DIGITAL ANGEL CORP
Form POS AM
June 18, 2004

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As filed with the Securities and Exchange Commission on June 18, 2004

Registration No. 333-100940

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Post-Effective Amendment No. 3
to

FORM S-1

REGISTRATION STATEMENT
Under
The Securities Act of 1933

DIGITAL ANGEL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

3679
(Primary Standard Industrial Classification Code Number)

52-1233960
(I.R.S. Employer Identification No.)

490 Villaume Avenue, South St. Paul, MN 55075
(651) 455-1621
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

Kevin N. McGrath
President and
Chief Executive Officer
490 Villaume Avenue
South St. Paul, MN 55075
(651) 455-1621
(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

copy to:

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:
From time to time after this Post-Effective Amendment No. 3 to the 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. ý

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. o

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. o

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. o

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

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), shall determine.

Explanatory Note: This Post-Effective Amendment No. 3 is being filed to update the Registration Statement on Form S-1 (Registration No. 333-100940), which was declared effective on January 21, 2003, and to de-register a total of 319,280 shares subject to the original Registration Statement. Of the shares being de-registered, 22,786 shares were to be resold by Mpact Communications, Inc. ("Mpact"), a selling stockholder. Digital Angel Corporation initially had agreed to issue to Mpact the 38,095 shares included in the original Registration Statement, but a total of 15,309 shares were ultimately issued by us to Mpact. The remaining 296,494 shares were sold by Applied Digital Solutions, Inc. to its debenture holders upon the exercise of options to purchase such shares and thus will not be sold by Applied Digital Solutions, Inc. under the Registration Statement.

PROSPECTUS

DIGITAL ANGEL CORPORATION

22,029,440 Shares

Common Stock

This prospectus covers the sale by us of 19,303,506 shares of our common stock, as more fully described in this prospectus in the section entitled "Plan of Distribution" beginning on page 55 and resales of up to 2,725,934 shares of our common stock that may be offered and sold from time to time by the selling stockholders identified in this prospectus in the section entitled "Selling Stockholders" on page 32. We will not receive any proceeds from the resale by the selling stockholders of the shares of our common stock pursuant to this prospectus.

The shares of our common stock are being registered to permit us and the selling stockholders to sell the shares from time to time in the public market. The shares of our common stock may be sold through ordinary brokerage transactions or through any other means described in this prospectus under "Plan of Distribution." The price at which the shares may be sold will be determined by the prevailing market price for the shares or in negotiated transactions. We cannot assure you that all or a portion of the shares of our common stock offered under the prospectus will be sold.

Our common stock is listed on the American Stock Exchange (AMEX) under the symbol "DOC." On June 14, 2004, the last reported sale price of our common stock was $3.08.

Investing in shares of our common stock involves risks. See "Risk Factors" beginning on page 5 of this prospectus.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

No dealer, salesperson or other person has been authorized to give any information or to make any representations other than those contained in or incorporated by reference into this prospectus in connection with the offer contained in this prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by us. Neither the delivery of this prospectus nor any sale made hereunder shall under any circumstances create an implication that there has been no change in our affairs since the date hereof. The selling stockholders are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where such offers and sales are permitted. The information contained in, and incorporated by reference into, this prospectus speaks only as of the date of this prospectus unless information specifically indicates that another date applies.

The date of this prospectus is , 2004.

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PROSPECTUS SUMMARY

This summary highlights selected information contained elsewhere in this prospectus and incorporated into this prospectus by reference. This summary may not contain all of the information that may be important to you in considering an investment in our common stock. You should carefully read the entire prospectus, including the documents that are incorporated by reference into this prospectus, before making an investment decision.

The Company

We were incorporated in Delaware on December 1, 1981 as Medical Advisory Systems, Inc. to provide medical assistance and technical products and services. On March 27, 2002, we completed a merger in which the former Digital Angel Corporation became a wholly-owned subsidiary of Medical Advisory Systems and was renamed "Digital Angel Technology Corporation," and Medical Advisory Systems was renamed "Digital Angel Corporation." In connection with the merger, Applied Digital Solutions contributed to Medical Advisory Systems all of its stock in Timely Technology Corp., a wholly-owned subsidiary, and Signature Industries, an 85.0%-owned subsidiary. These two subsidiaries, along with the former Digital Angel Corporation, comprised the Advanced Wireless Group of Applied Digital Solutions, Inc. As a result of this contribution, Timely Technology became our wholly-owned subsidiary, and Signature Industries became our 85.0%-owned subsidiary. As of May 31, 2004, Applied Digital Solutions, Inc. owned 22,303,506 of our outstanding shares of common stock, which constituted approximately 68.3% of our outstanding common stock.

Historically, we have suffered losses and have not generated positive cash flows from operations. In the three months ended March 31, 2004, we incurred a net loss of $3.7 million and used net cash in operations of $2.3 million. As of March 31, 2004, our accumulated deficit was $127.3 million. Our profitability and capital needs depend on many factors, including the success of our marketing programs, the maintenance and reduction of expenses, and the ability to coordinate successfully the operations of the business units. On March 1, 2004, we issued 3,000,000 shares of our common stock to Applied Digital Solutions in exchange for 1,980,000 shares of Applied Digital Solutions' common stock (as adjusted for a subsequent one-for-10 reverse split of Applied Digital Solutions' common stock). We expect to sell shares of Applied Digital Solutions' common stock from time to time to generate additional funds which we believe will be necessary to sustain our operations for the next 12 months. Through May 31, 2004, we had sold 910,350 shares of Applied Digital Solutions' common stock, resulting in aggregate net proceeds to us of $2.6 million.

Before January 22, 2004, we operated in four segments: Animal Applications, Wireless and Monitoring, GPS and Radio Communications and Medical Systems. With our acquisition of OuterLink Corporation in January 2004, we reorganized into three segments: Animal Applications, GPS and Radio Communications and Medical Systems. The former GPS and Radio Communications Segment, the Wireless and Monitoring Segment and the OuterLink Corporation business were combined to form the new GPS and Radio Communications segment, which is now managed as a single business unit. On April 19, 2004, we completed a transaction in which we sold certain assets of our Medical Systems segment. We expect to eliminate this segment, but we also expect that we will recognize losses in the Medical Systems segment through the second quarter of 2004.

Our corporate headquarters is located at 490 Villaume Avenue, South St. Paul, MN 55075. Our telephone number is 651-455-1621.

For a more complete discussion of our company, see "Business" beginning on page 11.

The Offering

This prospectus covers the sale by us of 19,303,506 shares of our common stock, as more fully described in this prospectus in the section entitled "Plan of Distribution" beginning on page 55, and resales of up to 2,725,934 shares of our common stock to be sold by the selling stockholders identified in this prospectus in the section entitled "Selling Stockholders" on page 32. We and the selling stockholders, or the selling stockholders' pledgees, donees, transferees or other successors in interest may, from time to time, sell all or a portion of the shares at fixed prices that may be changed, at market prices prevailing at the time of sale, at prices related to such market prices or at negotiated prices. We and the selling stockholders also may sell as shares directly to purchasers or may use brokers, dealers, underwriters or agents to sell our shares upon terms and conditions that will be described in the applicable prospectus supplement.

From time to time, the selling stockholders may be engaged in short sales, short sales against the box, puts and calls and other hedging transactions in our securities, and they may sell and deliver the shares in connection with such transactions or in settlement of securities loans. These transactions may be entered into with broker-dealers or other financial institutions. In addition, from time to time, a selling stockholder may pledge its shares pursuant to the margin provisions of its customer agreements with is broker-dealer. Upon delivery of the shares or a default by selling shareholder, the broker-dealer or financial institution may offer and sell the pledge shares from time to time. For a more complete description of the offering, see "Plan of Distribution" on page 55.

Use of Proceeds

All net proceeds from the sale of our common stock by the selling stockholders will go to the selling stockholders, and we will not receive any proceeds from the sale of the common stock by them.

Summary Financial Data

The following financial data should be read in conjunction with our financial statements and related notes, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and other financial information appearing elsewhere in this prospectus. We derived the following historical financial information from the consolidated financial statements of Digital Angel Corporation for the years ended December 31, 2003 and 2002, which have been audited by Eisner LLP, and the combined financial statements of the Advanced Wireless Group for the years ended December 31, 2001, 2000 and 1999, which have been audited by PricewaterhouseCoopers LLP. PricewaterhouseCoopers LLP's report on the combined financial statements contained an explanatory paragraph expressing doubt about the Advanced Wireless Group's ability to continue as a going concern. In addition, PricewaterhouseCoopers LLP was dismissed as the Advanced Wireless Group's independent accountant on April 11, 2002. The equity accounts of the Advanced Wireless Group have been restated based on the common shares received by the former shareholders of the Advanced Wireless Group in the merger.

The unaudited financial data as of and for the three months ended March 31, 2004 and 2003 includes all adjustments, including normal recurring adjustments, which our management considers necessary for fair presentation of our results for these unaudited periods.

	For the Three Months Ended March 31,		For the Years Ended December 31,				
	2004(1)	**2003**	**2003**	**2002(2)**	**2001**	**2000(3)**	**1999**
	(unaudited)						
	(Amounts in thousands, except per share data)						
Results of Operations Data:							
Product revenue	$ 10,676	$ 10,865	$ 33,748	$ 30,946	$ 33,220	$ 19,604	$ 14,380
Service revenue	450	533	2,964	3,297	2,691	2,888	
Total net revenue	11,126	11,398	36,712	34,243	35,911	22,492	14,380
Cost of products sold	6,195	5,639	20,095	18,293	20,252	11,517	7,964
Cost of services sold	348	395	1,172	2,216	2,047	1,434	
Gross profit	4,583	5,364	15,445	13,734	13,612	9,541	6,416
Selling, general and administrative expense(4)	4,824	4,280	16,764	37,538	22,798	10,792	7,513
Research and development expense	669	911	4,898	3,034	5,244	2,476	
Asset impairment charge(5)			2,986	63,818	726		
Interest income	(8)		(15)	(2)	(17)	(26)	
Interest expense Applied Digital Solutions, Inc.				1,806	1,591		
Interest expense others	293	138	921	303	528	115	41
Realized and unrealized losses on Applied Digital Solutions, Inc. common stock	2,586						
Other income	(43)	(42)	(353)	(599)			
(Loss) income before minority interest, equity in net loss of affiliate and income taxes	(3,738)	77	(9,756)	(92,164)	(17,258)	(3,816)	(1,138)
Provision for income taxes					41	58	
(Loss) income before minority interest and equity in net loss of affiliate	(3,738)	77	(9,756)	(92,164)	(17,299)	(3,874)	(1,138)
Minority interest share of (income) losses	(6)	33	298	96	217	4	170
Equity in net income of affiliate				(291)	(327)		
Net (loss) income	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (17,409)	$ (3,870)	$ (968)
Net loss per common share basic and diluted	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.93)	$ (0.21)	$ (0.05)

	For the Three Months Ended March 31,		For the Years Ended December 31,				
Weighted average common shares outstanding							
Basic	30,468	26,663	26,959	24,578	18,750	18,750	18,750
Diluted(6)	30,468	30,638	26,959	24,578	18,750	18,750	18,750

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	March 31,		December 31,				
	2004	2003	2003	2002	2001	2000	1999
	(unaudited)						
Balance Sheet Data:							
Cash	$ 1,690	$	$ 894	$ 214	$ 596	$ 206	$ 139
Restricted cash	785		765				
Property and equipment, net	7,544	7,656	7,665	7,769	14,476	5,408	1,115
Goodwill and other intangibles, net	53,865	48,808	45,608	48,893	72,876	77,645	2,713
Total assets	82,382	71,525	67,307	67,798	107,379	95,344	9,239
Long-term debt and notes payable	2,543	3,303	2,818	3,314	2,425	2,463	
Total debt	9,701	7,112	8,736	4,130	85,227	2,503	
Minority interest	6	265		298	394	612	616
Total stockholders' equity	61,970	55,345	48,483	55,012	16,116	87,809	5,574
Other Financial Data:							
Depreciation and amortization	$ 573	$ 434	$ 1,725	$ 3,638	$ 12,331	$ 2,962	$ 565
Net cash (used in) provided by operating activities	(2,274)	(3,089)	(4,691)	(2,730)	(3,196)	(1,432)	14
Net cash provided by (used in) investing activities	1,280	(241)	(1,352)	(567)	(1,307)	1,066	(88)
Net cash provided by financing activities	1,848	3,155	6,595	2,593	4,893	433	212
Capital expenditures	100	250	1,165	1,439	1,310	758	106

(1) Includes the results of operations of OuterLink Corporation from January 22, 2004.

(2) Includes the results of operations of Medical Advisory Systems from March 27, 2002.

(3) Includes the results of operations of (i) Timely Technology from April 1, 2000 and (ii) Destron Fearing Corporation from September 8, 2000.

(4) Selling, general and administrative expense includes management fees paid to Applied Digital Solutions of $193, $771, $262 and $241 for the years ended December 31, 2002, 2001, 2000 and 1999. No management fees were paid to Applied Digital Solutions in 2003 or in the three months ended March 31, 2004.

(5) Asset impairment expense for 2003 consists of a goodwill impairment charge of $2,375 and an intangible asset impairment charge of $611. Asset impairment expense for 2002 consists of a goodwill impairment charge of $57,406 and an asset impairment charge of $6,412 related to the write off of an exclusive perpetual license to a digital encryption and distribution software system. Asset impairment expense for 2001 relates to a goodwill impairment.

(6) Potentially dilutive securities are excluded from the number of weighted average shares outstanding in the three months ended March 31, 2004 and in the years ended December 31, 2003 and 2002. Including the dilutive securities would have had an anti-dilutive effect on our net loss per common share. Weighted average shares outstanding for the years ended December 31, 2001, 2000 and 1999 have been restated to reflect the number of common shares received by the former shareholders of the Advanced Wireless Group in the March 27, 2002 merger.

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized but instead tested for impairment at least annually.

The following table presents the impact of SFAS No. 142 on our summary financial data as indicated:

	For the Three Months Ended March 31,		For the Years Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
	(unaudited)						

	For the Three Months Ended March 31,		For the Years Ended December 31,				
			(In thousands, except per share data)				
Net (loss) income:							
Net (loss) income as reported	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (17,409)	$ (3,870)	$ (968)
Goodwill amortization					8,629	2,529	256
Equity method investment amortization					1,161		
Adjusted net (loss) income	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (7,619)	$ (1,341)	$ (712)
Basic and diluted loss per share:							
Net (loss) income per share, basic and diluted, as reported	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.93)	$ (0.21)	$ (0.05)
Goodwill amortization					0.46	0.13	0.01
Equity method investment amortization					0.06		
Adjusted (loss) income per share, basic and diluted	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.41)	$ (0.08)	$ (0.04)

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors and other information contained in or incorporated by reference into this prospectus and any accompanying prospectus supplement before deciding to purchase any shares of our common stock.

Recent changes in our senior management could have an adverse effect on our financial results.

We have recently experienced numerous changes with respect to our senior management. On September 4, 2003, Randolph K. Geissler resigned as Chief Executive Officer of Digital Angel Corporation after serving in such position since the March 2002 merger between Digital Angel Corporation and Medical Advisory Systems. From September 2000 until March 2002, Mr. Geissler served as Chief Executive Officer of Digital Angel Corporation, one of the predecessor corporations to our company.

Following Mr. Geissler's resignation, our Board appointed Kevin McLaughlin as the interim Chief Executive Officer of Digital Angel Corporation while we conducted a formal search for a permanent Chief Executive Officer. At the time of his appointment as interim Chief Executive Officer, Mr. McLaughlin was serving as President and Chief Operating Officer of Applied Digital Solutions. On November 3, 2003, we announced that we had agreed to appoint Van Chu as Chief Executive Officer. At the time of this announcement, Mr. Chu was Chief Executive Officer of OuterLink Corporation, a company that was acquired by Digital Angel Corporation in a merger on January 22, 2004. Mr. Chu assumed his duties as our Chief Executive Officer on November 7, 2003.

As described in greater detail in the "Business Recent Developments" section of this prospectus, Mr. Chu was terminated as Chief Executive Officer on January 12, 2004. On January 15, 2004, our board of directors appointed Kevin N. McGrath as President and Chief Executive Officer of Digital Angel Corporation.

Because we depend heavily on the skills of those persons holding senior management positions, the loss of any senior executive could materially adversely affect our financial results. These senior executives, in many cases, have strong relationships with our customers and suppliers. Therefore, the loss of the services of such senior executives or any general instability in the composition of our senior management could have a negative impact on our relationship with these customers and suppliers. We cannot ensure that we will be able to retain our senior executives and this uncertainty could have a material negative impact on our business.

As of May 31, 2004, our majority stockholder, Applied Digital Solutions, Inc. owned 68.3% of our common stock. Thus, it is able to completely control the board of directors and may support actions that conflict with the interests of the other stockholders.

As of May 31, 2004, Applied Digital Solutions was the beneficial owner of 68.3% of our common stock. It controls us with respect to all matters upon which our stockholders may vote, including the selection of the Board of Directors, mergers, acquisitions and other significant corporate transactions. Applied Digital Solutions has the ability to exercise control over us. Applied Digital Solutions may support actions that are contrary to or conflict with the interests of the other stockholders.

Our stockholders will experience dilution if Laurus Master Fund exercises its right to convert certain debt owed by us into shares of our common stock.

On July 31, 2003, we issued to Laurus Master Fund a two-year secured convertible note in the original principal amount of $2,000,000. The secured convertible note is convertible, at Laurus Master Fund's option, into shares of the our common stock at a per share price of $2.33. In connection with the issuance of the secured convertible note, we also issued to Laurus Master Fund a five-year warrant to purchase 125,000 shares of our common stock at exercise prices ranging from $2.68 to $3.38 per share.

On August 28, 2003, we issued a three-year secured revolving convertible note in the principal amount of $3,500,000 and a three-year secured minimum borrowing convertible note in the principal amount of $1,500,000 to Laurus Master Fund. When the two-year secured convertible note is repaid in full, either in cash or by conversion into our common stock, each of these notes will be convertible, at Laurus Master Fund's option, into shares of our common stock at $2.64 per share. In connection with the issuance of these notes, Laurus Master Fund also acquired a five-year warrant to purchase 115,000 shares of our common stock at exercise prices ranging from $2.55 to $2.95 per share.

Through May 31, 2004, Laurus Master Fund had converted $582,500 in principal amount of the two-year secured convertible note dated July 31, 2003 into 250,000 shares of our common stock. Our issuance of shares to Laurus Master Fund upon any other conversion of these notes or any exercise of the warrants may result in substantial dilution to other Digital Angel Corporation stockholders. In addition, Laurus Master Fund may offer and sell any and all of the shares of our common stock received in connection with conversion of the notes or exercise of the warrants at prices and times to be determined in its sole discretion. There is no independent or third-party underwriter involved in the offering of the shares of our common stock acquired by Laurus Master Fund, and there can be no guarantee that any disposition of those shares will be completed in a manner that is not disruptive to the trading market for our common stock.

Our stockholders will experience dilution upon conversion of the Series A Preferred Stock issued by us in the OuterLink Corporation acquisition.

On January 22, 2004, we acquired OuterLink Corporation of Concord, Massachusetts, in a merger. As consideration for the merger, we issued 100,000 shares of our Series A Preferred Stock in exchange for all of the issued and outstanding shares of OuterLink's capital stock. The Series A Preferred Stock is convertible into 4,000,000 shares of our common stock when the volume-weighted average price of our common stock equals or exceeds $4.00 per share for 10 consecutive trading days. The issuance of our common stock upon any conversion of the Series A Preferred Stock issued to the OuterLink stockholders would result in dilution to our current stockholders.

The terms of our debt obligations to Laurus Master Fund subject us to the risk of foreclosure on substantially all of our assets.

We may not have sufficient funds to repay Laurus Master Fund when the obligations on the convertible note, minimum borrowing note and revolving note mature. Accordingly, we may be required to obtain the funds necessary to repay these obligations either through refinancing, the issuance of additional equity or debt securities or the sale of assets. There can be no assurance that we can obtain the funds needed, if any, to repay the obligations from any one or more of these other sources on favorable economic terms or at all. If we are unable to obtain funds to repay this indebtedness, we may be forced to dispose of assets or take other actions on disadvantageous terms, which could result in losses to Digital Angel Corporation and could have a material adverse effect on our financial condition.

To secure the payment of all debts, liabilities and obligations owed to Laurus Master Fund, we have granted to Laurus Master Fund a security interest in and lien upon all of our property and assets, whether real or personal, tangible or intangible, whether now owned or hereafter acquired, or in which we now have, or at any time in the future may acquire, any right, title or interest. The occurrence of an event of default under the convertible note, minimum borrowing note or revolving note would subject us to foreclosure by Laurus Master Fund on substantially all of our assets to the extent necessary to repay any amounts due. Any such default and resulting foreclosure will have a material adverse effect on our financial condition.

Our earnings will decline if we write off additional goodwill and other intangible assets.

As of March 31, 2004, we had recorded goodwill of $48.4 million. On January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized but instead tested for impairment at least annually by applying a fair value based test. During the fourth quarter of 2003, we performed the annual impairment test for goodwill using a fair value based approach, primarily discounted cash flows. An evaluation of the Medical Systems reporting unit indicated that $2.4 million of goodwill was impaired. Additionally, management estimated that certain intangible assets at our Medical Systems reporting unit were impaired by $0.6 million. Accordingly, we recorded an impairment charge of $3.0 million in the fourth quarter of 2003, which is included as an asset impairment charge in the 2003 statement of operations. During the fourth quarter of 2002, we recorded an impairment charge of $57.4 million for goodwill at our GPS and Radio Communications and Medical Systems reporting units.

We will assess the fair value of our goodwill annually or earlier if events occur or circumstances change that would more likely than not reduce the fair value of our goodwill below its carrying value. These events or circumstances would include a significant change in business climate, including a significant, sustained decline in an entity's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business, or other factors. If we determine that significant impairment has occurred, we would be required to write off the impaired portion of goodwill. Impairment charges could have a material adverse effect on our financial condition and results of operations.

The exercise of outstanding options and warrants may adversely affect the market price of our common stock.

As of May 31, 2004, we had 10,094,000 options and 3,029,000 warrants outstanding to purchase from us a total of 13,123,000 shares of common stock at exercise prices ranging from $0.50 to $10.50 per share. In addition, as of May 31, 2004, we had 4,527,000 additional shares of common stock which may be issued in the future under our stock option plans. The exercise of outstanding options and warrants and the sale in the public market of the shares purchased upon such exercise may adversely affect the market price of our common stock.

We may continue to incur losses.

We incurred a net loss of $3.7 million for the three months ended March 31, 2004. In addition, we incurred net losses of $9.5 million, $92.4 million, $17.4 million in the years ended December 31, 2003, 2002 and 2001, respectively. Included in the $92.4 million loss for the year ended December 31, 2002 is a goodwill impairment charge of $57.4 million, an asset impairment charge of $6.4 million, and a $18.7 million charge arising from the remeasurement of options in connection with the merger. No assurance can be given as to when we will achieve profitability, if at all. Profitability depends on many factors, including the success of our marketing programs, our maintenance and reduction of expenses, and the ability to coordinate successfully the operations of our business units. If we fail to achieve and maintain sufficient profitability within the time frame expected by investors, the market price of our common stock may be adversely affected.

The Digital Angel technology is not proven, and we may not be able to develop products from this unproven technology.

We have invested approximately $15.6 million in the Digital Angel technology during the period from April 1, 1998 through March 31, 2004. The Digital Angel technology depends on the development, integration, miniaturization and successful marketing of several advanced technologies that have not previously been integrated or used. The Digital Angel technology depends upon advanced technology, including wireless communication, biosensors, motion determination and global positioning system capabilities. Many of these technologies are unproven or relatively new. The Digital Angel technology continues to be in the development stage, and we are uncertain when this technology will be incorporated into any products. This technology has not generated any significant revenue through March 31, 2004. No assurances can be given as to when or if the Digital Angel technology will be successfully marketed. Our ability to develop and commercialize products based on our proprietary technology will depend on our ability to develop products internally on a timely basis or to enter into arrangements with third parties to provide these functions. Our failure to develop and commercialize products successfully could have a material adverse effect on our financial condition and results of operations.

Infringement by third parties on our intellectual property or the development of substantially equivalent proprietary technology by our competitors could negatively affect our business.

Our success depends significantly on our ability to maintain patent and trade secret protection, to obtain future patents and licenses, and to operate without infringing on the proprietary rights of third parties. There can be no assurance that the measures we have taken to protect our intellectual property, including those relating to the Digital Angel technology, will prevent the misappropriation or circumvention of our intellectual property. In addition, there can be no assurance that any patent application, when filed, will result in an issued patent, or that our existing patents, or any patents that may be issued in the future, will provide us with significant protection against competitors. Moreover, there can be no assurance that any patents issued to or licensed by us will not be infringed upon or circumvented by others. Litigation to establish the validity of patents, to assert infringement claims against others, and to defend against patent infringement claims can be expensive and time-consuming, even if the outcome is in our favor. We also rely to a lesser extent on unpatented proprietary technology, and no assurance can be given that others will not independently develop substantially equivalent proprietary information, techniques or processes or that we can meaningfully protect our rights to such unpatented proprietary technology. Infringement on our intellectual property or the development of substantially equivalent technology by our competitors could have a material adverse effect on our business.

Domestic and foreign government regulation and other factors could impair our ability to develop and sell our products in certain markets.

The electronic animal identification market can be negatively affected by such factors as food safety concerns, consumer perceptions regarding cost and efficacy, international technology standards, national infrastructures, and slaughterhouse removal of microchips.

We are also subject to federal, state and local regulation in the United States, including regulation by the U.S. Food and Drug Administration, the U.S. Federal Communications Commission, the Federal Aviation Authority and the U.S. Department of Agriculture, and to regulation in other countries. We cannot predict the extent to which we may be affected by further legislative and regulatory developments concerning our products and markets. We are required to obtain regulatory approval before marketing most of our products. The regulatory process can be very time-consuming and costly, and there is no assurance that we will receive the regulatory approvals necessary to sell our products. Regulatory authorities also have the authority to revoke approval of previously approved products for cause, to request recalls of products and to close manufacturing plants in response to violations. Any such regulatory action, including the failure to obtain such approval, could prevent us from selling, or materially impair our ability to sell, our products in certain markets and could negatively affect our business.

We rely heavily on sales to government contractors of our animal identification products, and any decline in the demand by these customers for our products could negatively affect our business.

The principal customers for electronic identification devices for fish are government contractors that rely on funding from the United States government. Because these contractors rely heavily on government funds, any decline in the availability of such funds could result in a decreased demand by these contractors for our products. Any decrease in demand by such customers could have a material adverse effect on our financial condition and results of operations and result in a decline in the market value of our common stock.

We depend on a single production arrangement with Raytheon Microelectronics Espana, SA for our patented syringe-injectable microchips, and the loss of or any significant reduction in the production could have an adverse effect on our business.

We rely solely on a production arrangement with Raytheon Microelectronics Espana, SA for the manufacture of our patented syringe-injectable microchips that are used in all of our implantable electronic identification products. Raytheon utilizes our proprietary technology and our equipment in the production of our syringe-injectable microchips. The termination, or any significant reduction, by Raytheon of the assembly of our microchips or a material increase in the price charged by Raytheon for the assembly of our microchips could have an adverse effect on our financial condition and results of operations. In addition, Raytheon may not be able to produce sufficient quantities of the microchips to meet any significant increased demand for our products or to meet any such demand on a timely basis. Any inability or unwillingness of Raytheon to meet our demand for microchips would require us to utilize an alternative production arrangement and remove our automated assembly production machinery from the Raytheon facility, which would be costly and could delay production. Moreover, if Raytheon terminates our production arrangement, we cannot assure that the assembly of our microchips from another source would be on comparable or acceptable terms. The failure to make such an alternative production arrangement could have an adverse effect on our business.

We depend on principal customers.

For the three months ended March 31, 2004, we had one customer which accounted for 12.6% of our consolidated revenue, and our four largest customers, in the aggregate, accounted for 33.0% of our consolidated revenue. For the year ended December 31, 2003, we had one customer that accounted for 11.8% of our consolidated revenues, and our four largest customers accounted for, in the aggregate, 30.9% of our consolidated revenues. Our subsidiary, Signature Industries, Ltd., is heavily dependent on contracts with domestic government agencies and foreign governments, including the United Kingdom, primarily relating to military applications. The loss of, or a significant reduction in, orders from these or our other major customers could have a material adverse effect on our financial condition and results of operations.

We compete with other companies in the visual and electronic identification market, and the products sold by our competitors could become more popular than our products or render our products obsolete.

The market for visual and electronic identification for companion animals and livestock is highly competitive. We believe that our principal competitors in the visual identification market for livestock are AllFlex USA and Y-Tex Corporation and that our principal competitors in the electronic identification market are AllFlex USA, Datamars SA and Avid Identification Systems, Inc.

In addition, other companies could enter this line of business in the future. Certain of our competitors have substantially greater financial and other resources than us. We may not be able to compete successfully with these competitors, and these competitors may develop or market technologies and products that are more widely accepted than ours or that would render our products obsolete or noncompetitive.

Currency exchange rate fluctuations could have an adverse effect on our sales and financial results.

We generate a portion of our sales and incur a portion of our expenses in currencies other than U.S. dollars. To the extent that we are unable to match revenues received in foreign currencies with costs paid in the same currency, exchange rate fluctuations in any such currency could have an adverse effect on our financial results.

We depend on a small team of senior management, and we may have difficulty attracting and retaining additional personnel.

Our future success will depend in large part upon the continued services and performance of senior management and other key personnel. If we lose the services of any member of our senior management team, our overall operations could be materially and adversely affected. In addition, our future success will depend on our ability to identify, attract, hire, train, retain and motivate other highly skilled technical, managerial, marketing, purchasing and customer service personnel when they are needed. Competition for these individuals is intense. We cannot ensure that we will be able to successfully attract, integrate or retain sufficiently qualified personnel when the need arises. Any failure to attract and retain the necessary technical, managerial, marketing, purchasing and customer service personnel could have a material adverse effect on our financial condition and results of operations.

FORWARD-LOOKING STATEMENTS

This prospectus, any prospectus supplement and the information incorporated by reference may contain "forward-looking statements" which represent our expectations or beliefs including, but not limited to, statements concerning industry performance and our results, operations, performance, financial condition, plans, growth and strategies, which include, without limitation, statements preceded or followed by or that include the words "may," "will," "expect," "anticipate," "intend," "could," "estimate," or "continue" or the negative or other variations thereof or comparable terminology. Any statements contained in this prospectus, any prospectus supplement or the information incorporated by reference that are not statements of historical fact may be deemed to be forward-looking statements. These statements by their nature involve substantial risks and uncertainties, some of which are beyond our control, and actual results may differ materially depending on a variety of important factors, many of which are also beyond our control. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this prospectus. We do not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this prospectus or to reflect the occurrence of unanticipated events, except to the extent such updates and/or revisions are required to prevent these forward-looking statements from being materially false or misleading.

USE OF PROCEEDS

All net proceeds from the sale of our common stock will go to the selling stockholders who are selling common stock under this prospectus. We will not receive any proceeds from the sale of the common stock sold by them.

BUSINESS

Overview

We were incorporated in Delaware on December 1, 1981 as Medical Advisory Systems, Inc. to provide medical assistance and technical products and services. On March 27, 2002, we completed a merger pursuant to which the former Digital Angel Corporation became a wholly-owned subsidiary of Medical Advisory Systems and was renamed "Digital Angel Technology Corporation," and Medical Advisory Systems was renamed "Digital Angel Corporation." In connection with the merger, Applied Digital Solutions, Inc. contributed to Medical Advisory Systems all of its stock in Timely Technology, a wholly-owned subsidiary, and Signature Industries, an 85.0%-owned subsidiary. These two subsidiaries, along with Digital Angel Corporation, comprised Applied Digital Solutions' Advanced Wireless Group. As a result of this contribution, Timely Technology became a wholly-owned subsidiary of Digital Angel Corporation and Signature Industries became an 85.0%-owned subsidiary. As a result of the merger and subsequent transactions, Applied Digital Solutions owned 22,303,506 shares (or 68.3%) of our outstanding shares of common stock as of May 31, 2004.

Before January 22, 2004, we operated in four segments: Animal Applications, Wireless and Monitoring, GPS and Radio Communications and Medical Systems. With our acquisition of OuterLink Corporation in January 2004, we reorganized into three segments: Animal Applications, GPS and Radio Communications and Medical Systems. The former GPS and Radio Communications Segment, the Wireless and Monitoring Segment and the OuterLink Corporation business were combined to form the new GPS and Radio Communications segment, which is now managed as a single business unit. On April 19, 2004, we completed a transaction in which we sold certain assets of our Medical Systems segment. We expect to eliminate this segment, but we also expect that we will recognize losses in the Medical Systems segment through the second quarter of 2004.

Animal Applications

Our Animal Applications segment develops, manufactures and markets radio, electronic and visual identification devices for the companion animal, livestock, laboratory animal, fish and wildlife markets worldwide.

The Animal Applications segment's radio frequency identification products consist of miniature electronic microchips, readers and injection systems. We hold patents on our syringe-injectable microchip, which is encased in a glass or glass-like material capsule and incorporates an antenna and a microchip with a unique permanent identification code for the animal in which it is implanted. The microchip is typically injected under the skin using a hypodermic syringe, without requiring surgery. An associated reader device uses radio frequency to interrogate the microchip and read the code.

The Animal Applications segment's pet identification system involves the insertion of a microchip with identifying information in the animal. Readers at animal shelters, veterinary clinics and other locations can determine the animal's owner and other information. This pet identification system is marketed in the United States by Schering-Plough Animal Health Corporation under the brand name "Home Again ," in Europe by Merial Pharmaceutical, and in Japan by Dainippon Pharmaceutical. We have distribution agreements with a variety of other companies outside the United States to market our products. We have an established infrastructure with readers placed in approximately 70,000 global animal shelters and veterinary clinics. Over 2.5 million companion animals in the United States have been enrolled in the database, and more than 6,000 pet recoveries occur in the United States each month.

In addition to pursuing the market for permanent identification of companion animals, the Animal Applications segment also produces visual and electronic identification products, principally for livestock producers. Visual identification products typically include numbered ear tags. We have marketed visual identification products for livestock since the 1940s. Electronic identification products for livestock are currently being evaluated by livestock producers. Currently, sales of visual products represent virtually all of our sales to livestock producers. In the three months ended March 31, 2004, the Animal Applications segment represented 63.6% of our consolidated revenue, and in the year ended December 31, 2003, it represented 65.2% of our consolidated revenue.

GPS and Radio Communications

The GPS and Radio Communications segment consists of our former Wireless and Monitoring segment, the business of OuterLink Corporation (which we acquired in January 2004), and Signature Industries, located in the United Kingdom. This segment consists of the design, manufacture and support of GPS enabled equipment. Applications for the segment's products include location tracking and message monitoring of vehicles and aircraft in remote locations through systems that integrate GPS and geosynchronous satellite communications and GPS enabled equipment and intelligent communications products and services for telemetry, mobile data and radio communications applications serving commercial and military markets.

The GPS and Radio Communications segment is also developing technology, which it refers to as its Digital Angel technology. The Digital Angel technology is the integration and miniaturization into marketable products of three technologies: wireless communications (such as cellular), sensors (including bio-sensors) and position location technology (including GPS and other systems). This segment also includes high grade communications equipment leasing and complementary data systems that customers can use to locate and monitor their assets. In the three months ended March 31, 2004, the GPS and Radio Communications segment represented 33.2% of our consolidated revenue, and in the year ended December 31, 2003, it represented 28.6% of our consolidated revenue.

Medical Systems

Until April 19, 2004, we had a Medical Systems segment comprised of a staff of logistics specialists and physicians that operated from our medical telecommunications response center that provided medical assistance services and interactive medical information services to people traveling anywhere in the world, 24 hours per day, 7 days per week. Assistance was provided by telephone, satellite, high frequency radio, fax, Internet and telex. The primary market for the Medical Systems segment services was the maritime industry and the international travel insurance and assistance industry. Services included coordination of medical care, provision of general medical information, physician consultation, translation assistance, claims handling and cost containment on behalf of assistance companies, insurance companies or managed care organizations. We also offered medical training services to the maritime industry.

Our Medical Systems segment also sold a variety of kits containing pharmaceutical and medical supplies. Included in the kits were prescription and nonprescription medications, controlled substances, medical equipment and expendable medical supplies. The kits included our proprietary pharmaceutical manual, which provided information on proper storage, use and inventory control. All medications were specially labeled for use in our system. We directly supplied pharmaceuticals to our maritime and airline customers through our pharmaceutical warehouse facility located in Owings, Maryland. In the three months ended March 31, 2004, the Medical Systems segment represented 3.2% of our consolidated revenue, and in the year ended December 31, 2003, it represented 6.2% of our consolidated revenue.

On April 19, 2004, we completed a transaction in which we sold certain assets of our Medical Systems segment. However, we expect to continue to recognize financial losses in this segment through the second quarter of 2004.

Financial Information About Segments

Revenues from our various segments in the first quarters of 2004 and 2003 and in the years ended December 31, 2003, 2002 and 2001 are as follows:

	For the Three Months Ended March 31,		For the Years Ended December 31,		
	2004	2003	2003	2002	2001
	(unaudited)		(In thousands)		
Animal Applications	$ 7,072	$ 7,801	$ 23,948	$ 20,991	$ 22,247
GPS and Radio Communications	3,699	2,853	10,484	11,525	13,664
Medical Systems	355	744	2,280	1,727	

Please refer to the segment information in Note 9 to our financial statements as of and for the three months ended March 31, 2004 and Note 17 to our financial statements as of and for the years ended December 31, 2003, 2002 and 2001.

Recent Developments

Recent Changes in Management

On November 3, 2003, OuterLink's Chief Executive Officer, Mr. Van Chu, was appointed as our Chief Executive Officer. Mr. Chu's employment was terminated for cause, effective January 12, 2004, as a result of Mr. Chu's failure to fulfill the obligations of his employment. The terms of Mr. Chu's termination are subject to a confidentiality agreement dated January 22, 2004 among the Company, OuterLink Corporation and Mr. Chu. On January 12, 2004, our Board of Directors appointed Kevin N. McGrath as our President and Chief Executive Officer. Before joining Digital Angel Corporation, Mr. McGrath spent 16 years at Hughes Electronics Corp. based in El Segundo, California, during which time he served in different executive positions, including as Chairman of DirecTV Latin America, a Hughes subsidiary.

Stock Issued to Applied Digital Solutions, Inc.

On March 1, 2004, we issued 3,000,000 shares of our common stock to Applied Digital Solutions, Inc. pursuant to a stock purchase agreement with Applied Digital Solutions dated August 14, 2003. The stock purchase agreement provided for Applied Digital Solutions to purchase 3,000,000 shares of our common stock at a price of $2.64 per share and a warrant to purchase up to 1,000,000 shares of our common stock. The warrant is exercisable for five years beginning February 1, 2004 at an exercise price per share of $3.74 payable in cash or shares of common stock of Applied Digital Solutions. The consideration for the sale of our 3,000,000 shares and the warrant was payable in 1,980,000 shares of common stock of Applied Digital Solutions (as adjusted for Applied Digital Solutions' subsequent one-for-10 reverse stock split). Through May 31, 2004, we had sold approximately 910,350 shares of Applied Digital Solutions' common stock, resulting in aggregate net proceeds of approximately $2.6 million.

Sale of Certain Assets of Medical Systems Segment

On April 19, 2004, the Company sold certain assets of its Medical Systems segment. The assets sold to MedAire, Inc., the buyer, included all of the tangible and intangible intellectual property developed for the operation of the segment's medical services business, pharmaceutical supplies and other inventory items, customer and supplier contracts, computer software licenses, Internet website and domain name and mailing lists. Under the terms of the of the agreement, the purchase price, in addition to the buyer's assumption of certain liabilities, was $420,000 plus any prepaid deposits and the cost of the pharmaceutical inventory and supplies, as reduced by any pre-billings to or pro rata prepayment by Medical Systems segment's customers. The net amount paid to Digital Angel was $414,765.

In connection with exiting this activity, we recognized obligations and expect to record a loss of approximately $300,000. We expect to sell the Medical Systems segment's land and buildings in a separate transaction in which the sale proceeds will be above their carrying cost.

Competition

Principal methods of competition in all of our segments include geographic coverage, service and product performance.

Animal Applications

The animal identification market is highly competitive. The principal competitors in the visual identification market are AllFlex USA, Inc. and Y-Tex Corporation, and the principal competitors in the electronic identification market are AllFlex, USA, Inc., Datamars SA and Avid Identification Systems, Inc. We believe that our strong intellectual property position and our reputation for high quality products are our competitive advantages.

GPS and Radio Communications

The principal competitors for our subsidiary, Signature Industries, are Boeing North American Inc., General Dynamics Decision Systems, Tadiran Spectralink Ltd., Becker Avionic Systems, and ACR Electronics, Inc. We believe that being first to market with GPS in our search and rescue beacons and the use of our search and rescue beacons in over 40 countries are competitive advantages. In addition, the barriers to entry in this market are high due to the technical demands of the market.

The principal competitors for our subsidiary, OuterLink, are Blue Sky Networks, Sky Connect and Comtech Mobile Data Com. We believe our competitive advantages are lower cost communications, more frequent reporting on a near real time basis and the ability to provide additional messaging capabilities in addition to vehicle tracking.

Raw Materials

We have not experienced any significant or unusual problems in the purchase of raw materials or commodities during 2002 or 2003. We depend on a single production arrangement with a vendor for the manufacture of our patented syringe-injectable microchips that are used in our implantable electronic identification products. While we are dependent, in certain situations, on a limited number of vendors to provide certain raw materials and components, during the recent past, we have not experienced significant problems or issues procuring any essential materials, parts or components.

Patents and Trademarks

We own various patents and trademarks which we consider in the aggregate to constitute a valuable asset. We consider several of our patents offer a significant competitive advantage and/or barriers to entry in the Animal Applications segments.

Backlog

We generally produce goods to fill orders received and anticipated orders based on distributors' forecasts, and we also maintain inventories of finished goods to fill customer orders with short lead times. As a result, we generally do not have a significant backlog of orders, and any such backlog is not indicative of future sales.

Research and Development

During the three months ended March 31, 2004, we spent $669,000 ($523,000 in the Animal Applications segment and $146,000 in the GPS and Radio Communications segment) on research and development activities relating to the development of new products or improvements of existing products. During 2003, we spent $4.9 million ($2.9 million in the Animal Applications segment and $2.0 million in the GPS and Radio Communications segment) on research and development activities. We spent $3.0 million in 2002 and $5.2 million in 2001 on research and development activities.

Environmental Matters

We do not anticipate any material effect on our capital expenditures, earnings or competitive position due to compliance with government regulations involving environmental matters.

Seasonality

Our Animal Applications segment's revenues and operating income can be affected by the timing of animal reproduction cycles. Our other business segments are not considered to be seasonal.

Employees

As of May 31, 2004, we had 232 full time employees, including nine in management, 19 in sales positions, 42 in administrative positions, 47 in technical positions and 115 in production positions. Our Animal Applications production workforce is party to a collective bargaining agreement which expires May 31, 2005. We believe our relations with our employees are good.

Government Regulation

We are subject to federal, state and local regulation in the United States, including the Food and Drug Administration (FDA) and Federal Communications Commission (FCC). We are also subject to regulation by government entities in other countries.

United States Regulation

Animal products for food producing animals have been reviewed by the FDA's Center for Veterinary Medicine, and the FDA has determined that our product, as presently configured, is unregulated. As of December 31, 2003, Digital Angel products did not incorporate FDA regulated components. However, any applications directly related to medical information will require further FDA approval. The Digital Angel products have also been approved by the FCC. Our products coated with insecticide require approval by the United States Environmental Protection Agency, which has been obtained.

We are also licensed by the FCC to transmit at specified frequencies on satellites. Our aviation equipment must meet the approval of the Federal Aviation Authority and Transport Canada for manufacturing, installation and repair.

Regulation Abroad

Our products are subject to compliance with applicable regulatory requirements in those foreign countries where our products are sold. The contracts we maintain with our distributors in these foreign countries generally require the distributor to obtain all necessary regulatory approvals from the governments of the countries in which these distributors sell our products.

Financial Information About Geographic Areas

Revenues are attributed to geographic areas based on the location of the assets producing the revenues. Information concerning principal geographic areas as of and for the three months ended March 31, 2004 and the years ended December 31, 2003, 2002 and 2001 is as follows:

(In thousands)	United States	United Kingdom/Spain	Consolidated / Combined
Three Months Ended March 31, 2004			
Net revenue	$ 7,732	$ 3,394	$ 11,126
Long-lived assets excluding goodwill and other intangible assets, net	$ 6,185	$ 1,359	$ 7,544
Three Months Ended March 31, 2003			
Net revenue	$ 8,699	$ 2,699	$ 11,398
Long-lived assets excluding goodwill and other intangible assets, net	$ 6,580	$ 1,076	$ 7,656
Year Ended December 31, 2003			
Net revenue	$ 26,350	$ 10,362	$ 36,712
Long-lived assets excluding goodwill and other intangible assets, net	$ 6,287	$ 1,378	$ 7,665
Year Ended December 31, 2002			
Net revenue	$ 24,221	$ 10,022	$ 34,243
Long-lived assets excluding goodwill and other intangible assets, net	$ 6,697	$ 1,072	$ 7,769
Year Ended December 31, 2001			
Net revenue	$ 24,767	$ 11,144	$ 35,911
Long-lived assets excluding goodwill and other intangible assets, net	$ 13,276	$ 1,200	$ 14,476

Properties

We own a 79,692 square foot (gross building area) masonry and steel industrial two-building complex located in South St. Paul, Minnesota that is currently occupied by the Animal Application division's administrative, sales, engineering and manufacturing operations, plus one lessee. We occupy 53,800 square feet of the space. The portions of the buildings that we occupy have 6,000 square feet of office area, nine loading docks, one drive-in door and 13 to 16 foot clear ceilings. Our lessee occupies approximately 15,000 square feet of warehouse space under a lease which expires June 30, 2004. Monthly rental income from the lessee is $6,950. The South St. Paul property is encumbered by a mortgage in the aggregate principal amount of $2.4 million.

Our former Medical Systems segment's facilities consist of a campus of three buildings: a 12,000 square foot facility that contained two custom designed call centers and administrative offices; a 4,800 square foot facility that contained our computer technology center and our maritime pharmacy; and a third facility consisting of a two-story structure with approximately 3,000 square feet of usable office and storage space. The three buildings are owned by us and located on 1.44 acres of commercial land in Owings, Maryland, approximately 20 miles from Washington, D.C. The Owings, Maryland property is encumbered by a mortgage in the aggregate principal amount of $910,000. We expect to sell these land and buildings and that the sale proceeds will be above their carrying costs.

We currently lease a 2,500 square foot facility in a modern technology park in Riverside, California. The facility contains office and engineering space and a data processing technology center. The facility is rented on a month-to-month lease. Rent payments are $2,500 per month.

Our subsidiary, Signature Industries, Ltd., leases, under a long-term lease expiring in September 2042, a 60,000 square foot building located in Thamesmead, London, England that is currently occupied by administrative, sales, engineering and manufacturing personnel. In addition, this division leases three single-story buildings totaling 5,400 square feet within a small industrial estate in Springburn, Glasgow, Scotland for manufacturing operations. Rent payments for the facilities are $36,000 a month.

Our subsidiary, OuterLink Corporation, leases 10,471 square feet in an office building located in Concord, Massachusetts. The lease expires on August 31, 2004 with no renewal options. Rent is $18,000 per month.

We consider our properties to be suitable and adequate for their present purposes, well maintained and in good operating condition.

Legal Proceedings

Wurts Litigation

In February 2003, an action was filed in the Middlesex County Superior Court in the Commonwealth of Massachusetts. Our subsidiary, OuterLink Corporation, as well as a significant stockholder of OuterLink and a principal of the significant stockholder are named as defendants. Such principal was a director of OuterLink. The complaint alleged breach of an August 25, 1999 employment contract. The plaintiff was President and CEO of OuterLink Corporation from July 1999 through August 2002. The Complaint seeks damages based principally on a contractual severance provision that allegedly provided for four months of compensation for every year or fraction thereof served prior to termination. At the time of termination, the complaint alleges that the plaintiff's salary was $250,000 per year. The defendants answered denying all liability and counterclaimed. Discovery will be completed in this matter shortly and the Defendants intend to vigorously defend this matter and pursue their counterclaims. The ultimate outcome of this proceeding cannot be predicted at this time and we are currently unable to determine the potential effect of this litigation on its consolidated financial position, results of operation or cash flows.

eResearch Litigation

In June 2002, eResearch Technology, Inc., formerly known as Premier Research Worldwide, Ltd. ("ERT"), commenced a proceeding against U.S. Bank National Association ("US Bank"), subsequently intervened in by us in the New Jersey state court and subsequently removed to the United States District Court for the District of New Jersey. This suit was commenced to pursue alleged damages of approximately $350,000 due to the alleged failure by us and US Bank to register transfers of restricted Digital Angel shares sold by ERT in May 2002. We agreed to indemnify US Bank for all damages and reasonable costs relating to this litigation. We asserted a counterclaim against ERT based on ERT's breach of a license agreement and services agreements between the parties that resulted in the original issuance by us of 550,000 restricted common shares to ERT. We asserted that the damages to us exceeded $4 million, which did not include the share of profits which we sought to recover had ERT not breached the agreements. Furthermore, the alleged damages sought by the plaintiff in this matter did not take into account plaintiff's duty to mitigate damages which, if discharged, would have resulted in a profit to ERT. This matter was scheduled to be tried in June 2004. Before trial, all parties reached an agreement in principle to settle all claims without any party paying any amounts to any other party. The parties are in the process of negotiating a settlement agreement, thus the case has not yet been dismissed.

Electronic Identification Devices Litigation

In February 2004, Electronic Identification Devices, Ltd. ("EID") commenced a declaratory judgment action against us in the United States District Court for the Western District of Texas. This action seeks a declaration of patent non-infringement relating to our syringe implantable identification transponders. The lawsuit alleges that EID has developed a new transponder that it believes does not infringe on our patent. The lawsuit acknowledges that we obtained a judgment of infringement and two contempt orders against EID based on selling certain systems that infringed our patent in 1997, 1998 and 1999. On March 10, 2004, we filed a motion seeking dismissal of the declaratory judgment complaint or, in the alternative, that the action be transferred to Minnesota. The court has not yet ruled on our motion. Given the very early stage of this matter, the ultimate outcome of this proceeding cannot be predicted at this time. We are currently unable to determine the potential effect of this litigation on our consolidated financial position, results of operations or cash flows.

John Fernandez vs. United States of America vs. Medical Advisory Systems, Inc.

On December 29, 2003, John Fernandez filed a lawsuit in the Orlando Division of the United States District Court for the Middle District of Florida. The plaintiff filed the lawsuit against the United States of America as the operator of the ship on which the plaintiff served. He alleged that the United States had contracted with Medical Advisory Systems to provide medical advisory systems and that a physician at Medical Advisory Systems had rendered an incorrect long-distance diagnosis, resulting in injury to the plaintiff. Mr. Fernandez asserted against the United States claims of negligence under the Jones Act, unseaworthiness and maintenance and cure. He alleged damages in excess of $75,000, plus prejudgment and post-judgment interest at the legal rate and costs and disbursements of the action. On April 14, 2004, the United States served Medical Advisory Systems with a third party complaint in Admiralty in which it alleged that Medical Advisory Systems is liable to it for all or part of plaintiff's claim in that Medical Advisory Systems and/or its employee/physician rendering the medical advice was negligent. In response, on May 12, 2004, Medical Advisory Systems filed a motion to dismiss the third party complaint. Given the very early stage of this lawsuit, the ultimate outcome of this proceeding cannot be predicted at this time. We are currently unable to determine the potential effect of this litigation on our consolidated financial position, results of operations or cash flows.

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the American Stock Exchange (AMEX) under the symbol "DOC." The following table shows the high and low sales prices for our common stock as reported on AMEX for the periods indicated. On June 14, 2004, the last reported sale price of our common stock was $3.08. As of May 31, 2004, there were 32,720,511 shares of our common stock issued and 32,670,511 shares of our common stock outstanding, and we had 152 stockholders of record.

	High	Low
YEAR ENDED DECEMBER 31, 2004		
Second Quarter (through June 14, 2004)	$ 3.85	$ 3.01
First Quarter	$ 4.70	$ 2.85
YEAR ENDED DECEMBER 31, 2003		
Fourth Quarter	$ 5.00	$ 1.75
Third Quarter	$ 2.74	$ 1.78
Second Quarter	$ 3.00	$ 1.26
First Quarter	$ 2.55	$ 0.98
YEAR ENDED DECEMBER 31, 2002		
Fourth Quarter	$ 3.02	$ 2.09
Third Quarter	$ 3.74	$ 1.50
Second Quarter	$ 7.75	$ 2.01
First Quarter	$ 7.35	$ 2.90

We did not declare or pay dividends on our common stock in the three months ended March 31, 2004 or the years ended December 31, 2003 or 2002. We have never paid dividends on our common stock and do not anticipate paying dividends in the foreseeable future.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

We engaged Eisner LLP on May 23, 2002 as our independent registered public accounting firm to audit our financial statements for the fiscal year ending December 31, 2002. During 2000 and 2001 and in the subsequent interim period from January 1, 2002 through May 23, 2002, we did not consult with Eisner LLP on items which concern the application of accounting principles generally, or as to a specific transaction or group of either completed or proposed transactions, or as to the type of audit opinion that might be rendered on our financial statements. Eisner LLP did not prepare a report on our financial statements for fiscal 2000 or 2001. Therefore, no report was issued by Eisner LLP that could contain an adverse opinion or disclaimer of opinion, or a qualification or modification, as to uncertainty, audit scope or accounting principles. The audit report of Eisner LLP for the year ended December 31, 2002 contained an explanatory paragraph expressing doubt about our ability to continue as a going concern.

On May 14, 2002, Grant Thornton, LLP ("Grant Thornton") notified us that it had resigned as our certifying accountant. Because Grant Thornton was engaged on April 18, 2002, it did not prepare a report on our financial statements for fiscal 2000 or 2001. Therefore, no report was issued by Grant Thornton that could contain an adverse opinion or disclaimer of opinion, or a qualification or modification, as to uncertainty, audit scope or accounting principles. Between April 18, 2002 and May 14, 2002, there were no disagreements with Grant Thornton on any matter of accounting principles or accounting practices, financial statement disclosure, or auditing scope or procedure. Grant Thornton advised us that its decision to resign was caused by its resignation as auditor for Applied Digital Solutions, our majority shareholder.

On April 18, 2002, we dismissed BDO Seidman LLP ("BDO") as our certifying accountant. BDO's report on our financial statements for the past two fiscal years contained no adverse opinion or disclaimer of opinion, nor was the report qualified or modified as to uncertainty, audit scope, or accounting principle. The decision to change accountants was unanimously approved by our Board of Directors, including all members of our Audit Committee. During the fiscal years ending October 31, 2000 and 2001 and through the subsequent interim period beginning November 1, 2001 and ending April 18, 2002, there were no disagreements with BDO on any manner of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations and sales in various regions of the world. Additionally, we export to and import from other countries. Consequently, our operations may be subject to volatility because of currency fluctuations, inflation and changes in political and economic conditions in these countries. Sales and expenses may be denominated in local currencies and may be affected because currency fluctuations affect our product prices and operating costs or those of our competitors.

We presently do not use any derivative financial instruments to hedge our exposure to adverse fluctuations in interest rates, foreign exchange rates, fluctuations in commodity prices or other market risks, nor do we invest in speculative financial instruments.

Due to the nature of our borrowings and our short-term investments, we have concluded that there is no material market risk exposure and, therefore, no quantitative tabular disclosures are required.

MANAGEMENT

Directors

The following sets forth certain information as of March 31, 2004 regarding the members of our Board of Directors.

Kevin N. McGrath, who is 51 years old, has been our Chief Executive Officer and President since January 2004. From 1987 until 2003, he was employed at Hughes Electronics Corp. in a number of senior level executive positions, including Corporate Vice President of DirectTV International, President of Hughes Communications, Inc. and the senior financial executive of Hughes Space and Communications Group. From 1996 to 2003, he was Chairman of DirecTV Latin America (a subsidiary of Hughes Electronics Corporation). Prior to his work at Hughes, Mr. McGrath spent two years as Chief Financial Officer for Electronic Data Systems, Asia and Pacific and 10 years in various financial management positions at General Motors Corp. Mr. McGrath is a graduate of Princeton University and received a Masters of Business Administration from the Amos Tuck School at Dartmouth College.

Scott R. Silverman, who is 40 years old, is Chairman of our Board of Directors and has been a Director of Digital Angel Corporation since July 2003. He has served since August 2001 as a special advisor to the Board of Directors of Applied Digital Solutions, Inc. In March 2002, he was appointed to Applied Digital Solutions' Board of Directors and named President. In March 2003, Mr. Silverman was appointed Chairman of the Board and Chief Executive Officer of Applied Digital Solutions. From September 1999 to March 2002, Mr. Silverman operated his own private investment banking firm. From October 1996 to September 1999, he served in various capacities for Applied Digital Solutions, including positions related to business development, corporate development and legal affairs. From July 1995 to September 1996, Mr. Silverman served as President of ATI Communications, Inc., a subsidiary of Applied Digital Solutions. He began his career as an attorney specializing in commercial litigation and communications law at the law firm of Cooper Perskie in Atlantic City, New Jersey, and Philadelphia, Pennsylvania. Mr. Silverman is a graduate of the University of Pennsylvania and the Villanova University School of Law.

John R. (Jack) Block, who is 69 years old, joined our Board of Directors in January 2004. Mr. Block serves as Chairman of the Board's Government Relations Committee. He has served as the Executive Vice President of the Food Marketing Institute, a trade association in Washington, D.C., since January 2003, and for the past year has been President of its Wholesaler Division. From 1986 until 2003, Mr. Block was President and Chief Executive Officer of Food Distributors International and the International Foodservice Distributors Association (NAWGA/IFDA). Mr. Block was appointed to President Reagan's Cabinet in 1981 and served for five years as the Secretary of the U.S. Department of Agriculture. As a member of President Reagan's Cabinet and a key member of the Economic Policy Council, he dealt with a wide range of complex domestic farm program and tax issues. Under his leadership, the Department of Agriculture's Food for Peace Program was a primary resource in feeding the starving African continent. During his tenure as Secretary of Agriculture, Mr. Block visited more than 30 foreign countries, meeting with heads of state and agriculture ministers from all over the globe and negotiating sensitive agreements critical to U.S. farm interests. From 1977 to 1981, he served as Director of Agriculture for the State of Illinois. Mr. Block currently has a syndicated weekly radio commentary broadcast by more than 600 stations in 30 states. Mr. Block serves on a number of corporate boards, including those of NYSE-listed Deere & Co. and Hormel Foods Corporation. He is also a member of the Board of Advisors for the Retail Food Industry Center at the University of Minnesota, and he is President of the Board of Directors of the U.S. Friends of the World Food Programme, a joint initiative of the United Nations and the Food and Agricultural Organization, and Chairman of the Agribusiness Alliance of the Citizens Network for Foreign Affairs in Washington.

Kevin H. McLaughlin, who is 62 years old, has been a Director of Digital Angel Corporation since September 2003. He was our interim Chief Executive Officer from September 2003 through

November 2003. Mr. McLaughlin has served as a director of InfoTech USA, Inc., a 52.5% owned subsidiary of Applied Digital Solutions, since April 2002. He was appointed President of Applied Digital Solutions in May 2003 and Chief Operating Officer in March 2003. From April 12, 2002 until March 10, 2003, Mr. McLaughlin served as a director and Chief Executive Officer of InfoTech USA, Inc. From September 2001 until January 2002, he served as Chief Executive Officer of Computer Equity Corporation, a wholly-owned subsidiary of Applied Digital Solutions. Mr. McLaughlin joined Applied Digital Solutions as Vice President of Sales and Marketing in June 2000. From June 1995 to May 2000, he served as Senior Vice President of Sales for SCB Computer Technology, Inc.

Howard S. Weintraub, Ph.D., who is 60 years old, has been a Director of Digital Angel Corporation since March 2002. Dr. Weintraub retired from C. R. Bard, Inc., a medical device company, in 2003, where he was Vice President, R&D, Corporate Staff. From 1988 to 1998, he held a series of senior research and technology management positions at Bristol-Myers Squibb. Dr. Weintraub was previously associated with Ortho Pharmaceutical Corporation, a Johnson and Johnson company, from 1973 until 1988, where he held senior research management positions. He also has authored or co-authored over 50 scientific publications and abstracts. Dr. Weintraub previously served as chairman of the Industrial Pharmaceutical Technology Section of the AAPS (formerly APhA), and was the chairman of the Drug Metabolism sub-section of the Research and Pharmaceutical Manufacturers' Association. Dr. Weintraub earned a Bachelor of Science Degree in Pharmacy from Columbia University and his Ph.D. in biopharmaceutics from the State University of New York at Buffalo. He is a member of the Board of Directors of the privately-held biotechnology firm, Bioenergy, Inc., and a member of the Scientific Advisory Board of Polymerix Corporation, a specialty development-stage pharmaceutical company. He was also a Board Advisor to the Swiss Biotechnology firm, Modex Therapeutics, prior to its merger with IsoTis, NV, in 2002.

Michael S. Zarriello, who is 54 years old, has been a Director of Digital Angel Corporation since September 2003. He has served as Senior Vice President and Chief Financial Officer for Rural/Metro Corporation in Scottsdale, Arizona, since July 2003. From 1998 to 2003, Mr. Zarriello was a Senior Managing Director of Jesup & Lamont Securities Corporation and President of Jesup & Lamont Merchant Partners LLC, both of which are investment banking firms. From 1989 to 1997, Mr. Zarriello was a Managing Director-Principal of Bear Stearns & Co., Inc., and from 1989 to 1991, he served as Chief Financial Officer of the Principal Activities Group that invested Bear Stearns' capital in middle market companies. Mr. Zarriello also serves as a member of the Boards of Applied Digital Solutions and Good Samaritan Hospital in Suffern, New York. He serves on the Board of Directors and Audit Committee for Bon Secoures Charity Health System in New York.

Directors' Compensation

The Board has determined to pay each member of our Board of Directors who is not an employee or officer of Digital Angel Corporation or our "affiliate" (as the term "affiliate" is defined in our Amended and Restated Digital Angel Corporation Transition Stock Option Plan) $5,000 per quarter for serving on the Board; $5,000 per quarter for serving on the Audit Committee; $1,250 per quarter for serving as the Audit Committee Chair; $1,000 per quarter for serving on the Compensation Committee; $1,000 per quarter for serving on the Government Relations Committee; and $4,000 per quarter for serving as Chair of the Government Relations Committee. We also reimburse such directors for reasonable expenses incurred by them in rendering their duties as our directors, subject to such reimbursement practices and procedures as we reasonably impose. Under these arrangements, the following non-employee Directors received the following amounts during 2003: Scott R. Silverman ($0), Kevin H. McLaughlin ($0), John R. Block ($0), Howard S. Weintraub, Ph.D. ($44,000) and Michael S. Zarriello ($11,250).

Information regarding options granted to the directors during 2003 under the Amended and Restated Digital Angel Corporation Transition Stock Option Plan ("2002 Option Plan") is set forth below.

	Number of Shares Subject to Options Granted	Exercise Price	Grant Date	Expiration	Vesting*
Scott R. Silverman	250,000	$ 1.91	9/5/2003	9/4/2013	9/4/2004
Kevin H. McLaughlin	250,000	$ 1.91	9/5/2003	9/4/2013	9/4/2004
Michael S. Zarriello	250,000	$ 1.99	9/15/2003	9/14/2013	9/14/2004
Kevin N. McGrath	250,000	$ 2.08	12/18/2003	12/17/2013	12/17/2004
Scott R. Silverman	250,000	$ 3.89	12/31/2003	12/30/2013	12/30/2004

* All options have vested or will vest on these dates if the Director was or is a Director of Digital Angel Corporation on such dates. Of the options granted to Mr. McGrath, options to purchase 100,000 shares were vested upon his being named our Chief Executive Officer on January 12, 2004.

Executive Officers

The following discussion sets forth information as of March 31, 2004 about Messrs. James P. Santelli, Kevin L. Nieuwsma and David M. Cairnie, who are executive officers but not Directors of Digital Angel Corporation.

Name	Positions with the Company	Age
James P. Santelli	Vice President-Finance, Chief Financial Officer, Treasurer and Secretary	56
Kevin L. Nieuwsma	Vice President	36
David M. Cairnie	Managing Director, Signature Industries, Ltd.	59

James P. Santelli has been our Vice President-Finance, Chief Financial Officer, Treasurer and Secretary since March 27, 2002. He is a manager (Chief Financial Officer) and one of two governors of Digital Angel Holdings, LLC. He was Vice President-Finance and Chief Financial Officer of the former Digital Angel Corporation since September 2000 (which is now named Digital Angel Technology Corporation and is our wholly-owned subsidiary). Mr. Santelli joined the former Digital Angel Corporation (then named Destron Fearing Corporation) in September 1999 as Vice President-Finance and Chief Financial Officer. From October 1998 until September 1999, he was Chief Operating Officer of Doorlite, Inc., a manufacturer of specialty door glass with approximately $40 million in annual revenues. From November 1995 until October 1998, Mr. Santelli was Chief Financial Officer and Vice President, Finance of Hartzell Manufacturing, Inc., a manufacturer of custom plastic injected and metal die cast parts with approximately $90 million in annual revenue. From December 1994 until November 1995, he was a Strategy Consultant for Continental Financial Management Corp., which was a start-up asset financing company. Mr. Santelli has a Bachelor's degree in Economics from Carleton College and an MBA in Finance from Cornell University.

Kevin L. Nieuwsma has been Vice President since November 11, 2002. He has primary responsibility for our radio frequency identification (RFID) business. Since joining Digital Angel Corporation in June 1993, he has held various sales and marketing positions, including Manager of Electronic ID Sales, Manager of North American Companion Animal Sales, and Director of Strategic Development. From 1990 to 1993, Mr. Nieuwsma was Regional Sales Representative for Iowa Veterinary Supply Co. Mr. Nieuwsma has a Bachelor of Sciences degree with majors in Business Administration and Economics from Morningside College.

David M. Cairnie has been the Managing Director of our United Kingdom subsidiary, Signature Industries, Ltd., since March 27, 2002. Mr. Cairnie has been the Managing Director of Signature Industries, Ltd. since the management-led buy-out in 1993. Before the management led buy-out, Signature Industries, Ltd. was known as FKI Communications, a division of FKI plc, where Mr. Cairnie had been the Managing Director since 1990. Before joining FKI Communications, Mr. Cairnie worked for International Telephone and Telegraph (ITT). Mr. Cairnie completed the ITT Senior Management Development program at the London Business School and operated in various management roles before joining FKI.

Executive Compensation

The following table sets forth the compensation earned from Digital Angel Corporation by Randolph K. Geissler, our President and Chief Executive Officer from March 27, 2002 until September 5, 2003; Kevin H. McLaughlin, our interim Chief Executive Officer from September 5, 2003 through November 3, 2003; and Van Chu, our Chief Executive Officer from November 3, 2003 until January 12, 2004. Mr. Kevin N. McGrath was appointed as our President and Chief Executive Officer on January 12, 2004 and accordingly is not listed in the summary compensation table. The table below also provides information for each of the years ended December 31, 2003, 2002 and 2001 about our other three most highly compensated executive officers whose salary and bonus exceeded $100,000 in 2003 and about Thomas M. Hall, M.D., M.I.M., who was our Chief Executive Officer until March 27, 2002. (The officers identified in the table are known as the "Named Executive Officers.")

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Shares of Stock Underlying Options (#)	All Other Compensation ($)
	Annual Compensation				Long-Term Compensation Awards	
Randolph K. Geissler(1)	2003	250,000	60,000	49,917(2)	1,000,000	-0-
President and Chief Executive	2002	244,940	37,500(3)	48,800(4)	1,000,000	-0-
Officer	2001	-0-	-0-	-0-	-0-	-0-
Kevin H. McLaughlin(1)						
Former Chief Executive						
Officer	2003	-0-	-0-	-0-	250,000	-0-
Van Chu(1)						
Former Chief Executive						
Officer	2003	33,654	-0-	1,615(5)	1,000,000	-0-
Thomas M. Hall, M.D.,	2003	260,000	-0-	10,615(6)	-0-	-0-
M.I.M.	2002	260,000	-0-	-0-	-0-	-0-
Former Chief Executive	2001	260,000	-0-	1,000	150,000	-0-
Officer and Chief Physician						
James P. Santelli(7)	2003	171,634	-0-	-0-	100,000	-0-
Vice President-Finance and	2002	175,000	-0-	-0-	250,000	-0-
Chief Financial Officer						
Kevin L. Nieuwsma(8)	2003	145,090	-0-	-0-	200,000	-0-
Vice President	2002	134,954	-0-	-0-	100,000	-0-
	2001	-0-	-0-	-0-	-0-	-0-
David M. Cairnie	2003	176,143	4,738	-0-	-0-	-0-
Managing Director, Signature	2002	158,159	4,428	7,523(9)	50,000	-0-
Industries, Ltd.	2001	138,967	4,267	-0-	-0-	-0-

(1) Mr. Geissler was our President and Chief Executive Officer from March 2002 until September 5, 2003. Mr. McLaughlin was our interim Chief Executive Officer from September 5, 2003 to November 3, 2003. Mr. Chu was our Chief Executive Officer from November 3, 2003 until January 12, 2004. Mr. McLaughlin's salary as Chief Executive Officer was determined and paid by Applied Digital Solutions, and the options were granted to him in his capacity only as our Director.

(2) Consists of Mr. Geissler's $5,000 per month flexible perquisite allowance.

(3) Accrued in 2002 and paid in 2003.

(4) Consists of (i) $45,385 of Mr. Geissler's $5,000 per month flexible perquisite allowance payable beginning March 27, 2002, of which $25,385 was paid and $20,000 is accrued but not paid, and (ii) a $3,415 vehicle allowance. See "Employment Agreements."

(5)

Consists of Mr. Chu's vehicle allowance.

(6)
Consists of Dr. Hall's vehicle allowance.

(7)
Mr. Santelli became Vice President-Finance and Chief Financial Officer on March 27, 2002.

(8) Mr. Nieuwsma became Vice President on November 11, 2002.

(9) Consists of Mr. Cairnie's vehicle allowance.

The following table sets forth information concerning grants of stock options in the year ended December 31, 2003 to the Named Executive Officers. All grants of options were made under our 2002 Option Plan.

Stock Option Grants in Last Fiscal Year

Name	Securities Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price ($/sh)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation For Option Term 5% ($)	10% ($)
Randolph K. Geissler	1,000,000	26.1%	$ 1.97	9/1/2012	$ 1,238,922	$ 3,139,673
Kevin H. McLaughlin	250,000	6.5%	$ 1.91	9/4/2013	300,297	761,012
Van Chu	1,000,000	26.1%	$ 2.40	11/2/2013	1,509,347	3,824,982
James P. Santelli	100,000	2.6%	$ 3.89	12/30/2013	244,640	619,966
Thomas M. Hall, M.D., M.I.M.						
Kevin L. Nieuwsma	200,000	5.2%	$ 3.89	12/30/2013	489,280	1,239,932
David M. Cairnie						

The following table sets forth information concerning stock options exercised in the year ended December 31, 2003 and held as of December 31, 2003 by the Named Executive Officers.

Aggregated Option Exercises In Last Fiscal Year and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise(#)	Value Realized($)	Number of Unexercised Options at Fiscal Year End(#) Exercisable	Unexercisable	Value of Unexercised In-the-Money Options at Fiscal Year End($)(1) Exercisable	Unexercisable
Randolph K. Geissler	1,587,500	2,485,634	1,350,000		2,319,500	
Kevin H. McLaughlin	-0-	-0-		250,000		707,500
Van Chu	-0-	-0-		1,000,000		2,700,000
James P. Santelli	-0-	-0-	390,375	100,000	893,572	85,000
Thomas M. Hall, M.D., M.I.M.	105,000	126,800	180,000		88,500	
Kevin L. Nieuwsma	75,000	256,225	98,958	266,667	304,962	260,000

			Number of Unexercised Options at Fiscal Year End(#)		Value of Unexercised In-the-Money Options at Fiscal Year End($)(1)	
David M. Cairnie	-0-	-0-	16,667	33,333	22,500	44,500

(1) Based on the difference between the December 31, 2003 closing price of $4.74 per share as reported on the AMEX and the exercise prices of the options.

401(k) Profit Sharing Plan and Trust

We maintain a 401(k) profit sharing plan for the benefit of eligible employees and their beneficiaries in which executive officers participate on the same basis as all other employees, subject to certain overall and specific anti-discrimination restrictions. An employee is eligible to participate in the 401(k) plan after completing 60 days of service. The plan is a defined contribution profit sharing plan designed to be funded with both Digital Angel Corporation and employee contributions. Employees may voluntarily contribute up to 15% of their annual pay into the plan, not to exceed an annual dollar limitation, which was $12,000 in 2003. Employees may make contributions by payroll deductions. We may make matching contributions each year for eligible employees, the amount of which is determined by us. Distributions from the 401(k) plan are available only after reaching the age of $59^1/_2$ years (for salary deferral accounts) or termination of employment.

No amounts were paid or distributed during 2003 by the 401(k) plan to the Named Executive Officers. We contributed no benefit amounts under the plan for the Named Executive Officers or any other employees during 2003, 2002 or 2001.

Stock Option Plans

2002 Option Plan

The following is a summary of the terms of the 2002 Option Plan and is qualified in its entirety by reference to the 2002 Option Plan.

Effective April 11, 2002, our Board of Directors adopted the 2002 Option Plan, subject to approval by our stockholders, and reserved 5,195,312 shares of common stock for issuance under the 2002 Option Plan. On October 22, 2002, our stockholders approved the 2002 Option Plan and approved amendments to the 2002 Option Plan increasing the number of shares reserved for issuance to 11,195,312 shares and allowing our Board to designate participants in the 2002 Option Plan. On May 6, 2004, the stockholders approved an amendment to the 2002 Option Plan increasing the number of shares reserved for issuance to 16,195,312 shares. As of May 31, 2004, 16,195,312 shares of common stock were reserved for issuance under the 2002 Option Plan, and awards consisting of options to purchase 7,630,466 shares of common stock were outstanding under the 2002 Option Plan. As of May 31, 2004, there were outstanding options to purchase 1,500,000 shares of common stock which were granted outside the 2002 Option Plan and our 1998 Stock Plan. The Board of Directors and the Board's Compensation Committee administer the 2002 Option Plan. Benefits under the 2002 Option Plan may be granted to only employees and directors of Digital Angel Corporation and its affiliates, consisting of approximately 232 individuals as of May 31, 2004. The participants are those persons who are selected by the Board or the Committee.

The 2002 Option Plan permits the Board or the Committee to grant benefits in the form of stock options, stock appreciation rights, restricted stock, cash awards, performance-based awards or any combination thereof. Any of such awards may, as determined by the Board or the Committee, be granted in a manner such that they qualify for the performance-based compensation exemption of Section 162(m) of the Internal Revenue Code.

Options granted under the 2002 Option Plan may be either "incentive stock options" which satisfy the requirements of Section 422 of the Internal Revenue Code or "non-qualified stock options" which are not intended to meet such requirements. Incentive stock options may be granted only to participants who are employees of Digital Angel Corporation or its affiliates as of the date of grant. The Board or the Committee determines the per share option exercise price subject to the requirements imposed by the Internal Revenue Code and the 2002 Option Plan. The 2002 Option Plan and the Internal Revenue Code provide that the exercise price for shares under any incentive stock option shall not be less than the fair market value of the shares at the time the option is granted. The

2002 Option Plan provides that the exercise price for shares under non-qualified stock options shall not be less than 85% of the fair market value of the shares at the time the option is granted. Options may be exercised at such time or times and subject to such terms and conditions as are determined by the Board or the Committee. However, incentive stock options may not be exercised more than 10 years after the date they are granted.

Unless permitted by the Board or the Committee, each benefit granted under the 2002 Option Plan is not transferable other than by will or the laws of descent and distribution and is exercisable during the participant's lifetime only by the participant. Unless otherwise determined by the Board or the Committee, in the event of a "change of control" (as that term is defined in the 2002 Option Plan), all options and other awards then outstanding under the 2002 Option Plan will become fully vested.

The Board of Directors has the sole right and power to amend the 2002 Option Plan at any time. However, it cannot amend the 2002 Option Plan without approval of our stockholders in a manner which would cause options which are intended to qualify as incentive stock options to fail to qualify as such, in a manner which would cause the 2002 Option Plan to fail to meet the requirements of Rule 16b-3 under the Securities Exchange Act of 1934, or in a manner which would violate applicable law. The plan has no specific term and will continue in full force and effect until terminated. The 2002 Option Plan may be terminated at any time by the Board.

1998 Stock Plan

Effective March 1, 1998, the Board of Directors of Medical Advisory Systems, Inc. adopted the Medical Advisory Systems, Inc. Amended and Restated Employee and Director Stock Option Plan (the "1998 Stock Plan"). The 1998 Stock Plan and the Board's amendments to the 1998 Stock Plan were not submitted to our stockholders for their approval. Only options that are not incentive stock options may be granted under the 1998 Stock Plan. The exercise price per share of common stock under each option granted under the 1998 Stock Plan must not be less than the fair market value of the common stock at the close of business on the date the option is granted. Under the 1998 Stock Plan, "fair market value" is the average of the highest and lowest price for a share of common stock as quoted on the AMEX on the last trading date immediately before the date of the grant. The exercise price of an option may be paid with cash or a certified check, or with the surrender of shares of common stock having a fair market value on the date of exercise equal to that portion of the purchase price for which payment in cash or by certified check is not made.

Upon termination of employment except by death or in connection with a "change of control," an employee has three months after cessation of employment to exercise his options under the 1998 Stock Plan to the extent that such employee is entitled to exercise them on the date of cessation of employment. Upon a "change of control," all vested options immediately vest and are exercisable. The merger of the former Digital Angel Corporation with our wholly-owned subsidiary on March 27, 2002 triggered the vesting of options to purchase 600,000 shares under the 1998 Stock Plan. Upon an option holder's death while employed by Digital Angel Corporation, or within three months after having retired with the consent of Digital Angel Corporation, the employee's executors or administrators or the legatees or heirs of his estate have the right to exercise the options that are vested and not exercised to the extent that the deceased employee was entitled to exercise the options on the date of his death. However, no options are exercisable more than 10 years from the date they are granted. The plan expires on March 1, 2008. Under the 1998 Stock Plan, options may be granted to officers, directors, employees, advisors and consultants who render services to Digital Angel Corporation. As of May 31, 2004, 1,650,000 shares of common stock were reserved for issuance under the 1998 Stock Plan, and options to purchase 963,820 shares were outstanding under the 1998 Stock Plan.

Employment Agreements

Employment Agreements with Former Executive Officers of Medical Advisory Systems, Inc.

Before March 27, 2002, the effective date of the merger, Medical Advisory Systems, Inc. entered into employment agreements with Ronald W. Pickett and Thomas M. Hall, M.D. On October 26, 2001, it signed amendments to the employment agreements with each of Mr. Pickett and Dr. Hall that reflected both certain prior oral amendments to the employment agreements and additional amendments. The amendments confirmed the extension of the term of each of Mr. Pickett's and Dr. Hall's employment agreement through October 31, 2006 and established that Mr. Pickett would receive an annual salary of at least $180,000 and Dr. Hall would receive an annual salary of at least $260,000 throughout the term of their employment agreements. The amendments also provide that if Mr. Pickett's or Dr. Hall's employment was terminated or they resigned at any time following a "change of control" of Medical Advisory Systems, Inc., each of Mr. Pickett and Dr. Hall would be entitled to a $250,000 payment, plus an amount equal to all salary and other benefits that would have been paid under the employment agreement for the remainder of the term of their agreements as though no termination or resignation occurred, plus an amount equal to the value of the fringe benefits, such as medical and dental insurance and use of an automobile, to which Mr. Pickett and Dr. Hall otherwise would have been entitled under their employment agreements for the remainder of the term, plus participation in any profit sharing, stock option or similar plans. These payments are due 30 days after termination of employment. The definition of change of control in the employment agreements also was amended to include any consolidation, merger or share exchange, regardless of whether Medical Advisory Systems, Inc. was the surviving corporation, in which any or affiliated person acquires in excess of 20.0% of the combined voting power of the then-outstanding securities of Medical Advisory Systems, Inc.

Under the amended employment agreements, the March 27, 2002 merger of Medical Advisory Systems, Inc.'s wholly-owned subsidiary with the former Digital Angel Corporation constituted a change of control. Therefore, each of Mr. Pickett and Dr. Hall is entitled to a $250,000 payment from us plus the salaries and other benefits for the remaining term of their employment agreements upon the termination of their employment with us. Mr. Pickett resigned his position on March 27, 2002, and we paid to him the $250,000 amount due under his agreement. Because Dr. Hall remains our employee, we accrued for Dr. Hall's $250,000 payment due to him under his agreement. During 2003, we paid a total of $198,089 of salary and fringe benefits to Mr. Pickett and a total of $283,136 of salary and fringe benefits to Dr. Hall due to them under their agreements.

Employment Agreements with Former President and Chief Executive Officer

We entered into a five-year employment agreement with Randolph K. Geissler, our former President and Chief Executive Officer, dated as of March 8, 2002. The term of the employment agreement was five years, ending on March 7, 2007. On September 5, 2003, Mr. Geissler's employment agreement was terminated in connection with his resignation as President and Chief Executive Officer. After September 5, 2003, Mr. Geissler's terms of employment provided for us to pay Mr. Geissler a base salary of $185,000 per year, subject to annual adjustments or discretionary bonuses as determined by us, and Mr. Geissler was entitled to participate in welfare plans on the same basis as other employees. If Mr. Geissler was terminated by us not for cause, as defined, Mr. Geissler would have been entitled to severance equal to one year of salary to be paid in equal payments over a period of six months. The terms of Mr. Geissler's employment also provided that the options he then held to acquire 937,500 shares of our common stock at an exercise price of $0.77867 per share and to purchase 1,000,000 shares at an exercise price of $3.39 per share would continue in accordance with their terms. We also granted to Mr. Geissler an option to purchase 1,000,000 shares at an exercise price of $1.97 per share (equal to the closing price of our stock on September 3, 2003), vesting 100% upon grant and having an expiration date of September 1, 2012. None of the options are affected by Mr. Geissler's termination of employment from Digital Angel Corporation. The terms of employment included a non-compete clause through one year following the termination of Mr. Geissler's employment.

Employment Agreements with Current Executive Officers

We do not have a formal written employment agreement with Kevin N. McGrath, our President and Chief Executive Officer. The terms of Mr. McGrath's employment provide for us to pay Mr. McGrath a base salary of $250,000 per year and a bonus as determined by the Compensation Committee of the Board of Directors. In addition, we have agreed to pay Mr. McGrath's life insurance premiums of approximately $4,800 per year and a $1,000 per month automobile allowance.

Effective as of April 1, 2002, we entered into an employment agreement with Mr. James P. Santelli, our Vice President, Finance and Chief Financial Officer. The agreement has a term of three years. The term is automatically renewed for successive one-year terms on each anniversary date of the agreement, which is added at the end of the then existing term, unless either party notifies the other at least 60 days before such an anniversary date. The agreement provides that we shall pay to Mr. Santelli a base salary of $175,000 per year and that he is entitled to participate in any of our benefit and deferred compensation plans or programs as are from time to time available to our officers. The agreement contains confidentiality, non-compete and assignment of invention clauses. The agreement also provides that if the Board of Directors terminates Mr. Santelli's employment with us because of his willful and material misconduct or because he has breached the agreement in any material respect, or if Mr. Santelli terminates his employment other than for "good reason" (as that term is defined in the agreement), he is entitled to salary and benefits accrued through the date of termination of employment. If Mr. Santelli dies or becomes disabled (as disabled is determined under the agreement), if we terminate his employment for reasons other than his misconduct or his breach of the agreement, or if he terminates his employment for good reason, we must pay him his accrued compensation and benefits for the remaining term of the agreement, including any extensions. The employment agreement provides that upon a change of control, Mr. Santelli may terminate his employment at any time within one year after the change of control upon 15 days' notice. Upon such termination, we must pay to Mr. Santelli a severance payment equal to the base amount as defined in Section 280G(b)(3) of the Internal Revenue Code minus $1.00. Upon a change of control, all outstanding stock options held by Mr. Santelli would become fully exercisable.

We have an employment agreement with Kevin L. Nieuwsma effective as of October 1, 2000. The initial term of the agreement is one year, and the term is automatically extended for successive one-year periods unless either party gives written notice to the other party no later than 60 days before the expiration of each term. The agreement provides that we will pay to Mr. Nieuwsma a base salary of $125,000 per year and that he is entitled to participate in any of our benefit and deferred compensation plans or programs that are available to its officers. The agreement contains confidentiality, non-compete and assignment of inventions clauses. The agreement also provides that if the Board of Directors terminates Mr. Nieuwsma's employment because of his willful and material misconduct or because he has breached the agreement in any material respect, or if Mr. Nieuwsma terminates his employment other than for "good reason" (as that term is defined in the agreement), he is entitled to salary and benefits accrued through the date of termination of employment. If Mr. Nieuwsma dies or becomes disabled (as disabled is determined under the agreement), if we terminate his employment for reasons other than his misconduct or his breach of the agreement, or if he terminates his employment for good reason, we must pay him his accrued compensation and benefits through the date of termination, pay him compensation for 24 months after such date and provide him benefits for a period of 12 months after such date.

We have an employment agreement with David M. Cairnie effective April 13, 1993. The initial term of the agreement is one year until terminated by either party giving six months' notice or payment in lieu of such notice expiring on or at any time one year after the effective date of the agreement. The agreement provides that we will pay Mr. Cairnie £75,000 per year, or a higher rate as to which the parties may from time to time agree. The agreement also provides for a bonus based on the achievement of profits, as defined in the agreement. In addition, under the agreement, we are to provide an automobile to Mr. Cairnie. The agreement includes a non-compete provision.

Certain Transactions

In 2003, we paid $123,475 to Richard J. Sullivan, our former Director and Chairman.

In 2003, we recognized $495,000 of revenue under a Distribution and Licensing Agreement with Verichip Corporation, a wholly-owned subsidiary of Applied Digital Solutions, Inc.

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table sets forth information as of March 31, 2004 regarding the beneficial ownership of shares of our common stock by (i) each person (including any "group") who is known by us to beneficially own more than 5% of our common stock, (ii) each Named Executive Officer, (iii) each of our Directors as of March 31, 2004, and (iv) all Directors and executive officers as a group.

Name of Beneficial Owner(1)	Number of Shares Beneficially Owned	Percent of Outstanding Shares(2)
Current Directors and Executive Officers:		
Kevin N. McGrath	100,000(3)	*
Scott R. Silverman	50,000(4)	*
John R. Block	0	0%
Howard S. Weintraub, Ph.D.	250,000(5)	*
Michael S. Zarriello.	0	0%
James P. Santelli	365,375(6)	1.1%
Kevin L. Nieuwsma	33,333(7)	*
David M. Cairnie	16,667(8)	*
All current executive officers and Directors as a group (8 persons)	815,375(9)	2.6%
Former Named Executive Officers:		
Randolph K. Geissler	1,000,000(10)	3.0%
Kevin H. McLaughlin	0	0%
Van Chu	0	0%
Certain Other Beneficial Owners:		
Applied Digital Solutions, Inc. 400 Royal Palm Way Suite 410 Palm Beach, FL 33480	23,306,506(11)	71.6%

* Less than 1%.

(1) Unless otherwise indicated, we believe that the beneficial owners of the common stock described above, based on information furnished by such owners, have sole investment and voting power with respect to such shares, subject to community property laws where applicable.

(2) Based on 32,537,702 shares outstanding as of March 31, 2004, which does not include 13,130,692 shares of common stock subject to stock options and warrants outstanding as of March 31, 2004. However, as indicated, each figure showing the percentage of outstanding shares owned beneficially has been calculated by treating as outstanding and owned the shares which could be purchased by each beneficial owner within 60 days of March 31, 2004 upon the exercise of stock options and warrants.

(3) Consists of 100,000 shares subject to options held by Mr. McGrath.

(4) Consists of 50,000 shares subject to options held by Mr. Silverman.

(5)

Consists of 250,000 shares subject to options held by Dr. Weintraub.

(6) Consists of 365,375 shares subject to options held by Mr. Santelli.

(7) Consists of 33,333 shares subject to options held by Mr. Nieuwsma.

(8) Consists of 16,667 shares subject to options held by Mr. Cairnie.

(9) Consists of 815,375 shares subject to options held by all current executive officers and Directors as a group.

(10) Consists of 1,000,000 shares subject to options held by Mr. Geissler.

(11) Includes 1,000,000 shares subject to warrants held by Applied Digital Solutions.

SELLING STOCKHOLDERS

The following table provides certain information regarding the selling stockholders' beneficial ownership of our common stock before and after the offering. Beneficial ownership is determined under the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities.

Selling Stockholder	Number of Shares Owned Prior to the Offering	Number of Shares Being Offered For Sale	Number of Shares Owned After Offering	Percentage Of Class
Richard J. Sullivan	937,500(1)	937,500(1)	0	0%
Garrett A. Sullivan	468,750(2)	468,750(2)	0	0%
Evan McKeown(3)	30,469	30,469	0	0%
IBM Credit Corporation	1,163,906(4)	1,163,906(4)	0	0%
Mpact Communications, Inc.	15,309	15,309	0	0%
K. Brett Thackston	60,000	60,000	0	0%
Redington, Inc.	50,000(5)	50,000(5)	0	0%

(1) Since January 21, 2003, Mr. Richard J. Sullivan has sold 657,800 of these shares.

(2) Since January 21, 2003, Mr. Garrett A. Sullivan has sold all of these shares.

(3) Mr. McKeown is Senior Vice President and Chief Financial Officer of Applied Digital Solutions, our affiliate.

(4) Represents warrants to purchase 1,163,906 shares of our common stock at $1.067 per share, which is exercisable for five years beginning April 5, 2002.

(5) Represents warrants to purchase 50,000 shares at $3.60 per share, which is exercisable for five years beginning June 27, 2002.

SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with our financial statements and related notes, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and other financial information appearing elsewhere in this prospectus. We derived the following historical financial information from the consolidated financial statements of Digital Angel Corporation for the years ended December 31, 2003 and 2002, which have been audited by Eisner LLP, and the combined financial statements of the Advanced Wireless Group for the years ended December 31, 2001, 2000 and 1999, which have been audited by PricewaterhouseCoopers LLP. PricewaterhouseCoopers LLP's report on the combined financial statements contained an explanatory paragraph expressing doubt about the Advanced Wireless Group's ability to continue as a going concern. In addition, PricewaterhouseCoopers LLP was dismissed as the Advanced Wireless Group's independent accountant on April 11, 2002. The equity accounts of the Advanced Wireless Group have been restated based on the common shares received by the former shareholders of the Advanced Wireless Group in the merger.

The unaudited financial data as of and for the three months ended March 31, 2004 and 2003 includes all adjustments, including normal recurring adjustments, which our management considers necessary for fair presentation of our results for these unaudited periods.

(Amounts in thousands, except per share data)	For the Three Months Ended March 31, 2004(1)	2003	For the Years Ended December 31, 2003	2002(2)	2001	2000(3)	1999
	(unaudited)						
Results of Operations Data:							
Product revenue	$ 10,676	$ 10,865	$ 33,748	$ 30,946	$ 33,220	$ 19,604	$ 14,380
Service revenue	450	533	2,964	3,297	2,691	2,888	
Total net revenue	11,126	11,398	36,712	34,243	35,911	22,492	14,380
Cost of products sold	6,195	5,639	20,095	18,293	20,252	11,517	7,964
Cost of services sold	348	395	1,172	2,216	2,047	1,434	
Gross profit	4,583	5,364	15,445	13,734	13,612	9,541	6,416
Selling, general and administrative expense(4)	4,824	4,280	16,764	37,538	22,798	10,792	7,513
Research and development expense	669	911	4,898	3,034	5,244	2,476	
Asset impairment charge(5)			2,986	63,818	726		
Interest income	(8)		(15)	(2)	(17)	(26)	
Interest expense Applied Digital Solutions, Inc.				1,806	1,591		
Interest expense others	293	138	921	303	528	115	41
Realized and unrealized losses on Applied Digital Solutions, Inc. common stock	2,586						
Other income	(43)	(42)	(353)	(599)			
(Loss) income before minority interest, equity in net loss of affiliate and income taxes	(3,738)	77	(9,756)	(92,164)	(17,258)	(3,816)	(1,138)
Provision for income taxes					41	58	
(Loss) income before minority interest and equity in net loss of affiliate	(3,738)	77	(9,756)	(92,164)	(17,299)	(3,874)	(1,138)
Minority interest share of (income) losses	(6)	33	298	96	217	4	170
Equity in net income of affiliate				(291)	(327)		
Net (loss) income	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (17,409)	$ (3,870)	$ (968)
Net loss per common share basic and diluted	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.93)	$ (0.21)	$ (0.05)
Weighted average common shares outstanding							
Basic	30,468	26,663	26,959	24,578	18,750	18,750	18,750

	For the Three Months Ended March 31,						
Diluted(6)	30,468	30,638	26,959	24,578	18,750	18,750	18,750

	March 31,		December 31,				
	2004	2003	2003	2002	2001	2000	1999
	(unaudited)						
Balance Sheet Data:							
Cash	$ 1,690	$	$ 894	$ 214	$ 596	$ 206	$ 139
Restricted cash	785		765				
Property and equipment, net	7,544	7,656	7,665	7,769	14,476	5,408	1,115
Goodwill and other intangibles, net	53,865	48,808	45,608	48,893	72,876	77,645	2,713
Total assets	82,382	71,525	67,307	67,798	107,379	95,344	9,239
Long-term debt and notes payable	2,543	3,303	2,818	3,314	2,425	2,463	
Total debt	9,701	7,112	8,736	4,130	85,227	2,503	
Minority interest	6	265		298	394	612	616
Total stockholders' equity	61,970	55,345	48,483	55,012	16,116	87,809	5,574
Other Financial Data:							
Depreciation and amortization	$ 573	$ 434	$ 1,725	$ 3,638	$ 12,331	$ 2,962	$ 565
Net cash provided by (used in) operating activities	(2,274)	(3,089)	(4,691)	(2,730)	(3,196)	(1,432)	14
Net cash provided by (used in) investing activities	1,280	(241)	(1,352)	(567)	(1,307)	1,066	(88)
Net cash provided by financing activities	1,848	3,155	6,595	2,593	4,893	433	212
Capital expenditures	100	250	1,165	1,439	1,310	758	106

(1) Includes the results of operations of OuterLink Corporation from January 22, 2004.

(2) Includes the results of operations of Medical Advisory Systems from March 27, 2002.

(3) Includes the results of operations of (i) Timely Technology from April 1, 2000 and (ii) Destron Fearing Corporation from September 8, 2000.

(4) Selling, general and administrative expense includes management fees paid to Applied Digital Solutions of $193, $771, $262 and $241 for the years ended December 31, 2002, 2001, 2000 and 1999. No management fees were paid to Applied Digital Solutions in 2003 or in the three months ended March 31, 2004.

(5) Asset impairment expense for 2003 consists of a goodwill impairment charge of $2,375 and an intangible asset impairment charge of $611. Asset impairment expense for 2002 consists of a goodwill impairment charge of $57,406 and an asset impairment charge of $6,412 related to the write off of an exclusive perpetual license to a digital encryption and distribution software system. Asset impairment expense for 2001 relates to a goodwill impairment.

(6) Potentially dilutive securities are excluded from the number of weighted average shares outstanding in the three months ended March 31, 2004 and in the years ended December 31, 2003 and 2002. Including the dilutive securities would have had an anti-dilutive effect on our net loss per common share. Weighted average shares outstanding for the years ended December 31, 2001, 2000 and 1999 have been restated to reflect the number of common shares received by the former shareholders of the Advanced Wireless Group in the March 27, 2002 merger.

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized but instead tested for impairment at least annually.

The following table presents the impact of SFAS No. 142 on our summary financial data as indicated:

	For the Three Months Ended March 31,		For the Years Ended December 31,				
(In thousands, except per share data)	**2004**	**2003**	**2003**	**2002**	**2001**	**2000**	**1999**
Net income (loss):							
Net income (loss) as reported	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (17,409)	$ (3,870)	$ (968)
Goodwill amortization					8,629	2,529	256

	For the Three Months Ended March 31,						
Equity method investment amortization					1,161		
Adjusted net income (loss)	$ (3,744)	$ 110	$ (9,458)	$ (92,359)	$ (7,619)	$ (1,341)	$ (712)
Basic and diluted loss per share:							
Net income (loss) per share, basic and diluted, as reported	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.93)	$ (0.21)	$ (0.05)
Goodwill amortization					0.46	0.13	0.01
Equity method investment amortization					0.06		
Adjusted income (loss) per share, basic and diluted	$ (0.12)	$	$ (0.35)	$ (3.76)	$ (0.41)	$ (0.08)	$ (0.04)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and related notes thereto.

We consist of Digital Angel Corporation and its four subsidiaries Digital Angel Technology Corporation ("DATC"), Timely Technology Corp. ("TTC"), Signature Industries, Limited ("Signature") and OuterLink Corporation. DATC, TTC and Signature were known as the Advanced Wireless Group of Applied Digital Solutions, Inc. DATC is engaged in the business of developing and bringing to market proprietary technologies used to identify, locate and monitor people, animals and objects. DATC is the result of the merger in September 2000 of Destron Fearing Corporation and Digital Angel.net Inc., which was then a wholly-owned subsidiary of Applied Digital Solutions, Inc. Upon the acquisition of Medical Advisory Systems, Inc. in March 2002, Digital Angel Corporation re-organized into four segments: Animal Applications, Wireless and Monitoring, GPS and Radio Communications and Medical Systems. With our acquisition of OuterLink Corporation in January 2004, we reorganized into three segments: Animal Applications, GPS and Radio Communications and Medical Systems. The former GPS and Radio Communications Segment, the Wireless and Monitoring Segment and the OuterLink Corporation business, which are similar businesses, were combined to form the new GPS and Radio Communications segment, and it is now managed as a single business unit. Prior period segment information has been restated to reflect our current segment structure.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate these estimates, including those related to inventory obsolescence, goodwill, intangibles and other long-lived assets and income taxes. We base these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of the financial statements.

Goodwill, Intangibles and Other Long-Lived Assets

On January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized but instead tested for impairment at least annually by applying a fair value based test. There was no impairment of goodwill upon the adoption of SFAS 142 on January 1, 2002. However, based upon an annual review for impairment, we recorded impairment charges of $2.4 million and $57.4 million in the fourth quarters of 2003 and 2002, respectively. The impairment charge in 2003 related to the goodwill associated with the Medical Systems reporting unit. The impairment charge in 2002 related to the goodwill at the GPS and Radio Communications and Medical Systems reporting units. Further, we recorded an additional impairment charge in 2003 of $0.6 million relating to our Medical Systems reporting unit to write down certain intangible assets to their estimated fair value.

In accordance with SFAS 142, upon adoption, we were required to allocate goodwill to the various reporting units. The Company's reporting units consist of the following (the reporting units listed below are those businesses which have goodwill and for which discrete financial information is available and upon which segment management makes operating decisions):

- Animal Applications
- GPS and Radio Communications
- Medical Systems

Our reporting units at December 31, 2003 were the same as our reporting units at December 31, 2002.

We engaged an independent valuation firm to review and evaluate the goodwill as reflected on our books as of December 31, 2003 and 2002. Independently, the valuation firm reviewed the goodwill of the various reporting units (Animal Applications, GPS and Radio Communications and Medical Systems). Our management compiled the cash flow forecasts, growth rates, gross margin, fixed and variable cost structure, depreciation and amortization expenses, corporate overhead, tax rates, and capital expenditures, among other data and assumptions related to the financial projections upon which the valuation reports were based. The valuation firm's methodology including residual or terminal enterprise values were based on the following factors: risk free rate of 10 years; current leverage (E/V); leveraged beta Bloomberg; unleveraged beta; risk premium; cost of equity; after-tax cost of debt; and weighted average cost of capital. These variables generated a discount rate calculation.

The assumptions used in the determination of fair value using discounted cash flows were as follows:

- Cash flows were generated for five years based on the expected recovery period for the goodwill;
- Earnings before interest, taxes, depreciation and amortization were used as the measure of cash flow; and
- Discount rates ranging from 15% to 20%. The rate was determined based on the risk free rate of the 10-year U.S. Treasury Bond plus a market risk premium of 7.5%. (The discount rate we used was the rate of return expected from the market or the rate of return for a similar investment with similar risks).

The independent valuation firm performed a company comparable analysis utilizing financial and market information on publicly traded companies that are considered to be generally comparable to the Animal Applications, GPS and Radio Communications and Medical Systems reporting units. Each analysis provided a benchmark for determining the terminal values for each business unit to be utilized in its discounted cash flow analysis. The analysis generated a multiple for each reporting unit, which was incorporated into the appropriate business unit's discounted cash flow model.

The analyses for 2003 indicated that the remaining goodwill associated with the Medical Systems reporting unit of approximately $2.4 million was impaired. The analyses for 2002 indicated that approximately $25.9 million of the goodwill associated with the Medical Systems segment and $31.5 million of the goodwill associated with its GPS and Radio Communications segment was impaired.

Future goodwill impairment reviews may result in additional write-downs. Such determination involves the use of estimates and assumptions, which may be difficult to accurately measure or value.

We will assess the fair value of our goodwill annually or earlier if events occur or circumstances change that would more likely than not reduce the fair value of our goodwill below its carrying value. These events or circumstances would include a significant change in business climate, including a significant, sustained decline in an entity's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business, or other factors. If we determine that significant impairment has occurred, we would be required to write off the impaired portion of goodwill. Impairment charges could have a material adverse effect on our financial condition and results of operations.

Additionally, in 2003, management estimated that certain intangible assets at our Medical Systems reporting unit were impaired by $0.6 million. The GPS and Radio Communications segment recorded a $0.7 million impairment charge in 2001.

Property, plant and equipment and definite-lived intangible assets are depreciated or amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Long-lived assets are evaluated for impairment whenever events and circumstances indicate an asset may be impaired. During the fourth quarter of 2002, we determined that an exclusive perpetual license to a digital encryption and distribution software system that was purchased by Applied Digital Solutions in April 2001 and contributed to the Advanced Wireless Group in 2001 was impaired. Accordingly, we wrote off the net book value of the asset, which resulted in an impairment charge of $6.4 million in 2002. There were no write downs of any long-lived assets in 2003 or 2001.

Inventories

Estimates are used in determining the likelihood that inventory on hand can be sold. Historical inventory usage and current revenue trends are considered in estimating both obsolescence and slow-moving inventory. Inventory is stated at the lower of cost or market, determined by the first-in, first-out method, net of any reserve for obsolete or slow-moving inventory.

Deferred Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and tax planning strategies in assessing the need for the valuation allowance, in the event we were to subsequently determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Similarly, should we determine that we would not be able to realize all or part of our deferred tax assets in the future, an adjustment to the deferred tax asset would reduce income in the period such determination was made.

Revenue Recognition

Except for our subsidiary, OuterLink Corporation, we recognize product revenue at the time product is shipped and title has transferred, provided that a purchase order has been received or a contract has been executed, there are no uncertainties regarding customer acceptance, the sales price is fixed and determinable and collectibility is deemed probable. If uncertainties regarding customer acceptance exists, revenue is recognized when such uncertainties are resolved. There are no significant post-contract support obligations at the time of revenue recognition. Our accounting policy regarding vendor and post contract support obligations is based on the terms of the customers' contracts, billable upon occurrence of the post-sale support. Costs of products sold and services provided are recorded as the related revenue is recognized. We offer a warranty on our products. For non-fixed fee jobs, revenue is recognized based on the actual direct labor hours in the job multiplied by the standard billing rate and adjusted to net realizable value, if necessary. Revenues from contracts that provide services are recognized ratably over the term of the contract. Fixed fee revenues from contracts for services are recorded when earned and exclude reimbursable costs. Reimbursable costs incurred in performing such services are presented on a net basis and include transportation medical and communication costs.