acquisition date.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the polyright acquisition date. The estimated fair value of the identifiable assets acquired and liabilities assumed in the acquisition is based on management s best estimates. As the Company finalizes certain valuation assumptions, the provisional measurements of identifiable assets and liabilities, and the resulting goodwill and deferred income taxes are subject to change, and the final purchase price accounting could be different from the amounts presented herein.

Assets acquired and liabilities assumed as of July 18, 2011 (in thousands):

Cash and cash equivalents	$ 375
Accounts receivable	623
Inventory	589
Property and equipment	88
Other current assets	170
Accounts payable	(316)
Accrued expenses and other liabilities	(810)
Deferred revenue	(1,155)

Intangible assets subject to amortization		
Customer relationships		1,290
Order backlog		246
Deferred tax liabilities in connection with acquired intangible assets		(384)
Fair value of polyright net identifiable assets acquired	$	716

Intangible assets of $1.5 million consist primarily of customer relationships and order backlog. Customer relationships relate to polyright s ability to sell existing, in-process and future versions of its products to its existing customers. Order backlog represents future revenue to be derived from confirmed orders. The customer relationships were valued using the income approach based on DCF and using a discount rate of 24%. The discount rate used in the present value calculation was derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset s characteristics. The intangible assets of $1.5 million are subject to amortization and the Company expects to amortize these intangible assets on a straight-line basis over their expected useful lives of approximately one to six years.

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Of the total purchase consideration, $2.7 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the polyright acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company s Identity Management reportable segment in accordance with ASC 350. None of the goodwill recorded as part of the polyright acquisition will be deductible for United States federal income tax purposes.

The amounts of revenue and earnings of polyright included in the Company s condensed consolidated statement of operations from the polyright acquisition date to the period ending September 30, 2011 are as follows (in thousands):

Revenues	$ 1,403
Net loss	$ 295

Acquisition of idOnDemand

The Company completed the acquisition of idOnDemand on May 2, 2011 (the idOnDemand acquisition date), pursuant to a Stock Purchase Agreement dated April 29, 2011 between the Company and certain shareholders (the Selling Shareholders) of idOnDemand, under which the Company has acquired approximately 95.8% of the shares of idOnDemand in exchange for cash and shares of the Company s common stock. idOnDemand was a privately held corporation and is a provider of service-based identity credential provisioning and management. idOnDemand is headquartered in Pleasanton, California and maintains data centers in Santa Clara, California and Canberra, Australia. Initial consideration at closing consisted of approximately $2.4 million in cash and 995,675 shares of the Company s common stock. Shares issued at closing to the Selling Shareholders are subject to a three-year lock-up period from the closing date of the acquisition. Of the total initial share consideration paid to the Selling Shareholders, 407,289 shares will be released from the lock-up on the six month anniversary of the closing date. Beginning on the second anniversary of the closing date, the remaining shares will be released from the lock-up in equal amounts on a monthly basis until the expiration of the lock-up period.

The shares of the Company s common stock issued at closing were issued in reliance upon available exemptions from the registration requirements of the Securities Act of 1933, as amended (the Securities Act), including Section 4(2) thereof and Regulation S thereunder, as well as comparable exemptions under applicable state and foreign securities laws. In addition, Selling Shareholders may receive potential earn-out payments over a period of three years and eight months from the idOnDemand acquisition date, payable in shares of the Company s common stock and subject to achievement of specific financial and sales performance targets. Any shares issued in connection with the earn-out will be subject to a 12-month lock-up from date of issuance.

The idOnDemand acquisition is accounted for under the acquisition method of accounting in accordance with ASC 805. Under the acquisition method of accounting, the total purchase consideration, assets acquired and the liabilities assumed is measured at fair value as of the date of acquisition when control is obtained. The fair value of the consideration transferred and the assets acquired and liabilities assumed was determined by the Company and in doing so relied in part upon a third-party valuation report to measure the purchase consideration, identifiable intangible assets acquired and obligations related to earn-out payments.

Subsequent to the filing of the Company s Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, the Company received new information, which existed at the time of acquisition, related to idOnDemand s customer base and product offerings which impacted our preliminary purchase price allocation and measurement of contingent consideration. As a result of this new information, the fair value of contingent consideration, the fair value of noncontrolling interest as well as the fair value of net identifiable assets acquired was decreased by $5.3 million, $0.2 million and $0.3 million, respectively as of September 30, 2011, with corresponding adjustment to goodwill. The following table summarizes the remeasured fair value of total consideration for idOnDemand controlling and noncontrolling interest, the total fair value of net identifiable assets acquired at the idOnDemand acquisition date and the resulting goodwill recorded (in thousands):

Cash consideration	$ 2,396
Fair value of common stock	3,024
Fair value of contingent consideration	4,758
Fair value of total consideration transferred	10,178
Fair value of noncontrolling interest	468

Fair value of controlling and noncontrolling interest	10,646
Fair value of net identifiable assets acquired	(2,847)
Goodwill	$ 7,799

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The fair value of the shares of the Company s common stock issued in connection with the acquisition was determined using the closing market price of the Company s common stock as of the idOnDemand acquisition date of $3.64 per share and then discounted to reflect the restriction on the resale or transfer of shares under the Securities Act. The fair value of the contingent consideration was based on achieving certain revenue and profit targets as defined under the Stock Purchase Agreement. These contingent payments were probability weighted and also discounted to present value. The key assumptions in calculating the fair value of contingent consideration are as follows: 22.9% discount rate and probability adjusted revenues between $1.6 million and $14.5 million. The fair-value of the contingent consideration was classified as liability in accordance with ASC 480. As of September 30, 2011, there were no significant changes in the range of outcomes for the contingent consideration recognized as a result of the acquisition of idOnDemand, although the Company recognized $0.4 million of expenses as a result of passage of time (reduced impact of discounting) in accordance with ASC 480 which has been included in general and administration expenses in the condensed consolidated statement of operations. The acquisition-date fair value of the noncontrolling interests is derived by determining the fair value of the acquired business as a whole and then subtracting the consideration transferred by the Company for its controlling interest in idOnDemand.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed (including measurement period adjustments) at the idOnDemand acquisition date. The estimated fair value of the identifiable assets acquired and liabilities assumed in the acquisition is based on management s best estimates. As the Company finalizes certain valuation assumptions, the provisional measurements of identifiable assets and liabilities, and the resulting goodwill and deferred income taxes are subject to change and the final purchase price accounting could be different from the amounts presented herein.

Assets acquired and liabilities assumed as of May 2, 2011 (in thousands):

Accounts receivable	$	65
Inventory		70
Property and equipment		96
Other assets		291
Accounts payable		(123)
Accrued expenses and other liabilities		(116)
Deferred revenue		(148)
Intangible assets subject to amortization		
Developed technology		2,700
Patents		790
Customer relationships		390
Trade secrets		300
Order backlog		17
Trade name		60
Deferred tax liabilities in connection with acquired intangible assets and inventory fair value adjustment, net		(1,545)
Fair value of idOnDemand net identifiable assets acquired	$	2,847

Intangible assets of $4.3 million consist primarily of developed technology, patents, customer relationships, trade secrets, and trade name. Developed technology, patents and trade secrets relates to idOnDemand s technology and knowhow which is currently generating revenue. Customer relationships relate to idOnDemand s ability to sell existing, in-process and future versions of its products to its existing customers. Trade names represent future value to be derived associated with the use of existing trade names. Order backlog represents future revenue to be derived from confirmed orders. Developed technology, patents and trade name were valued using the relief from royalty method based on discounted cash flow (DCF). A discount rate of 18% was used to value developed technology and trade name and 20% to value patents. The customer relationships and trade secrets were valued using the income approach based on DCF and using a discount rate of 20%. The discount rates used in the present value calculations were derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset s characteristics. The intangible assets of $4.3 million are subject to amortization and the Company expects to amortize these intangible assets on a straight-line basis over their expected useful lives of approximately one to twelve years.

Of the total purchase consideration, $7.8 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the idOnDemand acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company s Identity Management reportable segment in accordance with ASC 350. None of the goodwill recorded as part of the idOnDemand acquisition will be deductible for United States federal income tax purposes.

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Deferred tax assets and liabilities resulting from the acquisition of idOnDemand have been netted, where applicable. Following the idOnDemand acquisition, idOnDemand has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $1.5 million which was recognized in the purchase price accounting has been netted with the Company s existing deferred tax assets. As a result, there was a $1.5 million reversal of the Company s valuation allowance. In accordance with ASC 805, the reversal of the valuation allowance was recorded as a tax benefit in the 2011 second quarter financial statements.

The Company recognized $0 and $0.2 million of acquisition-related costs that were expensed in the three and nine months ended September 30, 2011, respectively. These costs are included as part of general and administration costs in the condensed consolidated statement of operations.

The amounts of revenue and earnings of idOnDemand included in the Company s condensed consolidated statement of operations from the idOnDemand acquisition date to the period ending September 30, 2011 are as follows (in thousands):

Revenues	$ 363
Net loss	$ 1,546

Acquisition of Smartag

The Company completed the acquisition of Smartag on November 19, 2010 (the Smartag acquisition date). The Company paid approximately $3.2 million to acquire all the shares and intellectual property of Smartag, consisting of a one-time cash payment at the close of the transaction of $1.0 million and a debt note for approximately $2.2 million. The debt note carries an interest rate of 6% per year and is payable within 30 months from the closing date.

Certain closing balance sheet items in connection with the acquisition of Smartag were subject to post-closing adjustment which was finalized during the second quarter of 2011. As a result, the net assets acquired increased by $0.1 million and the purchase consideration was increased by $0.2 million which were accounted for as measurement period adjustments in the second quarter of 2011 with a corresponding adjustment to goodwill. The fair value of total consideration transferred was determined to be $3.2 million. The Company recognized identifiable intangible assets of $0.3 million related to the acquisition of Smartag, which are being amortized on a straight-line basis over their expected useful lives of approximately one to five years.

Acquisition of RockWest (now Multicard U.S.)

The Company completed the acquisition of RockWest on April 14, 2010 (the RockWest acquisition date). As a part of the purchase consideration for the acquisition, the Company issued an aggregate of 2.6 million restricted shares of its common stock to the sellers of RockWest. The shares issued to the Sellers are subject to a 24-month lock-up from the closing date of the acquisition. Additionally, the Sellers are eligible to receive limited earn-out payments (contingent consideration), based on achieving certain revenue and profit targets as defined under the Share Purchase Agreement, in the form of shares of common stock subject to a 12-month lock-up period.

The fair value of total consideration transferred, which included contingent consideration, was determined to be $4.5 million as of the RockWest acquisition date. The fair value of the contingent consideration is classified as liability in accordance with ASC 480. As of September 30, 2011, the Company remeasured the contingent consideration to fair value in accordance with ASC 480 and recognized $0.1 million and $0.2 million as a credit to expense during the three and nine months ended September 30, 2011, respectively, which has been included in general and administration expenses in the condensed consolidated statement of operations.

The Company recognized identifiable intangible assets of $2.2 million and goodwill of $3.0 million related to the acquisition of RockWest. The Company is amortizing the intangible assets on a straight-line basis over their expected useful lives of approximately one to six years.

Deferred tax assets and liabilities resulting from the acquisition of RockWest have been netted, where applicable. Following the RockWest acquisition, RockWest has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $0.6 million which was recognized in the purchase price accounting has been netted with the Company s existing deferred tax assets. As a result, there was a $0.6 million reversal of the Company s valuation allowance. In accordance with ASC 805, the release of the valuation allowance was recorded as a tax benefit in the 2010 second quarter financial statements.

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Pro forma financial information:

The results for the acquired polyright, idOnDemand, Smartag and RockWest businesses are included in the Company s condensed consolidated statements of operations since their respective acquisition dates. As a result of the timing of these acquisitions, the Company s condensed consolidated results for the periods presented are not directly comparable. The pro forma financial information is presented for informational purposes only and is not intended to represent or be indicative of the results of operations that would have been achieved if the polyright, idOnDemand, Smartag and RockWest acquisitions had been completed as of the date indicated, and should not be taken as representative of the Company s future consolidated results of operations or financial condition. The unaudited pro forma financial information in the table below summarizes the results of operations of the combined entity, as though the acquisitions had occurred as of the beginning of the periods presented. Preparation of the pro forma financial information for all periods presented required management to make certain judgments and estimates to determine the pro forma adjustments such as purchase accounting adjustments, which include, among others, cost of sales resulted from step up of inventory at fair value, amortization charges from acquired intangible assets, and income tax effects.

Pro forma results of operations for the three and nine months ended September 30, 2011 and 2010 are as follows (in thousands, unaudited):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Revenues	$ 27,002	$ 24,405	$ 78,308	$ 69,433
Net loss	(3,715)	(3,081)	(8,947)	(13,611)

4. Fair Value Measurements

The Company determines fair value based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of an asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value in accordance with ASC Topic 820 *Fair Value Measurement and Disclosures* (ASC 820):

Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations, in which all significant inputs are observable in active markets; and

Level 3 Valuations derived from valuation techniques, in which one or more significant inputs are unobservable.

The Company uses the following classifications to measure assets and liabilities at fair value, including an indication of the level in the fair value hierarchy in which each instrument is generally classified:

Cash equivalents include money market fund deposits with maturities of three months or less at the date of acquisition. These financial instruments are classified in Level 1 of the fair value hierarchy.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities that are