SCM MICROSYSTEMS INC
Form S-3
June 20, 2002

Table of Contents

As filed with the Securities and Exchange Commission on June 20, 2002

Registration No. 333-________

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-3
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

SCM MICROSYSTEMS, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	47211 Bayside Parkway Fremont, California 94538 (510) 360-2300 **(Address and Telephone number of Principal Executive Offices)**	77-0444317 **(I.R.S. Employer Identification Number)**

Andrew Warner
Chief Financial Officer
SCM Microsystems, Inc.
47211 Bayside Parkway
Fremont, California 94538
(510) 360-2300
(Name, address, including zip code, and telephone number, including area code, of agent for service)

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:
From time to time after the effective date of this Registration Statement.

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, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [X]

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

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

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

Calculation of Registration Fee

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price per Unit(1)	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common Stock, $0.001 par value	159,101	$ 9.60	$1,527,379.20	$ 140.52

(1) The Proposed Maximum Offering Price Per Share was estimated pursuant to Rule 457(c) on the basis of the average of the high and low prices reported on the NASDAQ National Market on June 19, 2002.

SCM Microsystems, Inc. hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until SCM Microsystems, Inc. shall file an 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 this registration statement shall become effective on such date as the commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED JUNE 20, 2002

SCM MICROSYSTEMS, INC.

UP TO 159,101 SHARES OF COMMON STOCK

WHICH THE SELLING STOCKHOLDERS MAY RESELL UNDER THIS PROSPECTUS

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State.

The stockholders of SCM Microsystems, Inc. listed in this prospectus may resell up to 159,101 shares of our Common Stock under this prospectus for their own accounts. We will not receive any of the proceeds from the sale of these shares by the selling stockholders.

These shares listed in this prospectus were acquired by the selling stockholders in connection with the acquisition of a third-party by one of SCM s subsidiaries.

The selling stockholders may offer their common stock through public or private transactions at prevailing market prices or at privately negotiated prices. These future prices are not known.

Our common stock is quoted on the Nasdaq National Market under the symbol SCMM . The last reported sale price of our common stock on the Nasdaq National Market on June 19, 2002 was $9.69.

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The selling stockholders are offering to sell, and seeking offers to buy, shares of SCM common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of the shares.

CONSIDER CAREFULLY THE RISK FACTORS
BEGINNING ON PAGE 5 IN THIS PROSPECTUS

NEITHER THE SECURITIES AND EXCHANGE COMMISSION 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.

The date of this prospectus is June , 2002.

TABLE OF CONTENTS

Table of Contents

TABLE OF CONTENTS

In this prospectus, unless indicated otherwise, SCM, the Company, we, us and our refer to SCM Microsystems, Inc. and its subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under the sections entitled Prospectus Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Business in the documents incorporated by reference herein and located elsewhere in this prospectus constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These statements relate to future plans, objectives, events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expect, anticipate, intend, plan, believe, estimate, potential, or of these terms or other comparable terminology. These forward-looking statements involve a number of risks and uncertainties and are only predictions. Our actual events or results may differ materially from any forward-looking statement. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Risk Factors. Please review these risk factors carefully. Also, please review the sections captioned Management s Discussion and Analysis of Financial Condition and Results of Operations in our annual report on Form 10-K for the Fiscal year ended December 31, 2001 and our quarterly report on Form 10-Q for the fiscal quarter ended March 31, 2002.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. Except as required by law, we undertake no obligation to update publicly any forward-looking statements for any reason after the date of this prospectus to conform these statements to actual results or to changes in our expectations. Before you invest in our common stock, you should be aware that the occurrence of the events described under Risk Factors and elsewhere in this prospectus could harm our business.

Table of Contents

OUR BUSINESS

SCM Microsystems designs, develops and sells hardware, software and silicon that enables people to conveniently and securely access digital content and services, including content and services that have been protected through digital encryption. We sell our products primarily into two broad markets: Security and Digital Media.

In the Security market, we provide reader technology for access control systems deployed on the digital television and PC platforms:

- our conditional access modules and interface technology are used by digital television broadcasters to restrict access to encrypted digital television broadcasts to paying subscribers; and
- our smart card readers and interface technology are used to control access to PCs, computer networks and the Internet to facilitate computer and network security and secure online transactions.

In the Digital Media market, we provide hardware and software products that help consumers capture, edit and share digital media content. Our Digital Media and Video products:

- allow users to easily capture on a personal computer media content such as analog or digital video, digital photos or digital music from multiple sources, such as VCRs, digital camcorders, digital cameras and MP3 music players;
- help users to edit and personalize their digital media content on a PC; and
- help users to convert their digital media content to a format where the content can be shared with family and friends, such as an electronic file for email or web posting, a compact disk, or CD, or digital versatile disk, or DVD.

Our target customers vary by market. For the Security market, our target customers are primarily manufacturers in the consumer electronics, computer and conditional access system industries. For the Digital Media market, our target customers are end user consumers as well as manufacturers in the computer and consumer electronics industries. We sell and license our products through a direct sales and marketing organization, both to the retail channel and to original equipment manufacturers, or OEMs. We also sell through distributors, value added resellers and systems integrators worldwide.

Operationally, we have organized our business around three divisions:

- Digital Television and Video, which focuses on products, development, customers and relationships in the global markets for digital TV and digital video solutions;
- PC Security, which focuses on products, development, customers and relationships in the global markets for solutions that enable smart card-based enterprise, financial and government PC Security applications; and
- Digital Media, which focuses on products, development, customers and relationships in the global market for solutions that enable data transfer between various digital devices and platforms.

While throughout 2001, we organized our business around these three divisions, beginning in fiscal 2002 we have structured our operations around two businesses:

- Security, which comprises our digital TV and PC security products, markets and activities and focuses on the global market for securing encrypted digital TV broadcasts and for enabling smart card based security solutions for the PC platform; and

Table of Contents

Digital Media and Video, which comprises our digital media and digital video products, markets and activities and focuses on the global market for capturing, editing and sharing digital media content, including digital video.

In addition, on February 28, 2002, we announced our intention to separate our Digital Media and Video business as an independent entity and make our Security business the core focus of our strategy going forward. We expect that the various activities relating to the separation of the Digital Media and Video business will not be completed for several months from the date hereof. We are evaluating various strategies to separate the Digital Media and Video business, including a spin-off or sale.

Table of Contents

RISK FACTORS

An investment in our common stock involves a high degree of risk. Prospective investors are cautioned that the statements made in this prospectus or in documents incorporated by reference herein that are not descriptions of historical facts may be forward-looking statements that are subject to risks and uncertainties. Actual results could differ materially from those currently anticipated because of a number of factors, including those identified herein under the heading Risk Factors and elsewhere in this prospectus or in documents incorporated by reference herein.

The risks and uncertainties described below are not the only risks we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the following risks actually occur, our business, financial condition, results of operations or product market share could be materially and adversely affected. The trading price of our common stock could decline due to any of these risks and you may lose part or all of your investment.

We have incurred operating losses and may not achieve profitability.

We have a history of losses with an accumulated deficit of approximately $74.3 million as of March 31, 2002. Although we were profitable for the quarter ending March 31, 2002, we may continue to incur losses in the future and may be unable to achieve profitability.

Our quarterly operating results will likely fluctuate.

Our quarterly operating results have varied greatly in the past and will likely vary greatly in the future depending upon a number of factors. Many of these factors are beyond our control. Our revenues, gross margins and operating results may fluctuate significantly from quarter to quarter due to, among other things:

- business and economic conditions overall and in our markets, and in particular, the demand in our retail channels;
- the timing and amount of orders we receive from our customers that, in the case of our consumer products and products sold to the government, may be tied to seasonal demand or budgetary cycles;
- cancellations or delays of customer product orders, or the loss of a significant customer;
- our backlog and inventory levels;
- our customer and distributor inventory levels and product returns;
- new product announcements or introductions by us or our competitors;
- our ability to develop, introduce and market new products and product enhancements on a timely basis, if at all;
- the sales volume, product configuration and mix of products that we sell;
- our success in expanding our sales and marketing organization and programs;
- technological changes in the market for our products;
- increased competition or reductions in the average selling prices that we are able to charge;
- fluctuations in the value of foreign currencies against the U.S. dollar;
- the timing and amount of marketing and research and development expenditures;

Table of Contents

our investment experience related to our strategic minority equity investments; and

costs related to events such as acquisitions, litigation and write-off of investments.

Due to these and other factors, our revenues may not increase or remain at their current levels. Because a high percentage of our operating expenses are fixed, a small variation in our revenue can cause significant variations in our earnings from quarter to quarter and our operating results may vary significantly in future periods. Therefore, our historical results may not be a reliable indicator of our future performance.

A number of factors make it difficult to estimate operating results prior to the end of a quarter.

We do not typically maintain a significant level of backlog. As a result, revenues in any quarter depend on contracts entered into or orders booked and shipped in that quarter. In recent periods, customers, including distributors of our consumer products, have tended to make a significant portion of their purchases towards the end of the quarter, in part because they are able, or believe that they are able, to negotiate lower prices and more favorable terms. This trend makes predicting revenues difficult. The timing of closing larger orders increases the risk of quarter-to-quarter fluctuation. If orders forecasted for a specific group of customers for a particular quarter are not realized or revenues are not otherwise recognized in that quarter, our operating results for that quarter could be materially adversely affected.

Weakness in the economy could decrease demand for our products or for our customers products, causing customers to decrease or cancel orders to us or to delay payment.

Recently, economic conditions in the United States have resulted in decreased demand from end users for many companies products, including ours. Throughout 2001 and during 2002 through the date hereof, we have experienced decreased actual and anticipated demand for our retail digital video editing products and for our digital media reader/writers sold through the retail and OEM channels. Reductions in consumer spending impacts our OEM business as well as our retail business because our OEM customers may reduce or cancel orders for our products if their own visibility of future orders is compromised by decreased demand or if increased pricing pressures force them to reduce costs by ceasing to bundle our products along with their own. Decreased or lower than expected sales will most likely adversely affect our stock price. Also, reduced or canceled orders for our products could lead to decreased sales in a particular period and, because many of our products are custom made for particular customers, could also cause us to write off inventory. In some cases, customers could delay payment or be unable to pay for orders made to us, causing us to increase our allowance for doubtful accounts or to write off certain receivables. In addition, if we anticipate that demand for our products will not increase, we may decide to reduce our operating expense base in order to maintain or reach profitability. Decreased sales, expense base decreases or any write-offs, or any combination of these, could have a materially adverse affect on our operating results.

There are risks associated with our decision to separate our Digital Media and Video business and our Security business.

On February 28, 2002, we announced our intention to create two distinct businesses within SCM, a Security business and a Digital Media and Video business. In addition, we announced our intention to separate our Digital Media and Video business as an independent entity and make our Security business the core focus of our strategy going forward. During the first and second quarters of 2002, we have initiated activities to create a separate legal entity around our Digital Media and Video business in preparation for its separation, which we expect will not be completed for several months. Our inability to properly implement the separation may adversely affect our revenues, results of operations and our stock price. Risks which could impact our ability to properly implement the separation include:

the separation process and results thereof will occupy a significant portion of senior management time and effort and may distract management and employees from the operation of these businesses;

the separation could be delayed or cancelled;

our separation strategy could be perceived negatively by our customers or cause them to choose our competitors products instead of ours;

Table of Contents

- implementation of the separation strategy could make it more difficult for us to retain employees and may otherwise adversely affect employee morale; and
- adverse market perception of the separation may cause our stock price to decline.

Also, there is no assurance that we will effectively implement the separation in a timely manner or at all. This implementation requires management to make and effect several administrative and employment-related decisions efficiently. If we do not implement these decisions efficiently, our operating results could be adversely affected. Furthermore, there is no assurance that, if we do implement the separation efficiently and in a timely manner, we will realize the benefits we contemplate from the separation. If we do not realize these benefits, our operations could be adversely affected and our stock price could decline.

Our listing on the Neuer Markt of the Frankfurt Stock Exchange exposes our stock price to additional risks of fluctuation.

Our common stock experiences a significant volume of trading on the Neuer Markt of the Frankfurt Stock Exchange. Because of this, factors that would not otherwise affect a stock traded solely on Nasdaq may cause our stock price to fluctuate. Investors outside the United States may react differently and more negatively than investors in the United States to events such as acquisitions, one-time charges and lower than expected revenue or earnings announcements. Any negative reaction by investors in Europe to such events could cause our stock price to decrease. In addition, the European economy and market conditions in general, or downturns on the Neuer Markt specifically, regardless of the Nasdaq market conditions, could negatively impact our stock price.

Our stock price has been and is likely to remain volatile.

The stock market has recently experienced significant price and volume fluctuations that have particularly affected the market prices of the stocks of technology companies. During the 12-month period from June 4, 2001 to June 4, 2002, the reported sale prices for our common stock on the Nasdaq market ranged between $4.55 to $17.23 per share. Volatility in our stock price may result from a number of factors, including:

- variations in our or our competitors financial and/or operational results;
- the fluctuation in market value of comparable companies in any of our markets;
- comments and forecasts by securities analysts;
- expected or announced relationships with other companies;
- trading patterns of our stock on the Nasdaq Stock Market or the Neuer Markt of the Frankfurt Stock Exchange;
- any loss of key management;
- announcements of technological innovations or new products by us or our competition;
- developments related to our decision to organize our company around a Security business and a Digital Media and Video business and to separate our Digital Media and Video business and focus on our Security business as a core strategy;
- litigation developments; and
- general market downturns.

In the past, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation. If we were the object of securities class action litigation, it could result in substantial costs and a diversion of our management s attention and resources.

Sales of our products depend on the development of several emerging markets.

We sell our products primarily to emerging markets that have not yet reached a stage of mass adoption or deployment. If demand for products in these markets does not develop and grow sufficiently, revenues and gross profit margins in either or both of our Security or our Digital Media and Video business could level off or decline. We cannot predict the future growth rate, if any, or size or composition of the market of our products in any of these markets. The demand and market acceptance for our products, as is common for new technologies, will be subject to high levels of uncertainty and risk and may be influenced by several factors, including general economic conditions.

In our Security business, these factors also include the following:

- the slow pace and uncertainty of adoption in Europe of open systems platforms that require conditional access modules, such as ours, that use the DVB-CI standard;
- the strength of entrenched security and set-top receiver suppliers in the United States who may resist the use of removable conditional access modules, such as ours, and prevent or delay opening the U.S. digital television market to greater competition; and
- the ability of financial institutions, corporate enterprises and the U.S. government to create and deploy smart card-based applications that will drive demand for smart card readers such as ours.

In our Digital Media and Video business, demand for our products will also be influenced by the following:

- the ability of flash memory card manufacturers to develop higher capacity memory cards that will drive demand for digital media readers, such as ours, that enable rapid transfer of large amounts of data;
- the availability of low cost hardware and software OEM solutions to allow expansion in the PC OEM market; and
- increased consumer acceptance of DVDs, CDs and DVD players and readers.

If we are unable to develop and maintain the strategic relationships necessary to develop, sell and market products that are commercially viable and widely accepted, the growth and success of our business may be limited.

If we are unable to anticipate market trends and the price, performance and functionality requirements for our products, we may not be able to develop and sell products that are commercially viable and widely accepted. We must collaborate closely with our customers, suppliers and other strategic partners to ensure that critical development, marketing and distribution projects proceed in a coordinated manner. Also, this collaboration is important because these relationships increase our exposure to information necessary to anticipate trends and plan product development. If any of our current relationships terminate or otherwise deteriorate, or if we are unable to enter into future alliances that provide us with comparable insight into market trends, our product development and marketing efforts may be adversely affected.

Our future success will depend on our ability to keep pace with technological change and meet the needs of our target markets and customers.

The markets for our Security and Digital Media and Video products are characterized by rapidly changing technology and the need to differentiate our products through technological enhancements. Our customers needs change and new products are introduced frequently. Product life cycles are short and industry standards are still evolving. These rapid changes in technology, or the adoption of new industry standards, could render our existing

Table of Contents

products obsolete and unmarketable. If one of our products is deemed to be obsolete or unmarketable, then we might have to reduce revenue expectations or write off inventories for that product. Our future success will depend upon our ability to enhance our current products and to develop and introduce new products on a timely basis that address the increasingly sophisticated needs of our customers and that keep pace with technological developments, new competitive product offerings and emerging industry standards. In addition, in cases where we are selected to supply products based on features or capabilities that are still under development, we must be able to complete our product design and delivery process in a timely basis, or risk losing current and any future business from our customers.

For example, our SmartReady, SmartSecure, SmartTrust and SmartRetail product families are designed to provide smart card-based security for PCs. Smart cards are beginning to be widely deployed by financial institutions, the U.S. government, corporations and other large organizations, in some cases in advance of anticipated security-oriented applications. However, standards for smart card readers are still emerging. We may not be able to comply with emerging standards in a timely manner or at all. If we cannot meet the standards requirements of the market or our prospective customers, we would likely lose orders to competitors.

Because we operate in markets for which industry-wide standards have not yet been fully set, it is possible that any standards eventually adopted could prove disadvantageous to or incompatible with our business model and product lines. If any of the standards supported by us do not achieve or sustain market acceptance, our business and operating results would be materially and adversely affected.

Our markets are highly competitive, and our customers may purchase products from our competitors.

The markets for our products are intensely competitive and characterized by rapidly changing technology. We believe that the principal competitive factors affecting the markets for our products include:

- the extent to which products support existing industry standards and provide interoperability;
- technical features;
- ease of use;
- quality and reliability;
- level of security;
- brand name, particularly in retail channels;
- strength of distribution channels; and
- price.

We believe that competition in our markets is likely to intensify as a result of increasing demand for the type of products we offer. We currently experience competition from a number of companies. In our Security business, our competitors include:

- Advanced Card Systems, Gemplus, O2Micro and OmniKey in smart card readers, ASICs and universal smart card reader interfaces.

In our Digital Media and Video business, our competitors include:

- Carry Computer Engineering, DataFab, Lexar, SanDisk, Simple Technology and SmartDisk for digital media readers; and
- ADS, Canopus, Pinnacle Systems, Roxio and ULead for digital video capture and editing products.

Table of Contents

We also experience indirect competition from some of our customers who sell alternative products or are expected to introduce competitive products in the future. We may in the future face competition from these competitors and new competitors, such as Motorola, that develop digital content security products. In addition, the market for our products may ultimately include technological solutions other than ours and our competitors.

Many of our current and potential competitors have significantly greater financial, technical, marketing, purchasing and other resources than we do. As a result, our competitors may be able to respond more quickly to new or emerging technologies or standards and to changes in customer requirements. Our competitors may also be able to devote greater resources to the development, promotion and sale of products and may be able to deliver competitive products at a lower end user price. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective customers. Therefore, new competitors, or alliances among competitors, may emerge and rapidly acquire significant market share. Increased competition is likely to result in price reductions, reduced operating margins and loss of market share.

Seasonal trends in sales of our products may affect our quarterly operating results.

Our business and operating results normally reflect seasonal trends. We have typically experienced lower revenue and operating income in the first quarter and second quarter and higher revenue in the third quarter and fourth quarter of each calendar year. We believe that the seasonal trends in our business and operating results are primarily due to the retail selling cycles of our consumer-oriented products, including our Digital Media and Video products. Because the market for consumer products is stronger in the second half of the year, we generally expect that our sales to retail distributors and to consumer-oriented OEMs will increase during that period. However, because of the unpredictability of the U.S. economy, there is no assurance that this increase will occur in the second half of 2002. In addition, our sales are impacted by the buying patterns of the U.S. government, which is an important customer for our PC Security products. These patterns tend to be variable in terms of the timing and size of orders, which contributes to the variability of our results on a quarterly basis.

A significant portion of our sales comes from a small number of customers and the loss of one of more of these customers could negatively impact our operating results.

Our products are generally targeted at OEM customers in the consumer electronics, computer, digital appliance, digital media and conditional access system industries, and to retail distributors. Sales to a relatively small number of customers historically have accounted for a significant percentage of our total sales. For example, sales to our top 10 customers accounted for approximately 42% of our total net revenue in 2001, with one customer, Aston, accounting for 11% of our net revenue. We expect that sales of our products to a limited number of customers will continue to account for a high percentage of our total sales for the foreseeable future. The loss or reduction of orders from a significant OEM or retail customer, including losses or reductions due to manufacturing, reliability or other difficulties associated with our products, changes in customer buying patterns, or market, economic or competitive conditions in the digital information security business or digital media and video business, could result in decreased revenues and/or inventory or receivables write-offs and otherwise harm our business and operating results.

We face risks related to our increased dependence on a retail distribution model for distribution of our Digital Media and Video products.

Historically, we sold substantially all our products directly to OEM customers. Following our acquisitions of Dazzle Multimedia and Microtech, we now sell a significant percentage of our products through our retail channel. Direct retail distribution creates additional risks for us including:

- increased exposure to demand cycles caused as a result of seasonal or economic trends;

- generally lower margins for products due to, among other factors, greater price competition and increased promotional and distribution costs;

- the need to develop, and the related marketing expense of developing brand recognition for our Dazzle and Microtech branded products;
- the need to protect the reputation of our brands for quality and value; and
- the need to successfully and cost-effectively maintain current retail channels and develop new retail distribution channels for these products.

We sell a substantial portion of our Digital Media and Video products through retailers, including Best Buy, CompUSA, Dixons/PC World, Fry s Electronics, Office Depot, Staples, Sears, B&H Photo, The Good Guys, MicroCenter and CameraWorld.com. Our retail distributors may have limited capital to invest in inventory, and their decisions to purchase our products are partly a function of pricing, terms and special promotions offered by us and our competitors over which we have no control and which we cannot predict. We could lose market share if the retailers that carry our products do not grow as quickly as retailers that carry our competitors products. Also, the amount of our products that retailers purchase is subject to factors we do not control. For instance, retailers decisions to purchase our products depend on pricing, terms and special promotions offered by our competitors. If retailers choose not to purchase our products or choose to purchase less than what we expect, our sales will decrease or not grow at the rate we expect.

We also sell our digital video products through distributors, including Ingram Micro, Northamber and Tech Data. Our distributor agreements are generally nonexclusive and may be terminated by either party without cause. If these agreements are terminated, we may not be able to find other distributors willing to purchase our digital video products. Certain distributors have experienced financial difficulties in the past. Distributors that account for significant sales of our consumer products may experience financial difficulties in the future, which could lead to reduced sales or write-offs.

Because a large percentage of our Digital Media and Video sales are to a small number of customers that are primarily retailers or distributors, this can exert pressure on our revenues generated from these customers. As a result of this pricing pressure, we have reduced and may need to continue to reduce the prices of some of our Digital Media and Video products. Any reduction in prices will negatively impact our gross margins unless we are able to reduce our costs. Also, some customers are requesting that we sell our products to them on a consignment basis. If we agree to these arrangements, our inventory levels will increase, and this will increase our costs and the risk of inventory write-offs.

We have global operations, which require significant managerial and administrative resources.

Operating in diverse geographic locations imposes significant burdens on our managerial resources. In particular, our management must:

- divert a significant amount of time and energy to manage employees and contractors from diverse cultural backgrounds and who speak different languages;
- manage different product lines for different markets;
- manage our supply and distribution channels across different countries and business practices; and
- coordinate these efforts to produce an integrated business effort, focus and vision.

In addition, we are subject to the difficulties associated with operating in a number of time zones, which may subject us to additional unforeseen difficulties or logistical barriers. Operating in widespread geographic locations requires us to implement and operate complex information and operational systems. In the future we may have to exert managerial resources and implement new systems that may be costly. Any failure or delay in implementing needed systems, procedures and controls on a timely basis or in expanding current systems in an efficient manner could have a material adverse effect on our business and operating results.

Table of Contents

Our key personnel are critical to our business, and such key personnel may not remain with us in the future.

We depend on the continued employment of our senior executive officers and other key management and technical personnel. If any of our key personnel leave and are not adequately replaced, our business would be adversely affected. We provide compensation incentives such as bonuses, benefits and option grants, which are typically subject to vesting over four years, to attract and retain qualified employees. In addition, certain of our executive officers are subject to one-year non-compete agreements. Non-compete agreements are, however, generally difficult to enforce. Employee retention may become more difficult because of the uncertainty associated with the separation of our Security and Digital Media and Video businesses. Even though we provide competitive compensation arrangements to our executive officers and other employees, we cannot be certain that we will be able to retain them, including those individuals that are subject to non-compete agreements.

We believe that our future success will depend in large part on our continuing ability to attract and retain highly qualified technical and management personnel. Competition for such personnel is intense, and we may not be able to retain our key technical and management employees or to attract, assimilate or retain other highly qualified technical and management personnel in the future.

Our OEM customers may develop technology similar to ours, resulting in a reduction in related customer purchases, canceled orders and direct competition from these customers.

We sell our products to many OEMs who incorporate our products into their offerings or who resell our products in order to provide a more complete solution to their customers. If our OEM customers develop their own products to replace ours, this would result in a loss of sales to those customers as well as increased competition for our products in the marketplace. In addition, these OEM customers could cancel outstanding orders for our products, which could cause us to write down inventory already designated for those customers.

The rapid growth of our businesses may create significant burdens on our systems.

Our business has grown substantially, with net revenue increasing from $23.6 million in 1995 to $184.9 million in 2001. We have expanded our Security business from solutions for the PC platform to include solutions for the digital television platform and have entered into the digital media and video markets. Managing businesses in each of these markets requires skilled management and substantial resources. To address our need for additional resources and because of various acquisitions, we have increased in size from 67 employees at December 31, 1995 to 515 as of March 31, 2002.

Our business model contemplates continued revenue growth. If we do not manage this growth effectively, our stock price and financial condition could be materially and adversely affected. Our growth and our growth plans have placed and are likely to continue to place a significant burden on our operating and financial systems and increase responsibility for senior management and other personnel. Our existing management or any new members of management may not be able to improve our existing systems and controls or implement new systems and controls in response to our anticipated growth. In addition, our intention to reduce or re-deploy personnel to reduce expenses from time to time may limit our capacity to grow.

Any delays in our normally lengthy sales cycle could result in significant fluctuations in our quarterly operating results.

Our initial sales cycle for a new OEM customer or retail distributor usually takes six to nine months. During this sales cycle, we may expend substantial financial resources and our management s time and effort with no assurance that a sale will ultimately result. The length of a new customer s sales cycle depends on a number of factors that we may not be able to control. These factors include the customer s product and technical requirements and the level of competition we face for that customer s business. Any delays in the sales cycle for new customers would limit our receipt of new revenue and might cause us to expend more resources to obtain new customer wins.

Table of Contents

We face risks associated with our past and future acquisitions.

A component of our business strategy is to seek to buy businesses, products and technologies that complement or augment our existing businesses, products and technologies. In 2000, we completed four acquisitions:

- Microtech in June 2000;
- 2-Tel B.V. in September 2000;
- Dazzle Multimedia in December 2000, by acquiring substantially all of the outstanding minority interest; and
- the Personal Video Division of FAST Multimedia in July 2000, an acquisition completed through Dazzle Multimedia.

The integration of the business and operations of any past or future acquisition is a complex, time consuming and expensive process. In order to successfully integrate any acquisition, we must, among other things, successfully:

- attract and retain key management and other personnel;
- integrate, both from an engineering and a sales and marketing perspective, the acquired products into our product offerings;
- coordinate research and development efforts;
- integrate sales forces;
- consolidate duplicate facilities; and
- cost effectively manage our combined business.

Past and future acquisitions may disrupt ongoing operations, divert management from day-to-day business and adversely impact our results of operations. In addition, these types of transactions often result in charges to earnings for such things as transaction expenses, amortization of goodwill, or expensing of in-process research and development. Our available cash and our securities may be used to buy or invest in companies or products, which could result in significant acquisition-related charges to earnings and dilution to our stockholders. Moreover, if we buy a company, we may have to incur or assume that company s liabilities, including liabilities that are unknown at the time of acquisition. We may be unable to complete any given acquisitions, which may limit the growth of our future revenues.

During the fourth quarter of 2001, the Company evaluated its intangible assets for possible impairment by examining a number of factors including the current economic conditions and markets of past acquisitions and their products, as well as the Company s best estimates for future revenues, cost of goods sold and operating costs related to those products. An independent valuation firm was used to assess the current value of these intangible assets given the information available. Based on the independent valuation firm s finding, the Company determined that the intangible assets from a number of past acquisitions were impaired. The Company recorded a $36.1 million impairment charge in 2001 in order to adjust intangible assets to their estimated fair value as of December 31, 2001.

Our business is subject to risks related to our international sales.

We were originally a German corporation, and we continue to conduct a substantial portion of our business in Europe. Approximately 58%, 48% and 52% of our revenues for the years ended December 31, 2001, 2000 and 1999, respectively, were derived from customers located outside the United States. Approximately 56% of our revenues for the quater ended March 31, 2002, 2000 and 1999, was derived from customers located outside the United States. Because a significant number of our principal customers are located in other countries, we anticipate that international

Table of Contents

sales will continue to account for a substantial portion of our revenues. As a result, a significant portion of our sales and operations may continue to be subject to certain risks, including:

- foreign currency exchange rate change, especially since we do not currently engage in hedging activities with respect to our foreign currency exposure;
- tariffs and other trade barriers, including import and export restrictions;
- potential adverse tax consequences;
- political or economic instability;
- compliance with foreign laws;
- difficulties in protecting intellectual property rights in foreign countries; and
- transportation delays and interruptions.

We could lose money and our stock price could decrease as a result of write downs of our strategic investments.

We have made strategic minority investments in private and public companies and in the future we may make additional strategic minority investments. Our strategic investments involve a number of risks and we have written down a number of these investments in 2001, including SmartDisk, Spyrus, and Satup. We may not realize the expected benefits of these transactions and we may lose all or a portion of our investment, particularly in the case of our private investments. If we were to lose these investments or if the investments were determined to be impaired, we would be forced to write off all or a portion of these investments, which would have a negative impact on our earnings in any given quarter.

Our products may have defects, which could damage our reputation, decrease market acceptance of our products, cause us to lose customers and revenue and result in liability to us, including costly litigation.

Highly complex products such as our Digital Media and Video hardware and software products may contain defects for many reasons, including defective design or defective material. Often, these defects are not detected until after the products have been shipped. If any of our products contain defects or have reliability, quality or compatibility problems, our reputation might be damaged significantly, we could lose or experience a delay in market acceptance of the affected product or products, and we might be unable to retain existing customers or attract new customers. In addition, these defects could interrupt or delay sales. We may have to invest significant capital, technical, managerial and other resources to correct potential problems and potentially divert these resources from other development efforts. If we fail to provide solutions to potential problems, we could also incur product recall, repair or replacement costs. These potential problems might also result in claims against us by our customers or others.

In addition, customers of our Security business rely on our token-based security products to prevent unauthorized access to their digital information. A malfunction of or design defect in our products could result in legal or warranty claims. Although we place warranty disclaimers and liability limitation clauses in our sales agreements and maintain product liability insurance, these measures may be ineffective in limiting our liability. Liability for damages resulting from security breaches could be substantial and the adverse publicity associated with this liability could adversely affect our reputation. These costs could have a material adverse effect on our business and operating results. In addition, a well-publicized security breach involving token-based and other security systems could adversely affect the market s perception of products like ours in general, or our products in particular, regardless of whether the breach is actual or attributable to our products. In that event, the demand for our products could decline, which would cause our business and operating results to suffer.

Table of Contents

Our business could suffer if we or our contract manufacturers cannot meet production requirements.

Most of our products are manufactured outside the United States because we believe that global sourcing enables us to achieve greater economies of scale, improve gross margins and maintain uniform quality standards for our products. Any significant delay in our ability to obtain adequate supplies of our products from our current or alternative sources would materially and adversely affect our business and operating results. In an effort to reduce our manufacturing costs, we have shifted volume production of many of our product components to our wholly owned subsidiary in Singapore, SCM Microsystems (Asia) Pte. Ltd. In addition, we use contract manufacturers in Europe and Asia. Foreign manufacturing poses a number of risks, including:

- transportation delays and interruptions;
- difficulties in staffing;
- currency fluctuations;
- potentially adverse tax consequences;
- unexpected changes in regulatory requirements;
- tariffs and other trade barriers; and
- political and economic instability.

If we or any of our contract manufacturers cannot meet our production requirements, we may have to rely on other contract manufacturing sources or identify and qualify new contract manufacturers. Despite efforts to do so, we may be unable to identify or qualify new contract manufacturers in a timely manner and these new manufacturers may not allocate sufficient capacity to us in order to meet our requirements.

We design and manufacture new products and technologies to address emerging markets that are early in their life cycles. In many cases, our products are the first of their kind to address the evolving business requirements of our customers. While we perform initial beta testing on all our products, in certain cases we are unable to test the efficacy of the design or functionality of our products for mass production. If we are successful in securing large contracts for our products, we cannot be certain that we will be able to produce them in sufficient quantities and that they will meet customer specifications.

We have a limited number of suppliers of key components.

We rely upon a limited number of suppliers of several key components of our products. For example, we currently utilize the foundry services of TEMIC, Philips and Atmel to produce our ASICs for our digital TV modules, we utilize the foundry services of Atmel and Samsung to produce our ASICS for our smart cards readers, and we purchase digital video compression chips from Zoran and LSI Logic and digital video editing software from Main Concept and DVD Cre8. Our reliance on only one supplier could impose several risks, including an inadequate supply of components, price increases, late deliveries and poor component quality. Disruption or termination of the supply of these components could delay shipments of our products. These delays could have a material adverse effect on our business and operating results and could also damage relationships with current and prospective customers.

We may be exposed to risks of intellectual property infringement by third parties.

Our success depends significantly upon our proprietary technology. We currently rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality agreements and contractual provisions to protect our proprietary rights. Our software, documentation and other written materials are protected under trade secret and copyright laws, which afford only limited protection. We generally enter into confidentiality and non-disclosure agreements with our employees and with key vendors and suppliers.

Our SmartOS and SmartReady trademarks are registered in the United States, and we continuously evaluate the registration of additional trademarks as appropriate. We currently have patents issued in both the United States and Europe and have other patent applications pending worldwide. In addition, we have licenses for various other U.S. and European patents associated with our products. Although we often seek to protect our proprietary technology through patents, it is possible that no new patents will be issued, that our proprietary products or technologies are not patentable or that any issued patent will fail to provide us with any competitive advantages.

There has been a great deal of litigation in the technology industry regarding intellectual property rights. Litigation may be necessary to protect our proprietary technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to use our proprietary information and software. In addition, the laws of some foreign countries do not protect proprietary and intellectual property rights to as great an extent as do the laws of the United States. Because many of our products are sold and a portion of our business is conducted overseas, primarily in Europe, our exposure to intellectual property risks may be higher. Our means of protecting our proprietary and intellectual property rights may not be adequate.

We may face claims of infringement of the intellectual rights of third parties, which could subject us to costly litigation, supplier and customer indemnification claims and the possible restriction on the use of our intellectual property.

We have from time to time received claims that we are infringing upon third parties intellectual property rights. Our suppliers and customers may also receive similar claims. We have historically agreed to indemnify suppliers and customers for alleged patent infringement. The scope of this indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorney s fees. We may periodically engage in litigation as a result of these indemnification obligations. Our insurance policies exclude coverage for third party claims for patent infringement.

As the number of products and competitors in our target markets grows, the likelihood of infringement claims also increases. Any claims or litigation may be time-consuming and costly, cause product shipment delays, or require us to redesign our products or enter into royalty or licensing agreements. If we are unable to modify our products or obtain a license on commercially reasonable terms, or at all, a competitor of ours or a claimant against us or our customers may stop us or our customers from selling the allegedly infringing products.

If we decide to incorporate third party technology into our products or if we are found to infringe on others intellectual property, we could be required to license intellectual property from a third party. We may also need to license some of our intellectual property to others in order to enable us to obtain cross-licenses to third party patents. We cannot be certain that licenses will be offered when we need them or that the terms offered will be acceptable. If we do obtain licenses from third parties, we may be required to pay license fees or royalty payments. In addition, if we are unable to obtain a license that is necessary to the manufacture of our products, we could be required to suspend the manufacture of products or stop our suppliers from using processes that may infringe the rights of third parties. We may be unsuccessful in redesigning our products or in obtaining the necessary licenses under reasonable terms or at all.

We may have to take back unsold Digital Media and Video inventory from our customers.

Although our contractual obligations to accept returned products from our retail, distributor and OEM customers are limited, if consumer demand is less than anticipated these customers may ask that we accept returned products. We may determine that it is in our best interest to accept returns in order to maintain good relations. While we have experienced some product returns to date, returns may increase even more than present levels in the future.

Our failure to promote our brand successfully and achieve strong brand recognition in our target markets could limit or reduce demand for our Digital Media and Video products.

We believe that brand recognition will be important to our success, particularly the recognizability of our Dazzle and Microtech brands. We plan to market these brands to increase awareness. If we fail to promote our brands successfully or if our marketing expenses are too large, our business may not grow as we anticipate. Also, if our products perform poorly or have other problems, the value of our brands will decrease.

Table of Contents

We may experience significant amortization charges and may have future non-recurring charges as a result of past acquisitions.

In connection with our previous acquisitions accounted for under the purchase method of accounting, in future periods we may experience significant charges related to the amortization of certain intangible assets. In addition, if we later determine that our intangible assets or goodwill are impaired, we will be required to take a related non-recurring charge to earnings.

Factors beyond our control could disrupt our operations and increase our expenses.

We face a number of potential business interruption risks that are beyond our control. In 2001, the State of California experienced:

- intermittent power shortages;
- sharp increases in the cost of energy; and
- interruptions of service to some business customers.

If power shortages continue to be a problem our business may be materially adversely effected. Additionally, we may experience natural disasters that could interrupt our business. Our corporate headquarters are located near a major earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure and overall operations is not known. Safety precautions have been implemented; however there is no guarantee that an earthquake would not seriously disturb our entire business process.

Table of Contents

USE OF PROCEEDS

We will not receive any proceeds from the sale of the shares by the selling stockholders. The selling stockholders will receive all the net proceeds from the sale of our common stock under this prospectus.

SELLING STOCKHOLDERS

The following table sets forth as of June 4, 2002 certain information with respect to the beneficial share ownership of the selling stockholders. Applicable percentage ownership in the following table is based on 15,616,334 shares of common stock outstanding as of June 4, 2002. Except as otherwise indicated, there has been no material relationship between any of the selling stockholders and the registrant in the past three years.

We have determined beneficial ownership in accordance with the rules of the Securities and Exchange Commission. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we include shares of common stock subject to options or warrants held by that person that are currently exercisable or will become exercisable within 60 days after June 4, 2002, while those shares are not included for purposes of computing percentage ownership of any other person. Unless otherwise indicated, the persons and entities named in the table have sole voting and investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

	Shares of Common Stock Beneficially Owned Prior to the Offering		Shares to be	Shares of Common Stock Beneficially Owned After the Offering	
Name of Selling Stockholder	Number	Percentage	Sold Pursuant to the Offering	Number	Percentage
Matthias Zahn	159,101	1.0%	159,101	0	*
Stefanie Koerner(1)	0	0%	0	0	*

(1) Mr. Zahn may transfer to Mrs. Koerner, his wife, any of the 159,101 shares.

Table of Contents

PLAN OF DISTRIBUTION

As used herein, the term selling stockholders includes donees and pledgees selling shares received from a selling shareholder named in this prospectus after the date of this prospectus. We have been advised by the selling stockholders that they intend to sell all or a portion of the shares offered hereby from time to time in the Nasdaq National Market and that sales will be made at prices prevailing in the Nasdaq National Market at the times of such sales. The selling stockholders may also make private sales directly or through a broker or brokers, who may act as agent or as principal. Further, the selling stockholders may choose to dispose of the shares offered hereby by gift to a third party or as a donation to a charitable or other non-profit entity. In connection with any sales, the selling stockholders and any brokers participating in such sales may be deemed to be underwriters within the meaning of the Securities Act of 1933, as amended (the Securities Act).

Any broker-dealer participating in such transactions as agent may receive commissions from the selling stockholders (and, if such broker acts as agent for the purchaser of such shares, from such purchaser). Usual and customary brokerage fees will be paid by the selling stockholders. All costs, expenses and fees in connection with the registration of the Shares offered hereby will be borne by the Company. Broker-dealers may agree with the selling stockholders to sell a specified number of shares at a stipulated price per share, and, to the extent such a broker-dealer is unable to do so acting as agent for the selling stockholders, to purchase as principal any unsold shares at the price required to fulfill the broker-dealer commitment to the selling stockholders. Broker-dealers who acquire shares as principal may thereafter resell such shares from time to time in transactions (which may involve crosses and block transactions and which may involve sales to and through other broker-dealers, including transactions of the nature described above) in the over-the-counter market, in negotiated transactions or otherwise at market prices prevailing at the time of sale or at negotiated prices, and in connection with such resales may pay to or receive from the purchasers of such shares commissions computed as described above.

We have advised the selling stockholders that Regulation M promulgated under the Exchange Act may apply to sales in the market and have informed them of the possible need for delivery of copies of this prospectus. The selling stockholders may indemnify any broker-dealer that participates in transactions involving the sale of the shares against certain liabilities, including liabilities arising under the Securities Act. Any commissions paid or any discounts or concessions allowed to any such broker-dealers, and, if any such broker-dealers purchase shares as principal, any profits received on the resale of such shares, may be deemed to be underwriting discounts and commissions under the Securities Act.

Upon our being notified by the selling stockholders that any material arrangement has been entered into with a broker-dealer for the sale of shares through a cross or block trade, a supplemental prospectus will be filed under Rule 424(c) under the Securities Act, setting forth the name of the participating broker-dealer(s), the number of shares involved, the price at which such shares were sold by the selling stockholders, the commissions paid or discounts or concessions allowed by the selling stockholders to such broker-dealer(s), and where applicable, that such broker-dealer(s) did not conduct any investigation to verify the information set out in this prospectus.

Any securities covered by this prospectus which qualify for sale pursuant to Rules 144 and 701 under the Securities Act may be sold under Rule 144 rather than pursuant to this prospectus. In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated), including any person who may be deemed to be our affiliate, is entitled to sell within any three month period restricted shares beneficially owned by him or her in an amount that does not exceed the greater of (i) 1% of the then outstanding shares