

VIISAGE TECHNOLOGY INC
Form 10-Q/A
July 28, 2006

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

FORM 10-Q/A

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2006.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from _____ to _____.

Commission File Number 000-21559

VIISAGE TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

(978) 932-2200

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

01821
(Zip Code)

Registrant's telephone number, including area code

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

Indicate by a check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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

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

| | Class | Outstanding at May 16, 2006 |
|--------------------------------|-------|-----------------------------|
| Common stock, \$.001 par value | | 29,074,156 |

EXPLANATORY NOTE

In accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, we are filing this Amendment No. 1 on Form 10-Q/A in response to comments received from the staff of the Securities and Exchange Commission in connection with their review of our joint proxy statement/prospectus contained in our Registration Statement on Form S-4.

In this filing we have specifically amended and restated Item 2 of Part I in response to the Staff's comments.

This report speaks as of the original filing date of our Form 10-Q (May 17, 2006) and has not been updated to reflect events occurring subsequent to that date. All information contained in this and our previous filings is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission.

VIISAGE TECHNOLOGY, INC.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the financial statements and accompanying notes contained in our 2005 Annual Report on Form 10-K and in this Quarterly Report on Form 10-Q.

COMPANY BACKGROUND

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

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

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

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

We generate revenue through the sale and licensing of products and services for verifying and managing identities. Our revenues increased to approximately \$23.4 million for the three months ended March 31, 2006 from \$16.8 million for the three months ended April 3, 2005. Our net loss for the three months ended March 31, 2006 increased to \$2.2 million from \$1.6 million for the three months ended April 3, 2005. The net loss for the three month period ended March 31, 2006 included \$626,000 of stock-based compensation expense related to the adoption of SFAS 123R effective January 1, 2006.

Our solutions ensure the production of secure credentials, enable automated background checks and help prevent and detect identity theft and fraud. Annually, our solutions produce more than 30 million secure government-issued credentials at more than 2,000 locations. We are the second largest provider of U.S. drivers' licenses with a 30% market share, and we are the sole source provider of passport production capability to the U.S. Department of State. We also are a recognized leader in biometrics in the fields of face recognition, iris identification and fingerprinting products, services and solutions. In addition, we are the leader in document authentication technology with approximately 3,000 installations in 17 countries. Our customers include governments, law enforcement agencies and businesses around the world.

The market for identity solutions has continued to develop at a rapid pace over the past 24 months. In particular, consumers of identity solutions are demanding end-to-end solutions with increased functionality that can solve their spectrum of needs across the identity life cycle. Our objective is to meet those growing needs by continuing to broaden our product and solution offerings to meet our customer needs, leveraging our existing customer base to provide additional products and services, expanding our customer base both domestically and abroad, and augmenting our competitive position through strategic acquisitions and alliances. We evaluate our business through financial metrics such as efforts to increase revenues and improve gross margin, as well as operational metrics such as new products introduced to market, new customers added and new technologies acquired. As an expanding company, we believe that our greatest challenge is choosing the right markets and best opportunities to pursue that will enable us to successfully grow our business.

Sources of Revenues

In our advanced technology identification solutions segment, we generate product revenues principally from sales of biometrics solutions which typically consist of our proprietary software together with commercial off-the-shelf cameras and workstations; document authentication solutions which typically consist of our proprietary document authentication system bundled with our proprietary software; and our secure printing solutions which typically consist of specialized printers and related consumables. In that segment, we generate services revenues from the design, customization and installation of secure credential issuance systems and customized biometrics solutions. We generate maintenance revenues from maintenance contracts that are typically included with the sale of our solutions and on the renewals of those contracts. In our fingerprint products and services segment, we generate revenue through the sale of background screening products and services. In our SecuriMetrics segment, we generate revenue through the development, customization and sale of biometrics solutions which typically consist of proprietary biometrics capture devices bundled together with our proprietary software. We measure the performance of our segments primarily based on revenues and operating income.

We market our solutions primarily to U.S. and foreign federal, state and local government agencies and law enforcement agencies. We also are working to expand the use of our solutions in commercial markets, particularly financial services and transportation. In a typical contract with a government entity for an identity solution, we agree to design the system, supply and install equipment and software and integrate the solution within the entity's existing network infrastructure. These contracts may be structured as fixed price contracts with payments made upon completion of agreed milestones or deliveries and with each milestone or delivery typically having a value specified in the contract. Alternatively, these contracts may be paid at a fixed price per credential issued as is typical in the drivers' license market, or per fingerprint delivered in the case of our fingerprinting products and services segment. Our customers usually impose specific performance and acceptance criteria that must be satisfied prior to acceptance of the system and corresponding payment.

Our growth in revenues since the fourth quarter of 2003 is due principally to increased demand for our solutions corresponding to heightened emphasis on secure credential issuance, document authentication and biometrics, as well as growth due to acquisitions. We anticipate that the U.S. Department of State will continue to be one of our major customers for the foreseeable future due to the continuing increase in the number of passports issued each year. We also anticipate steadily increasing funding for major government programs such as US VISIT, TWIC, HSPD-12, REAL ID and e-passport. Any delay or other changes in the rollout of these programs could cause our revenues to fall short of our expectations. We intend to continue our acquisition strategy to complement and expand our existing products, services and solutions.

We also expect to experience increased demand from a number of other governments as they deploy identity solutions, particularly document authentication, at points of entry and exit, including borders, seaports and airports, and in connection with national identification programs. Notwithstanding our expectations regarding demand for these solutions, the quantity and timing of orders from both U.S. and foreign government entities depends on a number of factors outside of our control, such as the level and timing of budget appropriations. Government contracts for identity solutions at points of entry and exit and in connection with national identification programs are typically awarded in open competitive bidding processes. Therefore, our future level of sales of our solutions for these deployments may vary substantially, and will depend on our ability to successfully compete for this business.

STRATEGIC INITIATIVES

The market for identity solutions has continued to develop at a rapid pace over the past 24 months. In particular, consumers of identity solutions are demanding end-to-end solutions with increased functionality that can solve their spectrum of needs across the identity life cycle. Building on the three acquisitions we completed in 2004, we have continued to address our customers' requirements through multiple initiatives, including:

the proposed merger with Identix Incorporated, which is expected to close mid-year 2006, whose multi-biometric technology provides a broad range of fingerprint and facial recognition technology offerings to identify individuals who wish to gain access to information or facilities, conduct transactions and obtain identifications, which we believe will expand and better serve the addressable market and result in greater long-term growth opportunities than either company will achieve operating alone;

the February 2006 acquisition of SecuriMetrics, Inc., a provider of the world's only full-function handheld iris recognition and multi-modal biometric devices, enabling us to now offer multiple and multi-modal biometric capabilities that include finger, face and iris, to better position both companies to vie for an even greater share of the biometrics market;

the December 2005 \$100 million investment in us by Aston Capital Partners, L.P., and the appointment of Robert LaPenta, founder and Chief Executive Officer of L-1 Investment Partners, LLC, as Chairman of our Board of Directors;

the December 2005 acquisition of Integrated Biometric Technology, Inc., a provider of proprietary fingerprint technology and background screening solutions, an important multi-modal recognition capability, which added to our identity software and services portfolio allowing us to offer end-to-end protection and security of personal identities; and

the December 2005 acquisition of the AutoTest Division of Openshaw Media Group, a provider of automated web-based applicant testing technologies for state departments of motor vehicles and other credential issuing agencies, further expanding our vision to provide end-to-end protection and security of personal identities by further strengthening the ability to proof identities before issuing credentials.

IMPACT OF PROPOSED MERGER WITH IDENTIX

Pending Merger with Identix

On January 11, 2006, we, through wholly-owned subsidiary, VIDS Acquisition Corp. (referred to as Merger Sub), entered into an Agreement and Plan of Reorganization (referred to as the Identix Merger Agreement) with Identix Incorporated, a Delaware corporation. Under the Identix Merger Agreement, Merger Sub will merge with and into Identix, and Identix will survive as our wholly-owned subsidiary. The merger is intended to be a tax-free reorganization for federal income tax purposes, and Identix stockholders will receive 0.473 of a share of our common stock for each share of Identix common stock they own (referred to as the Exchange Ratio). Based upon our closing price of \$17.69 on Wednesday, January 11, 2006, this represented a price of \$8.367 per Identix share. To the extent permitted by Identix' stock option plans, we will assume Identix' stock option plans and outstanding stock options and will assume all outstanding warrants to purchase Identix common stock. The assumed stock option plans will be converted into our stock option plans and assumed outstanding options and warrants will be converted into the right to receive Viisage common stock based on the Exchange Ratio. We, as well as Identix, have made customary reciprocal representations, warranties and covenants in the Merger Agreement, including, among others, covenants (i) not to (A) solicit proposals relating to alternative business combination transactions or (B) subject to certain exceptions, enter into discussions concerning or to provide confidential information in connection with alternative business combination transactions, (ii) to cause stockholder meetings to be held to consider approval of the merger (in the case of Identix) and approval of the stock issuance in connection with the merger, along with certain charter amendments (in the case of Viisage), and (iii) subject to certain exceptions, for the board of directors of Identix, to recommend adoption by its

stockholders of the Merger Agreement and for our board of directors to recommend approval of the stock issuance and charter amendments. Consummation of the merger is subject to reciprocal closing conditions, including stockholder approvals, antitrust approvals, absence of governmental restraints, effectiveness of a Form S-4 registration statement, accuracy of representations, and receipt of tax opinions. The Identix Merger Agreement contains certain termination rights for both us and Identix, and further provides that, upon termination of the agreement under specified circumstances, the terminating party must pay a termination fee of \$20 million.

In accordance with the provisions of Statement of Financial Accounting Standards No. 141, we intend to account for the merger as a purchase transaction for financial reporting purposes under accounting principles generally accepted in the United States. After the merger, the results of operations of Identix will be included in our consolidated financial statements. The cost of the acquisition, which is equal to the aggregate merger consideration, including the fair value of vested stock options of Identix assumed by us and transaction costs, will be allocated based on the fair values of the Identix assets acquired and the Identix liabilities assumed. These allocations will be based upon valuations and other studies that have not yet been finalized.

The proposed merger with Identix along with the acquisitions of IBT and SecuriMetrics are expected to have a material effect on the Company's operations including but not limited to:

Expected synergies resulting from providing a comprehensive product line to current and future customers.

Expected future growth in revenues and profits from expanded markets for identity solutions.

Enhancing of technical capabilities resulting from combining the intellectual capital of the combined entity

Consolidation of marketing resources and facilities.

Consolidation of corporate functions of the separate entities in Stamford, Connecticut.

Rationalizing technology costs and research and development activities

Realigning business units to complement each unit's unique capabilities.

It is likely that in connection with the merger, costs will be incurred to realize the benefits of the merger including facilities restructuring, organizational restructurings and asset impairments. These costs and their timing have not yet been determined and are likely to be material.

SEGMENTS AND GEOGRAPHIC INFORMATION

SFAS No. 131 *Disclosures about Segments of a Business Enterprise and Related Information* establishes standards for reporting information about operating segments. Operating segments are defined as components of a company about which the chief operating decision maker evaluates regularly in deciding how to allocate resources and to assess performance. Effective with the acquisition of IBT in December 2005, the Company's business began operating in two business segments, the advanced technology identity solutions segment and the fingerprint products and services segment. Effective with the acquisition of SecuriMetrics, the Company began operating in a third segment. The Company categorizes product and service revenues into three main categories identified by the markets which it serves: *State and Local*, *Federal*, and *Commercial/Emerging Markets*. The Company's advanced technology identity solutions segment enables governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy utilizing secure credential provisioning and authentication systems, biometric technology and the creation, enhancement and/or utilization of identity databases. The Company's fingerprint products and services segment provides solutions to government, civil, and commercial customers that require criminal background checks and screening, and its SecuriMetrics segment provides full-function handheld iris recognition and multi-modal biometric devices, software applications and services.

During the three months ended April 3, 2005, the Company operated in a single segment, the advanced technology identity solutions segment, and thus all revenues and the operating loss was generated from that segment. The Company measures segments based on revenues, operating income/(loss) and total assets. Operating results by segment for the three months ended March 31, 2006 are as follows (in thousands):

| | Revenue | Operating Income (Loss) | Total Assets |
|---|-----------|----------------------------|-----------------|
| Segment: | | | |
| Advanced technology identity solutions(*) | \$ 17,051 | \$ (1,705) | \$ 201,597 |
| Fingerprint products and services | 5,588 | (34) | 68,645 |
| SecuriMetrics | 799 | (536) | 31,421 |
| Totals | \$ 23,438 | \$ (2,275) | \$ 301,663 |

Goodwill for the advanced technology identity solutions segment was \$94,475 and for the fingerprint products and services segment was \$58,710, and the SecuriMetrics segment was \$22,265 as of March 31, 2006.

(*) includes corporate general and administrative expenses.

Revenues by market for the three months ended March 31, 2006 and April 3, 2005 were as follows (in thousands):

| | Three Months Ended March 31, 2006 | April 3, 2005 |
|-----------------------------|---|------------------|
| State and Local | \$ 17,561 | \$ 8,983 |
| Federal | 5,670 | 7,627 |
| Commercial/Emerging Markets | 207 | 200 |
| | \$ 23,438 | \$ 16,810 |

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

| | Three Months Ended | |
|---------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| United States | \$ 21,259 | \$ 15,801 |
| Rest of World | 2,179 | 1,009 |
| | \$ 23,438 | \$ 16,810 |

Of the total revenue for the three month periods ended March 31, 2006 and April 3, 2005, approximately \$1.8 million and \$1 million were earned from export sales, respectively. The Company did not have significant international sales to individual countries for the periods presented.

DEPENDENCE ON SIGNIFICANT CUSTOMERS

For the near future, we believe that we will continue to derive a significant portion of our revenues from a limited number of large contracts. For the three-month period ended March 31, 2006, two customers, U.S. Transportation Security Administration and the Department of State accounted for 19% and 18% of our revenues, respectively. For the three-month periods ended April 3, 2005, one customer, U.S. Department of State, accounted for 29% of our revenues. As of March 31, 2006 and December 31, 2005, the U.S. Department of State was the only customer that had a balance of greater than 10% of total accounts receivable, which was approximately \$2.9 million and \$3.3 million, respectively.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

We prepare our financial statements in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. Consistent with U.S. GAAP, we have adopted accounting policies that we believe are most appropriate given the facts and circumstances of our business. The application of these policies has a significant impact on our reported results. In addition, some of these policies require management to make assumptions and estimates. These assumptions and estimates, which are based on historical experience and analysis of current conditions, have a significant impact on our reported results and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. The most significant assumptions and estimates relate to the allocation of the purchase price of the acquired businesses, valuation of goodwill and other intangible assets, revenue recognition, income taxes, litigation and valuation of other financial instruments, including warrants and stock options. If actual results differ significantly from these estimates, there could be a material effect on our financial statements.

Valuation of Goodwill and Other Long-Lived and Intangible Assets

Our long-lived assets include property, plant and equipment, other intangible assets and goodwill. As of March 31, 2006, the balances of property, plant and equipment, intangible assets and goodwill, all net of accumulated depreciation and amortization, were \$19.5 million, \$31.6 million and \$175.5 million, respectively. As of December 31, 2005, the balances of property, plant and equipment, intangible assets and goodwill, all net of accumulated depreciation and amortization, were \$19.5 million, \$27.3 million and \$152.2 million, respectively.

We depreciate property, plant and equipment and intangible assets that have finite lives, and amortize those assets over their estimated useful lives. For purposes of determining whether there are any impairment losses, as further discussed below, our management has evaluated the carrying amounts of our identifiable long-lived

tangible and intangible assets, including their estimated useful lives when indicators of impairment are present. For all long-lived tangible and intangible assets, if an impairment loss were identified based on the fair value of the asset, as compared to the carrying amounts of the asset, such loss would be charged to expense in the period we identify the impairment. Furthermore, based on our review of the carrying amounts of the long-lived tangible and intangible assets with finite lives, we may determine that shorter estimated useful lives are more appropriate. In that event, we would record depreciation and amortization over fewer future periods, which would reduce our earnings.

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

significant underperformance relative to expected operating results;

significant changes in the manner of use of acquired assets or the strategy for our overall business;

underutilization of our tangible assets;

discontinuance of product lines by ourselves or our customers;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

significant decline in our market capitalization relative to net book value.

Although we believe that the carrying values of our long-lived tangible and intangible assets were realizable as of March 31, 2006, future events could cause us to conclude otherwise.

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

Due to our acquisitions dating back to 2004, goodwill and other intangible assets were recorded as a result of the purchase price allocation of the acquired businesses. The amounts recorded for goodwill and other intangible assets represent estimates of fair values which are based on current valuation methodologies. With respect to the

2006 acquisition, the valuation is preliminary and subject to adjustment based on additional analyses of values as additional information is obtained. Management believes that any differences between the preliminary and final allocations will not be material.

Valuations of acquired businesses require us to provide significant estimates and assumptions, which are derived from information obtained from the management of the acquired businesses, and our business plans for the acquired businesses or intellectual property and other sources. Critical estimates and assumptions used in the initial valuation of goodwill and other intangible assets include, but are not limited to:

future expected cash flows from product sales, customer contracts and acquired developed technologies and patents;

expected costs to complete any in-process research and development projects and commercialize viable products and estimated cash flows from sales of such products;

the acquired companies' brand awareness and market position;

assumptions about the period of time over which we will continue to use the acquired brand and intangible assets; and

discount rates.

These estimates and assumptions may not materialize because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be different from actual results, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairment which will require us to record an impairment charge in the period in which it is identified. The estimated fair value of the reporting unit used to evaluate the carrying amount of goodwill pursuant to SFAS 141 decreased by \$53 million, or 16%, from 2004 to 2005 as a result of changes in lower projected revenues and profitability during the projected period.

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

As of March 31, 2006, we have recorded goodwill of \$175.5 million. We perform impairment reviews on the carrying values of goodwill arising from the aforementioned acquisitions at least annually. Future cash flows and operating results used in the impairment review are based on management's projections and assumptions. Actual results could differ from such projections used to originally value the acquisitions, which could result in significant impairment charges in the future.

Revenue Recognition

Historically, revenue consisted primarily of sales from the delivery of personal identification solutions to federal and state government customers, some of which are fulfilled through the delivery of hardware and software licenses, as well as providing software maintenance, technical support, training, installation and consulting services. Revenue is recognized in accordance with Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, and Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*, and related interpretations. When a customer arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met:

Persuasive evidence of an arrangement exists We require evidence of an agreement with a customer specifying the terms and conditions of the products or services to be delivered typically in the form of a signed contract or purchase order.

Delivery has occurred For Product Sales, delivery generally takes place when title to the products, which in certain instances includes hardware and software licenses, are shipped to or accepted by the customer. For services, delivery takes place as the services are provided.

The fee is fixed or determinable Fees are fixed or determinable if they are not subject to a refund or cancellation and do not have payment terms that exceed our standard payment terms. Typical payment terms are net 30 days.

Collection is probable We perform a credit review of all customers with significant transactions to determine whether a customer is creditworthy and collection is probable.

Transactions which typically do not involve significant production, modification or customization of software, or do not include services considered to be essential to the functionality of the software, include:

Document issuance solutions, primarily to federal and state government customers;

Printing system components and consumables including printers, secure coating, ribbon, film, and other parts, primarily to federal government customers;

Licenses of off-the-shelf versions of face recognition software;

Services and software to scan, collect, and transmit fingerprints for identity and background verification; and

Document authentication products and services, which typically include sales of hardware, software, maintenance and support. Revenue on these transactions is generally recognized upon passage of title for product sales, and delivery of services, provided the four revenue criteria listed above are met at that time. In certain cases, customer acceptance is required, in which case revenue is deferred until customer acceptance is obtained. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. Consulting, training and other similar services are typically recognized as the services are performed. Software maintenance, hardware replacement, and technical support for such products, are typically recognized ratably over the contract term, which approximates the timing of the services rendered. Revenue for time and material arrangements is recognized as the services are rendered. Expenses on all services are recognized when the costs are incurred. Revenue from the collection of fingerprints for identity and background verification is recognized when the fingerprint is transmitted to applicable background vetting agency, and is recognized on a gross basis where we are the prime contractor, and on a net basis where we are the subcontractor.

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Many of our arrangements include multiple elements for which we apply the provisions of EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. Such elements typically include one or more

of the following: hardware, software licenses, rights to additional software products, software maintenance, hardware replacement, technical support services, training, installation and consulting services. For multiple-element arrangements including software, which do not involve significant modification or customization of the software or services that are considered essential to the functionality of the software, we allocate value to each element based on its relative fair value, if sufficient vendor-specific objective evidence (VSOE) of fair value exists for each element of the arrangement. VSOE of fair value is determined based on the price charged when each element is sold separately. If sufficient VSOE exists for all undelivered elements, but does not exist for the delivered element, then the residual method is used to allocate value to each element. Under the residual method, each undelivered element is allocated value based on VSOE of fair value for that element, as described above, and the remainder of the total arrangement fee is allocated to the delivered element. If sufficient VSOE does not exist for all undelivered elements, revenue is deferred until such evidence does exist for any undelivered elements, generally maintenance and support, at which time revenue is recognized for all delivered elements. Revenue for maintenance and support is recognized ratably over the remaining term of any maintenance and support period.

In the case of multiple-element arrangements that involve significant production, modification or customization of the software, or involve services that are considered to be essential to the functionality of the software, contract accounting under SOP 97-2 and SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, is applied. When VSOE of fair value exists for software maintenance or technical support in arrangements requiring contract accounting, the consulting and license fees are combined and revenue is recognized on the percentage of completion basis, and the software maintenance or technical support are typically recognized ratably over the contract term.

In general, transactions which involve significant production, modification or customization of software, or services considered to be essential to the functionality of the software, include:

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

Identity solutions contracts, typically providing for the development, customization and installation of face recognition systems for government agencies, law enforcement agencies and businesses. These contracts are generally fixed price, and include milestones and acceptance criteria for the various deliverables under the contract. These contracts are accounted for as long-term contracts in accordance with SOP 97-2 and SOP 81-1, and revenue is recognized on a percentage-of-completion using the cost-to-cost method. We use the percentage-of-completion methodology to account for revenue under these contracts because a high level of certainty exists regarding expected cash flows from these contracts, and a reliable basis exists for estimating the percentage of the contract that is completed at the end of the accounting period.

Consulting, training and other similar services for such products are generally recognized along with the product component under the percentage of completion method. Software maintenance, hardware replacement, and technical support for such products, are typically recognized ratably over the contract term, unless provided on a time and material basis, in which case revenue is recognized as the services are rendered. Expenses on all services are recognized when the costs are incurred.

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

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

Design and integration complexities;

Nature and number of workstations and sites installed;

Projected number of secure credentials to be produced;

Size of the database;

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

Competitive environment.

Under the percentage-of-completion, we measure the percentage complete using either input measures (e.g. costs incurred) or output measures (e.g. contract milestones), whichever provides the most reliable and meaningful measure of performance. Milestones are specific events or deliverables clearly identified in the contract and can include delivering customized systems, installation and services as defined by the contract. When milestone measures are used, billings occur and revenue is recognized when performance milestones and customer acceptance criteria have been achieved. We recognize revenue based on the total milestone billable to the customer less revenue related to any future maintenance requirements. On contracts where milestones are not used, we generally recognize revenue on a cost-to-cost basis using direct labor dollars method. The cumulative impact of any revision in estimates to complete or recognition of losses on contracts is reflected in the period in which the changes or losses become known. We record costs and estimated earnings in excess of billings under these contracts as current assets.

Derivative Instruments and Hedging Activities

In 2005, Viisage began to utilize foreign currency forward contracts for specific purchase obligations denominated in foreign currencies. All gains and losses resulting from the change in fair value of the derivatives are recorded in earnings. None of the contracts were terminated prior to settlement. As of March 31, 2006, Viisage had committed to six foreign currency forward contracts to purchase approximately 142.8 million Japanese Yen for approximately \$1.2 million. The fair value of these contracts at March 31, 2006 was approximately \$1.2 million. All of these contracts have since been settled.

RESULTS OF OPERATIONS

The results of operations of the Company in the first quarter of 2006 have been materially impacted by the acquisitions of IBT, SecuriMetrics and the AutoTest product line as well as the adoption of SFAS No. 123(R) and increases in the Company's cash balance. The following schedule summarizes the most significant developments that affected the Company's results of operations for the quarter ended March 31, 2006 as compared to the same period in the prior year (in thousands):

| | Net |
|--|-------------------|
| | Income/ (Loss) |
| Quarter ended April 3, 2005 | \$ (1,642) |
| Effect of: | |
| IBT Acquisition | (34) |
| SecuriMetrics Acquisition | (536) |
| AutoTest Acquisition | 527 |
| Adoption of SFAS No. 123(R) | (626) |
| Interest income from increased cash balances | 640 |
| Other | (487) |
| Total, quarter ended March 31, 2006 | \$ (2,158) |

Consolidated Results of Operations

The 2006 results of operations were significantly affected by the acquisitions of IBT, which comprises the entire fingerprint products and services segment, and SecuriMetrics. The following table summarizes the effects to the statement of operations:

| | March 31, | April 3, | Net | Change | Other |
|--------------------|------------|------------|----------|----------|----------|
| | 2006 | 2005 | Change | due to | Changes |
| | | | | acquired | segments |
| Revenues | \$ 23,438 | \$ 16,810 | \$ 6,628 | \$ 6,387 | \$ 241 |
| Cost of Revenues | 17,039 | 11,399 | 5,640 | 5,432 | 208 |
| Gross Margin | 6,399 | 5,411 | 988 | 955 | 33 |
| Operating Expenses | 8,674 | 6,802 | 1,872 | 1,525 | 347 |
| Operating Loss | \$ (2,275) | \$ (1,391) | \$ (884) | \$ (570) | \$ (314) |

We are seeing increased levels of activity in terms of the size and number of contracts which are addressable by us, and we believe this trend will continue. Foreign, U.S., and State Government, and commercial programs include the Western Hemisphere Travel Initiative, U.S. VISIT, HSPD-12, REAL ID, TWIC and Registered Traveler, each of which represent significant business opportunities for us.

Revenues

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| | Three months ended | |
|-----------------------|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |
| Service revenues | \$ 15,213 | \$ 10,061 |
| Product revenues | 8,225 | 6,749 |
| Total revenues | \$ 23,438 | \$ 16,810 |

Revenues increased by \$6.6 million of which approximately \$6.4 million related to acquisitions of IBT and SecuriMetrics. The remaining increases are related to the Advanced Technology Solutions discussed below. The SecuriMetrics revenues of \$0.8 million are included in product revenues and the IBT revenues of \$5.6 million are included in service revenues.

Costs of revenues and gross margin

| | Three months ended | |
|-------------------|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |
| Costs of revenues | \$ 17,039 | \$ 11,399 |
| Gross margin | 27% | 32% |

Cost of revenues increased by \$5.6 million of which \$5.4 million related to the acquisitions of IBT and SecuriMetrics. The remaining increase is related to the Advanced Technology Solutions segment discussed below. The SecuriMetrics cost of revenues are included in services. Gross margin as percentage of sales was adversely impacted by the results of operations of the acquired companies.

Sales and marketing expenses

| | Three months ended | |
|------------------------------|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |
| Sales and marketing expenses | \$ 2,369 | \$ 2,109 |

Sales and marketing expenses increased by \$0.3 million. The acquisitions of IBT and SecuriMetrics accounted for substantially all of the increase. Sales and marketing expenses for the Advanced Technology Solutions segment are discussed below and reflect a charge of \$0.1 million for stock compensation expense.

Research and development expenses

| | Three months ended | |
|-----------------------------------|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |
| Research and development expenses | \$ 1,611 | \$ 1,229 |

Research and development expenses increased by \$0.4 million, of which \$0.3 million are related to the acquisitions of IBT and SecuriMetrics. The remainder of the increase is related to the increase in stock compensation expense of the Advanced Technology Solutions segment discussed below.

General and administrative expenses

| | Three months ended | |
|-------------------------------------|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |
| General and administrative expenses | \$ 4,577 | \$ 3,364 |

General and administrative expenses increased \$1.2 million of which \$0.9 million is attributed to the acquisition of IBT and SecuriMetrics. The remaining increase is related to the Advanced Technology Solutions segment discussed below, and reflects a stock compensation charge of \$0.2 million.

Amortization of purchased intangible assets

| | Three months ended | |
|--|--------------------|------------------|
| | March 31, 2006 | April 3, 2005 |

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| | | |
|---|--------|--------|
| Amortization of purchased intangible assets | \$ 117 | \$ 100 |
|---|--------|--------|

Amortization of the purchased intangibles increased as a result of the acquisitions of IBT and SecuriMetrics.

The following summarizes the segment information for the three months ended March 31, 2006 and April 3, 2005:

| | Three Months Ended | |
|---|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Advanced Technology Identity Solutions | | |
| Revenues | \$ 17,051 | \$ 16,810 |
| Operating Loss | (1,705) | (1,391) |
| Fingerprint Products and Services | | |
| Revenues | 5,588 | |
| Operating Loss | (34) | |
| SecuriMetrics | | |
| Revenues | 799 | |
| Operating Loss | (536) | |
| Consolidated | | |
| Revenues | 23,438 | 16,810 |
| Operating Loss | (2,275) | (1,391) |

All corporate costs are included in the advanced technology identity solutions segment. The Company measures performance of each segment by reference to revenues and operating income (loss).

The following discussion of operations by management focuses on the advanced technology identity solutions results of operations for the first quarter of 2006 compared to the same period in the prior year.

Advanced Technology Identity Solutions Results of Operations

Revenue

| | Three Months Ended | | |
|-----------------------|---------------------------|---------------------------|--------------------------|
| | March 31, 2006 | Percent Change | April 3, 2005 |
| Service revenues | \$ 9,625 | -7% | \$ 10,392 |
| Product revenues | 7,426 | 16% | 6,418 |
| Total revenues | \$ 17,051 | 1% | \$ 16,810 |

Services revenues include multi-year service contracts for systems implementation, maintenance, credential production and other related services. During the three-month period ending March 31, 2006, service revenues decreased approximately \$767,000. For the state and local market, service revenue decreased by \$356,000 to approximately \$7.0 million from \$7.4 million in the first quarter of 2005. This decrease was primarily due to the net effect of completion of drivers license contracts ending in 2005 resulting in decreased revenue of approximately \$1.2 million compared to the same quarter in the prior year, partially offset by a new drivers license contract that entered full production in the fourth quarter of 2005 and contributed approximately \$229,000 to first quarter of 2006, and increased card volumes and the completion of milestones of approximately \$615,000 compared to the prior year period. Pricing on drivers license contracts is typically fixed for the duration of the contract. Facial recognition software service revenue decreased by approximately \$686,000 for the three months ended March 31, 2006 compared to the same quarter in the prior year due to completion of the implementation phase of three significant contracts in the first quarter of 2005. The declines in services revenue were partially offset by Federal service revenue, which increased approximately \$275,000 during the first three months of 2006 compared to the same period in the prior year primarily due to services performed for the Department of State on the e-passport program.

Product revenues for Historical Viisage include the sale of printers and consumables under our contract with the Department of State, document authentication systems, testing systems, and facial recognition software. Product revenues in the three-month period ended March 31, 2006 increased by \$1.0 million relative to the comparable period in the prior year. Revenues from sales of document authentication and testing systems increased by approximately \$1.7 million, primarily as a result of two significant customer orders, partially offset by a previously anticipated decline in product sales to the Federal government.

Cost of Revenues and Gross Margin

| | Three Months Ended | |
|---|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Services cost of revenues | \$ 6,709 | \$ 7,121 |
| Product cost of revenues | 3,373 | 3,060 |
| Stock based compensation expense | 85 | |
| Amortization of purchased intangible assets | 1,441 | 1,218 |
| | \$ 11,608 | \$ 11,399 |
| As a percentage of revenues | 68% | 68% |

| | Three Months Ended | |
|-----------------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Gross Margin | \$ 5,443 | \$ 5,411 |
| As a percentage of revenues | 32% | 32% |

The increase in product gross margin as a percentage of sales for the three months ended March 31, 2006 is primarily the result of the sale of higher margin product to the Department of State and sales of our facial recognition software. The decline in services gross margin as a percentage of revenues is a result of the previously anticipated completion of drivers license contracts in states in which the asset base was fully depreciated. As a percentage of revenue, amortization expense increased from 7% in the first quarter of 2005 to 9% in the first quarter of 2006. Amortization expense included in cost of revenues increased as a result of the amortization of completed technology intangible assets associated with the purchase of the AutoTest business in December 2005.

Sales and Marketing Expenses

| | Three Months Ended | |
|---------------------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Sales and Marketing Expenses | \$ 1,969 | \$ 2,109 |
| Stock compensation expense | 131 | |
| | \$ 2,100 | \$ 2,109 |
| As a percentage of net revenues | 12% | 13% |

Sales and marketing expense consists primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions and other marketing and sales support expenses. Sales and marketing expenses are unchanged for the three months ended March 31, 2006 compared to the same period in the prior year primarily resulting from the decreased use of outside professional services and the timing of trade shows offset by stock compensation expense of \$131,000. We expect our sales and marketing expenses to decline as a percentage of revenues in future quarters.

Research and Development Expenses

| | Three Months Ended | |
|-----------------------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Research and Development Expenses | \$ 1,236 | \$ 1,229 |
| Stock compensation expense | 69 | |
| | \$ 1,305 | \$ 1,277 |
| As a percentage of net revenues | 8% | 7% |

Research and development expense consists primarily of salaries and related personnel costs and prototype costs related to the design, development, testing and enhancement of our products. The slight increase in research and development expenses, both in relative and absolute terms, is a result of increases in personnel costs and stock compensation expense of \$69,000. We expect our research and development expenses to decline as a percentage of revenues in future quarters.

General and Administrative Expenses

| | Three Months Ended | |
|-------------------------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| General and Administrative Expenses | \$ 3,449 | \$ 3,364 |
| Stock compensation expense | 215 | |
| | \$ 3,664 | \$ 3,364 |
| As a percentage of net revenues | 22% | 20% |

General and administrative expenses consist primarily of salaries and related personnel costs for our executive and administrative personnel, professional and board of directors fees, public and investor relations and insurance. For the three-month period ending March 31, 2006, the increase in general and administrative expenses relative to the comparable period in the prior year was primarily the result of increased personnel costs of \$273,000 and stock compensation expense of \$215,000, partially offset by the reduction of professional fees from the first quarter of 2005 related to the completion of the prior year annual audit. We expect our general and administrative expenses to decline as a percentage of revenues in future quarters.

Fingerprint Products and Services Results of Operations

IBT was acquired on December 16, 2005, and its results of operations have been consolidated since that time and comprises the fingerprint products and services segment. Service revenues from IBT were approximately \$5.6 million for the three month period ending March 31, 2006. Approximately 90% of these revenues were derived from contracts with the Transportation Security Administration and the Florida Department of Financial Services.

Service cost of revenue was approximately \$4.8 million, or 86% of revenues, for the three month period ending March 31, 2006, and consists of variable costs paid to the relevant government agencies that evaluate the fingerprints as well as costs for subcontractor services to capture and transmit fingerprints and to process related transactions. Amortization of intangible assets, which are included in cost of revenues, are associated with customer contracts and completed technology amounted to \$239,000, or 4% of revenues, and is included in total cost of revenues. As a percentage of revenue, amortization expense is expected to decrease as revenues increase.

Sales and marketing expense was approximately \$130,000, or 2% of revenues, and consists primarily of salaries and related personnel costs, travel and entertainment expenses.

General and administrative expense was approximately \$634,000, or 11.4% of revenues, and consists primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses, and professional fees.

SecuriMetrics Results of Operations

SecuriMetrics was acquired on February 17, 2006, and its results of operations have been consolidated since that time. Revenues from SecuriMetrics were approximately \$799,000 from the date of acquisition through March 31, 2006, all of which were from product sales to the U.S. Government. Revenues are expected to increase significantly over the remainder of the year as SecuriMetrics delivers on existing contracts.

Cost of product revenue was approximately \$614,000, or 77% of revenues from the date of acquisition through March 31, 2006. Amortization expense included in cost of revenues was \$188,000, or 24% of revenues and was related to the amortization of intangible assets associated with completed and core technology. As a percentage of revenue, these costs are expected to decrease over the remainder of the year as a result of increased revenue.

Sales and marketing expense was approximately \$139,000, or 17% of revenues and consists primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions, and other marketing and sales support expenses. As a percentage of revenue, these costs are expected to decrease for the rest of the fiscal year as a result of increased revenue.

Research and development expense was approximately \$297,000, or 37% of revenues and consists primarily of salaries and related personnel costs and prototype costs related to the design, development, testing and enhancement of iris recognition products. As a percentage of revenue, these costs are expected to decrease over the remainder of the year as a result of increased revenue.

General and administrative expense was approximately \$279,000, or 35% of revenues, and consists primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses and professional fees. As a percentage of revenue, these costs are expected to decrease over the remainder of the year as a result of increased revenue.

The following reconciles the individual segments' financial statements captions to the related consolidated financial statements for the three months ended March 31, 2006:

| | Advanced Technology Identity Solutions | Fingerprint Products & Services | SecuriMetrics | Total |
|--------------------------|---|------------------------------------|---------------|-----------|
| Revenues | \$ 17,051 | \$ 5,588 | \$ 799 | \$ 23,428 |
| Cost of revenues | 11,608 | 4,817 | 614 | 17,039 |
| Sales & marketing | 2,100 | 130 | 139 | 2,369 |
| Research & development | 1,305 | 9 | 297 | 1,611 |
| General & administrative | 3,664 | 634 | 279 | 4,577 |

Consolidated Share-Based Compensation

Effective January 1, 2006, we began accounting for our employee and director stock option plans and employee stock purchase plans in accordance with the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R). SFAS No. 123R revised SFAS No. 123, *Accounting for Stock-Based Compensation*, and superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees*. The revised statement addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the option to account for share-based payments using APB Opinion No. 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of operations based upon the grant-date fair value of those instruments. We used the modified prospective method of transition as provided by SFAS No. 123R, and as a result, compensation expense related to share based payments is recorded for periods beginning January 1, 2006. Under the modified prospective method, stock based compensation expense is generally recognized over the vesting period for new awards granted after January 1, 2006 and for unvested awards outstanding at January 1, 2006. For the three months ended March 31, 2006 our loss from continuing operations and net loss

were increased by approximately \$626,000 for share-based compensation expense related to the adoption of SFAS No. 123R.

Share-based compensation expense recognized for the three months ended March 31, 2006 totaled approximately \$659,000 on a consolidated basis, of which \$508,000 was included in the advanced technology identity solutions segment, \$86,000 was included in the fingerprint products and services segment, and \$65,000 was included in the SecuriMetrics segment. No tax benefit was recognized in the statement of operations due to our history of operating losses and full valuation allowance on our deferred tax assets. In addition, no share-based compensation cost was capitalized for any period presented.

As of March 31, 2006 there was approximately \$9.0 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under our stock incentive plans which is expected to be recognized over the remaining vesting period.

Consolidated Interest Income and Expense

| | Three Months Ended | |
|--------------------------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Interest income | \$ 671 | \$ 31 |
| Interest expense | (6) | (47) |
| Net interest income/(expense) | \$ 665 | \$ (16) |

The increase in interest income is primarily related to a higher average cash balance during the first quarter of 2006 compared to the comparable period in 2005, and to a lesser extent to increases in interest rates. Interest expense for the first quarter of 2006 decreased by approximately \$41,000 compared to the same period in the prior year due to lower outstanding debt.

Consolidated Other Income

| | Three Months Ended | |
|-------------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Other Income, net | \$ 17 | \$ 123 |

Net other income is primarily the result of realized and unrealized currency transaction gains and losses on yen-denominated purchases. We typically purchase forward exchange contracts to hedge currency transaction exposure. The decline in net other income is a result of increased use of forward exchange contracts in 2006.

Consolidated Income Taxes

| | Three Months Ended | |
|--------------|---------------------------|--------------------------|
| | March 31, 2006 | April 3, 2005 |
| Income Taxes | \$ 565 | \$ 358 |

For the three-month period ended March 31, 2006, we had a deferred provision for federal income taxes of approximately \$508,000 which resulted from tax deductible goodwill amortization related to the acquisitions of TDT, AutoTest and IBT. No current provision for federal income taxes was recorded for the three-month periods ended March 31, 2006 and April 3, 2005. Included in income tax expense was state income tax expense of approximately \$57,000 for the three-month period ending March 31, 2006 and approximately \$58,000 in the same period in the prior year, which is primarily the result of state tax minimums in certain jurisdictions in which we operate. The increase in income tax expense is due to the AutoTest and IBT acquisitions which occurred in the fourth quarter of 2005.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

As of March 31, 2006 we had \$48.6 million of working capital including \$46.4 million in cash and cash equivalents. In addition we have financing arrangements, as further described below, available to support our ongoing liquidity needs. We believe that our existing cash and cash equivalent balances, existing financing arrangements and cash flows from operations will be sufficient to meet our operating and debt service requirements for the next 12 months, and to fund our acquisition strategy in the near term. However, if we cannot achieve our business plan in 2006, or if we enter into material new contracts, or require cash to pursue strategic acquisitions, we may be required to seek additional capital, either in the form of debt or equity. There can be no assurance that such financing will be available on commercially reasonable terms, or at all. Our ability to meet our business plan is dependent on a number of factors, including those described in the section of this report entitled Risk Results. We will continue to evaluate our capital requirements in order to meet the objectives of our growth strategy.

On December 14, 2004, we entered into a Loan and Security Agreement with Citizens Bank of Massachusetts. The Loan and Security Agreement permits us to borrow up to \$25 million, subject to certain financial covenants which may restrict the amounts borrowed. As of March 31, 2006, we estimate that the incremental amount available to us under the Loan and Security Agreement was approximately \$8.5 million based on the financial covenants in the agreement. Any amounts borrowed under the Loan and Security Agreement bear interest at the rate of Citizens prime rate minus 0.25% or the London Interbank Offered Rate (LIBOR) plus 2.5%, at our option, and must be repaid on or before May 30, 2007. At various times during 2005 and 2006, we entered into amendments to the Loan and Security Agreement to modify the financial covenants and make certain other changes. As of March 31, 2006, there were commitments of \$8.5 million in letters of credit and performance bonds to certain of our customers under the Loan and Security Agreement, and there are no amounts borrowed under this agreement.

In accordance with the Loan and Security Agreement, borrowings are secured by the inventory, receivables, equipment and other business assets (excluding intellectual property) of Viisage and our subsidiaries. We are required to maintain the following financial covenants under the Loan and Security Agreement:

The ratio of our cash, cash equivalents and billed accounts receivable to the sum of our current liabilities plus outstanding bank loans and letters of credit may not be less than 1.10:1.0 at the end of any fiscal quarter;

The ratio of our cash, cash equivalents and billed accounts receivable to the sum of our adjusted current liabilities (as defined in the Loan and Security Agreement) plus outstanding bank loans and letters of credit may not be less than .85:1.0 at the end of any fiscal quarter;

Our earnings before taxes, interest and depreciation and amortization (EBITDA) may not be less than \$750,000 for the discrete fiscal quarter ending March 31, 2006, nor less than \$2.5 million for any fiscal quarter thereafter;

The ratio of our total indebtedness (as defined in the Loan and Security Agreement) to our EBITDA may not be more than 1.50:1.0 for the trailing twelve month period ending on any fiscal quarter end, commencing December 31, 2005;

The ratio of our cash flow (as defined in the Loan and Security Agreement) to our fixed charges may not be less than 2.0:1.0 for the trailing twelve month period ending on any fiscal quarter end, commencing December 31, 2005; and

We must maintain a minimum cash and cash equivalents position of at least \$7.5 million at all times.

As of March 31, 2006, we were in compliance with the covenants under the Loan and Security Agreement. If we do not remain in compliance with the applicable covenants, Citizens could refuse to lend funds to us and could require immediate repayment of any amounts outstanding.

In 2003 we entered into arrangements for an aggregate of approximately \$1.5 million of equipment financing with three of our suppliers. These project lease arrangements are accounted for as capital leases. There are no financial covenants associated with these leasing arrangements. The interest rates on these capital leases are fixed between 6% and 8%. The terms of these leases range from 12 months to 60 months. Also in 2005, we entered into an arrangement for financing of database licenses with another vendor. As of March 31, 2006, there was a total of \$328,000 outstanding under these arrangements, \$151,000 of which is included in current portion of long-term debt and \$177,000 of which is in long-term debt.

In 2004 we purchased an asset for \$800,000 which is payable in installments over four years. As of March 31, 2006, we had approximately \$186,000 outstanding, which represented the present value of future payments remaining under this agreement, \$91,000 of which was included in other current liabilities and \$95,000 of which was included in long-term debt, net of current portion.

In October 2005, we entered into an investment agreement with L-1 Investment Partners, LLC, or L-1, subsequently assigned by L-1 to its affiliate, Aston Capital Partners, L.P., or Aston, under which we issued and sold to Aston 7,619,047 shares of our common stock at \$13.125 per share, and issued to Aston warrants to purchase an aggregate of 1,600,000 shares of our common stock at an exercise price of \$13.75 per share. The proceeds of the issuance, net of transaction costs, were approximately \$98.7 million. Under the investment agreement with Aston, \$85 million of the proceeds will be used to finance acquisitions subject to approval by Viisage's board of directors. At March 31, 2006, approximately \$18 million of our cash balances are required to be used for acquisitions pursuant to the terms of this investment agreement.

Cash flows

| | Three Months Ended | |
|---|--------------------|-------------------|
| | March 31, 2006 | April 3, 2005 |
| Consolidated Cash Flow Data: | | |
| Net cash provided by (used in): | | |
| Operating activities | \$ 3,701 | \$ (380) |
| Investing activities | (30,673) | (643) |
| Financing activities | 1,028 | (119) |
| Effect of exchange rates on cash and cash equivalents | (13) | (8) |
| Net increase (decrease) in cash and cash equivalents | \$ (25,957) | \$ (1,150) |

The net loss for the first quarter was \$2.2 million, which included non-cash charges of \$4.1 million for depreciation and amortization, \$659,000 for stock-based compensation and \$508,000 for deferred taxes. Cash flows from operating activities improved by \$4.1 million for the three months ended March 31, 2006 as compared to the corresponding period for the prior year. Excluding the impact of working capital changes described below, cash flows from operating activities improved from \$1.6 million to \$3.1 million. Other changes in operating assets and liabilities resulted in a net decrease in cash as discussed below.

On February 17, 2006, we acquired SecuriMetrics for \$28.4 million cash, including professional fees, and placed an additional \$2 million placed in escrow for 18 months. In addition, the former SecuriMetrics stockholders may earn up to an additional \$13 million in consideration, of which \$11.5 million would be paid in common stock at a value of \$17.69 and \$1.5 million would be paid in cash, subject to SecuriMetrics meeting performance thresholds

and resolving contingencies. We purchased \$1.3 million of property and equipment, primarily to support new and extended contracts in our drivers license business. We also expended cash of \$962,000 for professional fees related to our pending acquisition of Identix.

Cash provided by financing activities was \$1.0 million, and was primarily the result of proceeds received from exercises of common stock by our employees.

Working Capital

Accounts receivable related to the recent acquisitions by Viisage of SecuriMetrics was approximately, \$293,000 and for IBT was approximately \$597,000 at March 31, 2006, respectively, and for IBT was \$546,000 at December 31, 2005. Other accounts receivable increased by \$373,000, as of March 31, 2006 from December 31, 2005, primarily due to increases in revenue. Total days sales outstanding decreased as a result of the inclusion of a full quarter of IBT operating results, which has a business model that typically collects cash at the time services are performed.

Inventories related to the recent acquisition by Viisage of SecuriMetrics was \$1.4 million at March 31, 2006. Excluding the effects of SecuriMetrics on inventory, other inventory increased approximately \$668,000 was primarily due to inventory purchases in the first quarter for the AutoTest business acquired in December relative to customer orders received prior to quarter end.

Other current assets increased by \$1.0 million primarily as a result of \$688,000 paid for insurance and other deposits.

Accounts payable, accrued expenses and other current liabilities related to the recent acquisitions by Viisage of SecuriMetrics was \$1.6 million and for IBT was \$3.6 million at March 31, 2006, respectively. Accounts payable, accrued expenses and other current liabilities related to the recent acquisitions by Viisage for IBT was \$2.5 million at December 31, 2005. Accounts payable and accrued expenses increased to \$18.0 million at March 31, 2006 from \$11.4 million at December 31, 2005 primarily due to accrued professional fees related to our pending merger with Identix, timing of payment of accrued payroll and related costs and of other professional fees.

Total deferred revenue increased to \$5.2 million of which \$3.4 million relates to the current portion. The increase is related primarily to annual maintenance renewals and payments received on customer projects for which revenue recognition criteria was not met as of March 31, 2006.

During 2004, IBT's contract with a Florida state agency was terminated and awarded to a competing firm. IBT challenged the method by which this contract was awarded and the case was settled by requiring the competitor to utilize IBT's equipment and to remit a fixed fee per fingerprint to IBT. IBT, as merchant of record, collects all receipts and deposits the receipts into a jointly-owned bank account by IBT and the prime contractor. As billings are rendered, receivables are recorded as restricted assets and a payable to the prime contractor in an equal amount is recorded. Cash collected on the prime contractor's behalf and remaining in IBT's account is recorded as a component of restricted assets with an offsetting payable to the contractor, which is included in payable to prime contractor. The restricted cash and receivables, included in restricted assets, were as follows (in thousands):

| | March 31, 2006 | December 31, 2005 |
|--------------------------------|-------------------|----------------------|
| Restricted cash | \$ 364 | \$ 36 |
| Restricted accounts receivable | | 392 |
| Total restricted assets | \$ 364 | \$ 428 |
| Payable to prime contractor | \$ 364 | \$ 428 |

CONTRACTUAL OBLIGATIONS

The following table sets forth our contractual obligations as of March 31, 2006 (in thousands).

| | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|--|--------------|-----------------------------|----------------------|----------------------|------------------------------|
| Operating lease obligations | \$ 2,956 | \$ 640 | \$ 2,011 | \$ 305 | \$ |
| Capital lease and long term debt obligations | \$ 514 | \$ 242 | \$ 272 | \$ | \$ |

As of March 31, 2006, we had standby letters of credit issued by Citizens Bank for approximately \$2.3 million to certain of our customers.

CONTINGENT OBLIGATIONS

Our principal contractual commitments involve payments under capital leases and operating leases.

INFLATION

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

FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains or incorporates forward-looking statements within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate and management's beliefs and assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by or on our behalf. Words such as expect, anticipate, intend, plan, believe, seek, estimate, variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We have included important factors in the cautionary statements in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005 under the heading "Risk Factors" and in Section 1A of Part II below under the heading "Risk Factors" that we believe could cause our actual results to differ materially from the forward-looking statements we make. We do not intend to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 6 EXHIBITS

The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this report.

VIISAGE TECHNOLOGY, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: July 28, 2006

By: */s/* BERNARD C. BAILEY
Bernard C. Bailey
President and Chief Executive Officer
(Principal Executive Officer)

Date: July 28, 2006

By: */s/* BRADLEY T. MILLER
Bradley T. Miller
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

EXHIBIT INDEX

| Exhibit No. | Note | Description |
|--------------------|-------------|--|
| 31.1 | (a) | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | (a) | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | (a) | Certification of Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | (a) | Certification of Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

| Note | Description |
|-------------|--------------------|
| (a) | Filed herewith. |