IDENTIVE GROUP, INC.
Form 10-Q
May 10, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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: 000-29440

IDENTIVE GROUP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

1900 Carnegie Avenue, Building B

Santa Ana, California 92705

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES INCLUDING ZIP CODE)

(949) 250-8888

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

N/A

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

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x	Smaller reporting company ¨

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

At April 30, 2013, 62,298,139 shares of common stock were outstanding, excluding 618,400 shares held in treasury.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2013	**2012**
Net revenues:		
Products	$ 16,890	$ 17,501
Services	4,174	3,705
Total net revenues	21,064	21,206
Cost of revenues:		
Products	10,343	10,446
Services	2,550	2,022
Total cost of revenues	12,893	12,468
Gross profit	8,171	8,738
Operating expenses:		
Research and development	2,010	2,491
Selling and marketing	5,719	7,008
General and administrative	4,604	5,524
Re-measurement of contingent consideration		429
Total operating expenses	12,333	15,452
Loss from operations	(4,162)	(6,714)
Interest expense, net	(687)	(291)
Foreign currency (loss) gain, net	(221)	220
Loss before income taxes and noncontrolling interest	(5,070)	(6,785)
Income tax benefit	114	179
Consolidated net loss	(4,956)	(6,606)
Less: Loss attributable to noncontrolling interest	175	377
Net loss attributable to Identive Group, Inc. stockholders equity	$ (4,781)	$ (6,229)
Basic and diluted net loss per share attributable to Identive Group, Inc. stockholders equity	$ (0.08)	$ (0.11)
Weighted average shares used to compute basic and diluted loss per share	60,233	58,599

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(unaudited)

	Three Months Ended March 31,	
	2013	**2012**
Consolidated net loss	$ (4,956)	$ (6,606)
Other comprehensive (loss) income, net of tax of nil:		
Unrealized gain on defined benefit plans	19	
Foreign currency translation (loss) gain	(183)	742
Total other comprehensive (loss) income	(164)	742
Consolidated comprehensive loss	(5,120)	(5,864)
Less: Comprehensive loss attributable to noncontrolling interest	238	417
Comprehensive loss attributable to Identive Group, Inc. stockholders equity	$ (4,882)	$ (5,447)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(unaudited)

	March 31, 2013	December 31, 2012 (A)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,485	$ 7,378
Accounts receivable, net of allowances of $395 and $401 as of March 31, 2013 and December 31, 2012, respectively	15,188	17,261
Inventories	10,498	8,892
Prepaid expenses and other current assets	3,590	3,659
Total current assets	34,761	37,190
Property and equipment, net	9,141	8,892
Goodwill	44,711	45,270
Intangible assets, net	11,439	11,882
Other assets	1,396	1,671
Total assets	$ 101,448	$ 104,905
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 13,336	$ 12,926
Liability to related party	1,548	1,552
Liability for consumer cards	5,705	5,811
Financial liabilities	5,046	4,532
Deferred revenue	3,164	2,843
Accrued compensation and related benefits	3,307	3,164
Other accrued expenses and liabilities	7,565	6,490
Total current liabilities	39,671	37,318
Long-term liability to related party	6,063	6,177
Long-term financial liabilities	8,590	9,795
Other long-term liabilities	2,238	2,025
Total liabilities	56,562	55,315
Commitments and contingencies (see Note 13)		
Stockholders Equity:		
Identive Group, Inc. stockholders equity:		
Preferred stock, $0.001 par value; 10,000 shares authorized; none issued and outstanding		
Common stock, $0.001 par value: 130,000 shares authorized; 60,878 and 60,809 shares issued and outstanding as of March 31, 2013 and December 31, 2012, respectively	61	61
Additional paid-in capital	338,227	337,811
Treasury stock, 618 shares as of March 31, 2013 and December 31, 2012, respectively	(2,777)	(2,777)

Accumulated deficit	(290,792)	(286,011)
Accumulated other comprehensive income	1,278	1,379
Total Identive Group, Inc. stockholders equity	45,997	50,463
Noncontrolling interest	(1,111)	(873)
Total stockholders equity	44,886	49,590
Total liabilities and stockholders equity	$ 101,448	$ 104, 905

A. The condensed consolidated balance sheet has been derived from the audited consolidated financial statements at December 31, 2012 but does not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

Year Ended December 31, 2012 and Three Months Ended March 31, 2013

(unaudited)

	Identive Group, Inc. Stockholders							
	Common Stock		Additional Paid-in			Accumulative Other		
(In thousands)	Shares	Amount	Capital	Treasury Stock	Accumulated Deficit	Comprehensive Income	Noncontrolling Interest	Total Equity
Balances, December 31, 2011	58,309	$ 58	$ 331,758	$ (2,777)	$ (235,675)	$ 1,777	$ 1,792	$ 96,933
Net loss					(50,336)		(3,232)	(53,568)
Other comprehensive loss						(398)	(35)	(433)
Issuance of common stock in connection with payment solution acquisition	1,358	1	3,040					3,041
Noncontrolling interest in connection with payment solution acquisition							2,131	2,131
Issuance of common shares to acquire additional noncontrolling interest in payment solution	548	1	1,167				(1,168)	
Acquisition of noncontrolling interest in idOnDemand			(139)				(361)	(500)
Issuance of common stock in connection with earn-out agreement	57		128					128
Issuance of common stock in connection with ESPP	298	1	340					341
Issuance of common stock in connection with stock bonus and incentive plans	239		420					420
Stock options grants in connection with stock bonus and incentive plans			99					99
Stock-based compensation expense for stock options			816					816
Stock-based compensation expense for ESPP			182					182
Balances, December 31, 2012	60,809	$ 61	$ 337,811	$ (2,777)	$ (286,011)	$ 1,379	$ (873)	$ 49,590
Net loss					(4,781)		(175)	(4,956)
Other comprehensive loss						(101)	(63)	(164)
Issuance of common stock in connection with ESPP	69		56					56
Stock-based compensation expense for stock options			296					296
Stock-based compensation expense for ESPP			64					64
Balances, March 31, 2013	60,878	$ 61	$ 338,227	$ (2,777)	$ (290,792)	$ 1,278	$ (1,111)	$ 44,886

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Three Months Ended March 31,	
	2013	**2012**
Cash flows from operating activities:		
Net loss	$ (4,956)	$ (6,606)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred income taxes	(117)	3
Depreciation and amortization	995	1,474
Accretion of interest to related party liability	171	188
Amortization of debt issuance costs	139	
Interest on financial liabilities	375	99
Re-measurement of contingent consideration		429
Stock-based compensation expense	475	504
Pension charges	105	
Changes in operating assets and liabilities:		
Accounts receivable	1,833	630
Inventories	(1,761)	(942)
Prepaid expenses and other assets	171	53
Accounts payable	792	818
Liability to related party	(272)	(263)
Deferred revenue	367	1,181
Accrued expenses and other liabilities	1,220	51
Net cash used in operating activities	(463)	(2,381)
Cash flows from investing activities:		
Capital expenditures	(568)	(1,480)
Net cash acquired from acquisitions		572
Net cash used in investing activities	(568)	(908)
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee stock purchase plan	56	178
Cash paid for acquisition of noncontrolling interest		(500)
Payments on financial liabilities	(1,026)	(385)
Net cash used in financing activities	(970)	(707)
Effect of exchange rates on cash and cash equivalents	108	96
Net decrease in cash and cash equivalents	(1,893)	(3,900)
Cash and cash equivalents at beginning of period	7,378	17,239
Cash and cash equivalents at end of period	$ 5,485	$ 13,339

Supplemental disclosures of cash flows information:		
Common stock issued in connection with business combinations	$	$ 3,041
Common stock issued in connection with stock bonus and incentive plans	$	$ 259
Stock option grants in connection with stock bonus and incentive plans	$	$ 117
Property and equipment subject to accounts payable	$ 285	$ 42
Leasehold improvements funded by lease incentives	$ 500	$

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Identive Group, Inc. (Identive or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of the Company s unaudited condensed consolidated financial statements have been included. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or any future period. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012. The preparation of unaudited condensed consolidated financial statements necessarily requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented. In our business overall, we may experience significant variations in demand for our products quarter to quarter, and overall we typically experience a stronger demand cycle in the second half of our fiscal year. As a result, the quarterly results may not be indicative of the full year results.

Going Concern

The accompanying condensed consolidated financial statements have been prepared under the assumption that the Company will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has historically incurred operating losses and has a total accumulated deficit of approximately $290.8 million as of March 31, 2013. These factors, among others, including the recent effects of the U.S. Government sequester and related budget uncertainty on certain parts of our business, have raised significant doubt about the Company s ability to continue as a going concern. The condensed consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

The ability to continue as a going concern is contingent upon the Company s ability to generate revenue and cash flow to meet its obligations on a timely basis and its ability to raise financing or dispose of certain noncore assets as required. The Company s plans may be adversely impacted if it fails to realize its assumed levels of revenues and expenses or savings from its cost reduction activities. If events, like the sequester, cause a significant adverse impact on its revenues, expenses or savings from its cost reduction activities, the Company may need to delay, reduce the scope of, or eliminate one or more of its development programs or obtain funds through collaborative arrangements with others that may require the Company to relinquish rights to certain of its technologies, or programs that the Company would otherwise seek to develop or commercialize itself, and to reduce personnel related costs. The Company may resort to contingency plans to make these needed cost reductions upon determination that funds will not be available in a timely matter. These contingency plans include consolidating certain functions, including integration of newly acquired entities into the group and elimination of duplicate general and administration expenses by expanding the scope of shared services in the Americas and European regions, or disposing of non-performing or underperforming assets. The Company may also need to raise additional funds through public or private offerings of additional debt or equity during the course of the year or in the near term as it may deem appropriate. The sale of additional debt or equity securities may cause dilution to existing stockholders. However, there can be no assurance that the Company will be able to raise such funds if and when they are required. Failure to obtain future funding when needed or on acceptable terms would adversely affect its ability to fund operations.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to current period presentation. In the consolidated statements of operations, amount related to re-measurement of contingent consideration was included in general and administrative in previous periods, which is now disclosed as a separate line item within operating expenses. In addition, net revenues and cost of revenues are split into products and services revenues and as a result, prior period revenues and cost of revenues have also been reclassified to conform to the current period presentation.

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Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (ASU 2013-02). The updated accounting standard is an amendment to ASU 2011-12, which requires companies to present information about reclassifications out of accumulated other comprehensive income in a single note or on the face of the financial statements. The updated standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted this standard effective January 1, 2013. The Company s adoption of this standard did not have a significant impact on its consolidated financial statements.

2. Acquisitions

Acquisition of payment solution AG

On January 30, 2012 (payment solution acquisition date), through its majority-owned subsidiary Bluehill ID AG, the Company acquired approximately 58.8% of the outstanding shares and thereby obtained control of payment solution AG, a company organized under the laws of Germany (payment solution). In exchange for the shares of payment solution, the Company issued an aggregate of 1,357,758 shares, or approximately 2.4% of its outstanding common stock, to the Selling Shareholders, having a value of approximately $3.0 million. On April 2, 2012, the Company acquired additional noncontrolling interest and increased its ownership to approximately 82.5% of the outstanding shares of payment solution. In exchange for the additional shares of payment solution, the Company issued 548,114 shares of its common stock to the Selling Shareholders, having a value of approximately $1.2 million.

The payment solution acquisition was accounted for under the acquisition method of accounting in accordance with Accounting Standards Codification (ASC) Topic 805, *Business Combinations* (ASC 805). During the fourth quarter of 2012, the Company finalized the measurement of identifiable acquired assets and assumed liabilities and as a result, the amounts of such assets and liabilities and the resulting goodwill and deferred income tax have changed as compared to the provisionally reported amounts in the Quarterly Report on Form 10-Q for the quarter ended March 31, 2012. The following table summarizes the final fair value of total consideration transferred for payment solution controlling and noncontrolling interests, the total fair value of net identifiable liabilities acquired at the payment solution acquisition date and the resulting goodwill recorded (in thousands):

Fair value of common stock	$ 3,041
Fair value of total consideration transferred	3,041
Fair value of noncontrolling interest	2,131
Fair value of controlling and noncontrolling interest	5,172
Fair value of net identifiable liabilities acquired	8,083
Goodwill	$ 13,255

The following table summarizes the final fair value of the assets acquired and liabilities assumed at the payment solution acquisition date. The fair value of the identifiable assets acquired and liabilities assumed in the acquisition was based on management s best estimates.

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Assets acquired and liabilities assumed as of January 30, 2012 (in thousands):

Cash and cash equivalents	$ 572
Accounts receivable	303
Inventory	34
Property and equipment	1,955
Other current assets	287
Accounts payable	(1,746)
Liabilities to related party	(432)
Liability for unclaimed consumer cards	(5,800)
Financial liabilities	(5,239)
Other accrued expenses and liabilities	(951)
Unfavorable contracts subject to amortization	(538)
Intangible assets subject to amortization	4,232
Deferred tax liabilities in connection with acquired intangible assets	(760)
Fair value of payment solution net identifable liabilities acquired	$ (8,083)

Of the total purchase consideration, $13.3 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the payment solution acquisition is assigned to the Company s Identity Management reportable segment in accordance with ASC 350, *Intangibles Goodwill and Other* (ASC 350). None of the goodwill recorded as part of the payment solution acquisition will be deductible for income tax purposes.

3. Fair Value Measurements

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

Level 1 Quoted prices (unadjusted) for identical assets and liabilities in active markets;

Level 2 Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly; and

Level 3 Unobservable inputs.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of March 31, 2013 and December 31, 2012, there were no assets and liabilities that are measured and recognized at fair value on a recurring basis. As of March 31, 2013 and December 31, 2012, the maximum possible amounts payable for contingent consideration are reflected in the table below; however, the earn-out liability remains zero as there were no significant changes in the range of outcomes for the contingent consideration for polyright and idOnDemand.

As of March 31, 2012, the Company s liability that was measured at fair value on a recurring basis includes contingent consideration by acquisition, and is as follows (in thousands):

	March 31, 2012			
	Maximum amount payable	Amount paid	Expense (income) recognized for changes in fair value	Amount outstanding
Contingent consideration:				
idOnDemand	$ 21,000	$	$ 412	$ 5,875
polyright	737		17	329
	$ 21,737	$	$ 429	$ 6,204

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The sellers of polyright and idOnDemand are eligible to receive limited earn-out payments (contingent consideration) in the form of shares of common stock subject to certain lock-up periods under the terms of their respective acquisition agreements. The fair value of the contingent consideration is based on achieving certain revenue and profit targets as defined under the applicable acquisition agreement. These contingent payments are probability weighted and are discounted to reflect the restriction on the resale or transfer of such shares. The valuation of the contingent consideration is classified as a Level 3 measurement because it is based on significant unobservable inputs and involves management judgment and assumptions about achieving revenue and profit targets and discount rates. The unobservable inputs used in the measurement of contingent consideration are highly sensitive to fluctuations and any changes in the inputs or the probability weighting thereof could significantly change the measured value of the contingent considerations at each reporting period. The fair value of the contingent consideration is classified as a liability and is re-measured each reporting period in accordance with ASC 480, *Distinguishing Liabilities from Equity* (ASC 480). As of March 31, 2012, the Company remeasured the total contingent consideration to fair value and recognized $0.4 million as an expense during the three months ended March 31, 2012, as disclosed in the condensed consolidated statements of operations.

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

As of March 31, 2013, there were no assets and liabilities that are measured and recognized at fair value on a non-recurring basis.

As of December 31, 2012, there were no liabilities that are measured and recognized at fair value on a non-recurring basis. The Company s intangible assets are measured at fair value on a non-recurring basis if impairment is indicated. During the year ended December 31, 2012, intangible assets were measured at fair value resulting in an impairment charge of $24.8 million which was recorded in its consolidated statements of operations. The Company measured the fair value of these assets primarily using discounted cash flow projections. The discounted cash flow projections requires estimates for expected performance such as revenue, gross margin and operating expenses, in order to discount the sum of future independent cash flows using discount rates which were determined based on an analysis of each individual identified intangible asset group and consideration of the aggregate business of the Company. The discount rates used in the present value calculations were in the range of 16% to 20%, except for one asset group where it was 50%. The discount rates were derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset s characteristics. The Company evaluated the inputs and outcomes of its discounted cash flow analysis by comparing these items to available market data. Acquired intangible assets are classified as Level 3 assets, due to the absence of quoted market prices. See Note 7, Goodwill and Intangibles Assets, for further information.

4. Stockholders Equity of Identive Group, Inc.

2011 Employee Stock Purchase Plan

In June 2011, Identive s stockholders approved the 2011 Employee Stock Purchase Plan (the ESPP). Initially, 2.0 million shares of common stock are reserved for issuance over the term of the ESPP, which is ten years. In addition, on the first day of each fiscal year commencing with fiscal year 2012, the aggregate number of shares reserved for issuance under the ESPP is automatically increased by a number equal to the lowest of (i) 750,000 shares, (ii) two percent of all shares outstanding at the end of the previous year, or (iii) an amount determined by the Board. If any option granted under the ESPP expires or terminates for any reason without having been exercised in full, the unpurchased shares subject to that option will again be available for issuance under the ESPP. Under the ESPP, eligible employees may purchase shares of common stock at 85% of the lesser of the fair market value of the Company s common stock at the beginning of or end of the applicable offering period and each offering period lasts for six months. The first six-month exercise period under the ESPP commenced on July 1, 2011. The plan contains an automatic reset feature under which if the fair market value of a share of common stock on any exercise date (except the final scheduled exercise date of any offering period) is lower than the fair market value of a share of common stock on the first trading day of the offering period in progress, then the offering period in progress shall end immediately following the close of trading on such exercise date, and a new offering period shall begin on the next subsequent January 1 or July 1, as applicable, and shall extend for a 24-month period ending on December 31 or June 30, as applicable. As of June 30, 2012 and December 31, 2011, the plan automatically reset and a new offering period began on July 1, 2012 and January 1, 2012, respectively. As of January 1, 2013 and 2012, respectively, the aggregate number of shares reserved for issuance under the ESPP is automatically increased by 750,000 shares each in accordance with the terms of the plan. There were 68,606 shares of common stock issued under the ESPP during the quarter ended March 31, 2013. As of March 31, 2013, there are 3,133,153 shares reserved for future grants under the ESPP.

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The following table illustrates the stock-based compensation expense resulting from the ESPP included in the consolidated statements of operations for the quarter ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cost of revenue	$ 16	$ 5
Research and development	12	5
Selling and marketing	19	9
General and administrative	17	7
Total	$ 64	$ 26

As of March 31, 2013, there was $0.2 million of total unrecognized compensation cost related to the ESPP that is expected to be recognized on a straight-line basis over the remaining vesting periods of fifteen months.

Stock-Based Compensation Plans

The Company has various stock-based compensation plans to attract, motivate, retain and reward employees, directors and consultants by providing its Board of Directors (the Board) or a committee thereof the discretion to award equity incentives to these persons. The Company s stock-based compensation plans, the majority of which are stockholder approved, consist of the Director Option Plan, 1997 Stock Option Plan, 2000 Stock Option Plan, 2007 Stock Option Plan (the 2007 Plan), the Bluehill ID AG Executive Bonus Plan and Share Option Plan (the Bluehill Plans), the 2010 Bonus and Incentive Plan (the 2010 Plan), and the 2011 Incentive Compensation Plan (the 2011 Plan).

Stock Bonus and Incentive Plans

In connection with its acquisition of Bluehill ID AG in January 2010, the Company assumed the Bluehill Plans, pursuant to which options to purchase 2.0 million shares of the Company s common stock may be granted to executives, key employees and other service providers, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), based upon the achievement of certain performance targets or other terms and conditions as determined by the administrator of the plans. No grants have been made under these plans since the date of assumption.

In June 2010, Identive s stockholders approved the 2010 Plan, under which cash and equity-based awards may be granted to executive officers, including the CEO and CFO, and other key employees (Participants) of the Company and its subsidiaries and members of the Company s Board, as designated from time to time by the Compensation Committee of the Board. An aggregate of 3.0 million shares of the Company s common stock was reserved for issuance under the 2010 Plan as equity-based awards, including shares, nonqualified stock options, restricted stock or deferred stock awards. These awards provide the Company s executives and key employees with the opportunity to earn shares of common stock depending on the extent to which certain performance goals are met. For services rendered, Company executives are eligible to receive an incentive bonus in cash and shares of the Company s common stock with certain lock-up periods. In addition, the Company s executives and key employees are eligible to receive a grant of non-qualified stock options in an amount equal to 20% of the number of U.S. dollars in the participant s base salary. The Compensation Committee may make incentive awards based on such terms, conditions and criteria as it considers appropriate, including awards that are subject to the achievement of certain performance criteria. Stock awards are generally fully vested at the time of grant, but subject to a 24-month lock-up from the date of grant. Because the award of share-based payments described above represents an obligation to issue a variable number of the Company s shares determined on the basis of a monetary value derived solely on variations in an operating performance measure (and not on the basis of variations in the fair value of the entity s equity shares), the award is considered a share-based liability in accordance with ASC 480 and is remeasured to fair value each reporting period. Since the adoption of the 2011 Plan (described below), the Company utilizes shares from the 2010 Plan only for performance-based awards to Participants and all equity awards granted under the 2010 Plan are issued pursuant to the 2011 Plan. As of March 31, 2013, a total of 1.0 million shares have been issued pursuant to the 2011 Plan.

On June 6, 2011, Identive s stockholders approved the 2011 Plan, which is administered by the Compensation Committee of the Board of Directors. The 2011 Plan provides that stock options, stock units, restricted shares, and stock appreciation rights may be granted to officers, directors, employees, consultants, and other persons who provide services to the Company or any related entity. The 2011 Plan serves as a successor plan to the Company s 2007 Plan. The Company reserved 4.0 million shares of common stock under the 2011 Plan, plus 4.6 million shares common stock that remained available for delivery under the 2007 Plan and the 2010 Plan as of June 6, 2011. In aggregate, as of June 6,

2011, 8.6 million shares were available for future grants under the 2011 Plan, including shares rolled over from 2007 Plan and 2010 Plan. From June 6, 2011 through March 31, 2013, a total of 2.8 million options have been granted pursuant to the 2011 Plan.

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Stock-Based Compensation Expense (Stock Bonus and Incentive Plans)

The following table illustrates the stock-based compensation expense resulting from stock bonus and incentive plans included in the condensed consolidated statements of operations for the three months ended March 31,2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cost of revenue	$	$ 1
Research and development		8
Selling and marketing	52	93
General and administrative	63	260
Total	$ 115	$ 362

The total amounts for the three months ended March 31, 2013 and 2012 were accrued for and included in the accrued compensation and related benefits in the consolidated balance sheets as of March 31, 2013 and 2012, respectively.

Stock Option Plans

The Company s stock options plans are generally time-based and expire seven to ten years from the date of grant. Vesting varies, with some options vesting 25% each year over four years; some vesting 25% after one year and monthly thereafter; some vesting 100% on the date of grant; some vesting 1/12th per month over one year; some vesting 100% after one year; some vesting monthly over four years; and some vesting 1/12th per month, commencing four years from the date of grant. The Director Option Plan and 1997 Stock Option Plan both expired in March 2007. The 2000 Stock Option Plan expired in December 2010 and as noted above, the 2007 Plan was discontinued in June 2011 in connection with the approval of the 2011 Plan. As a result, options will no longer be granted under any of these plans.

As of March 31, 2013, an aggregate of approximately 0.2 million options were outstanding under the Director Option Plan and 1997 Stock Option Plan, 0.3 million options were outstanding under the 2000 Stock Option Plan, 1.1 million options were outstanding under the 2007 Plan, and 2.6 million options were outstanding under the 2011 Plan. These outstanding options remain exercisable in accordance with the terms of the original grant agreements under the respective plans.

A summary of the activity under the Company s stock-based compensation plans for the quarter ended March 31, 2013 and for the year ended December 31, 2012 is as follows:

	Stock Options					Stock Awards	
	Shares Available for Grant	Number Outstanding	Average Exercise Price per share	Average Intrinsic Value	Remaining Contractual Life (in years)	Number Granted	Fair Value
Balance at Janurary 1, 2012	10,114,332	2,266,821	$ 2.86	$ 49,298	5.90		
Authorized							
Granted	(2,447,033)	2,208,110	$ 1.17			238,923	$ 419,824
Cancelled or Expired	101,740	(425,959)	$ 2.85				
Exercised							
Balance at December 31, 2012	7,769,039	4,048,972	$ 1.94	$ 825,309	7.43		
Authorized							
Granted	(250,000)	250,000	$ 1.34				
Cancelled or Expired	57,057	(90,873)	$ 1.59				

Exercised		(188)	$	0.72		
Balance at March 31, 2013	7,576,096	4,207,911	$	1.91	$ 794,795	7.14
Vested or expected to vest at March 31, 2013		3,933,038	$	1.96	$ 696,324	6.98
Exercisable at March 31, 2013		2,700,947	$	2.28	$ 284,591	5.97

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The following table summarizes information about options outstanding as of March 31, 2013:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.72 - $ 1.09	717,625	9.39	$ 0.80	146,313	$ 0.89
$1.10 - $ 1.20	927,215	8.70	1.20	707,653	1.20
$1.21 - $ 2.26	874,091	8.79	1.65	282,952	2.04
$2.27 - $ 2.63	988,748	5.66	2.51	883,884	2.52
$2.64 - $ 8.34	700,232	2.81	3.47	680,145	3.49
$0.72 - $ 8.34	4,207,911	7.14	$ 1.91	2,700,947	$ 2.28

The weighted-average grant date fair value per option for options granted during the three months ended March 31, 2013 and 2012 was $1.34 and $2.00, respectively. 188 options were exercised during the three months ended March 31, 2013 and no options were exercised during the three months ended March 31, 2012. Cash proceeds from the exercise of stock options were $135 and zero during the three months ended March 31, 2013 and 2012, respectively.

Stock-Based Compensation Expense (Stock Options)

The following table illustrates the stock-based compensation expense resulting from stock options included in the condensed consolidated statements of operations for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cost of revenue	$ 4	$ 3
Research and development	22	8
Selling and marketing	99	60
General and administrative	171	45
Stock-based compensation expense, net of income taxes of nil	$ 296	$ 116

At March 31, 2013, there was $0.9 million of unrecognized stock-based compensation expense, net of estimated forfeitures related to non-vested options, that is expected to be recognized over a weighted-average period of 2.84 years.

Common Stock Reserved for Future Issuance

As of March 31, 2013, the Company has reserved an aggregate of approximately 14.8 million shares of its common stock for future issuance under its various equity incentive plans, of which approximately 5.5 million shares are reserved for future grants under the 2011 Plan and 2010 Plan, approximately 4.2 million shares are reserved for future issuance pursuant to outstanding options under all other stock option and incentive plans, 3.1 million shares are reserved for future issuance under the ESPP and approximately 2.0 million shares are reserved for future issuance under the Bluehill Plans.

As of March 31, 2013, the Company has reserved an aggregate of approximately 3.3 million shares of common stock for future issuance in connection with its acquisition of Bluehill ID, consisting of approximately 2.0 million shares for the outstanding options assumed at the closing of the Bluehill ID acquisition and approximately 1.3 million shares for the noncontrolling shareholders of Bluehill ID.

As of March 31, 2013, the Company has reserved an aggregate of approximately 8.6 million shares of common stock for future issuance pursuant to outstanding warrants, consisting of approximately 3.7 million shares pursuant to outstanding warrants in connection with its November 2010 private placement and approximately 4.9 million shares pursuant to outstanding warrants in connection with its April 2009 acquisition of Hirsch.

As of March 31, 2013, the Company has reserved an aggregate of approximately 6.9 million shares of common stock for future issuance for contingent consideration in connection with its acquisition of idOnDemand and polyright, consisting of approximately 6.7 million shares and approximately 0.2 million shares, respectively.

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Net Loss per Common Share Attributable to Identive Group, Inc. Stockholders Equity

Basic and diluted net loss per share is based upon the weighted average number of common shares outstanding during the period. For the three months ended March 31, 2013 and 2012, common stock equivalents consisting of outstanding stock options and warrants were excluded from the calculation of diluted loss per share because these securities were anti-dilutive due to the net loss in the respective period. For the three months ended March 31, 2013 and 2012, the total number of shares excluded from diluted loss per share relating to these securities was 2,139,840 and 2,305,108, respectively.

5. Inventories

The Company s inventories are stated at the lower of cost or market. Inventories consist of (in thousands):

	March 31 2013	December 31 2012
Raw materials	$ 4,216	$ 4,002
Work-in-process	645	248
Finished goods	5,637	4,642
Total	$ 10,498	$ 8,892

6. Property and Equipment

Property and equipment, net consists of (in thousands):

	March 31 2013	December 31 2012
Land	$ 275	$ 282
Building and leasehold improvements	2,443	1,988
Furniture, fixture and office equipment	5,148	5,067
Machinery	9,654	9,789
Software	2,030	1,812
Total	19,550	18,938
Accumulated depreciation	(10,409)	(10,046)
Property and equipment, net	$ 9,141	$ 8,892

The Company recorded depreciation expense of approximately $0.6 million and $0.5 million during the three months ended March 31, 2013 and 2012, respectively. A net increase of $0.4 million in accumulated depreciation is due to depreciation expense of $0.6 million recorded during the year, offset by change in foreign exchange rates between the balance sheet dates of $0.2 million.

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7. Goodwill and Intangible Assets

Goodwill

The following table presents goodwill and changes in the carrying amount of goodwill for each of the Company s business segments as of March 31, 2013, and December 31, 2012 (in thousands):

	Total	Identity Management	ID Products
Balance at December 31, 2011	$ 59,044	$ 49,478	$ 9,566
Goodwill acquired during the period	12,958	12,958	
Goodwill impairment during the period	(27,084)	(18,712)	(8,372)
Goodwill measurement period adjustment	297	297	
Currency translation adjustment	55	16	39
Balance at December 31, 2012	45,270	44,037	1,233
Currency translation adjustment	(559)	(529)	(30)
Balance at March 31, 2013	$ 44,711	$ 43,508	$ 1,203

The gross amount of goodwill was $72.4 million and accumulated goodwill impairment was $27.1 million as of March 31, 2013 and December 31, 2012. Of the total goodwill, a certain amount of goodwill is designated in a currency other than U.S. Dollars and is adjusted at each reporting period for the change in foreign exchange rates between the balance sheet dates. In accordance with its accounting policy and ASC 350, the Company tests its goodwill and any other intangibles with indefinite lives annually for impairment and assesses whether there are any indicators of impairment on an interim basis. Management did not identify any impairment indicators during the three months ended March 31, 2013.

The Company performed its annual impairment test for all reporting units on December 1, 2012 and concluded that there was no impairment to goodwill during the year ended December 31, 2012, other than the impairment identified in its interim assessment. During the second quarter of 2012, the Company experienced a significant decline in its stock price and the Company s demand outlook deteriorated due to macroeconomic uncertainty and associated softness in demand for the Company s offerings. These factors were considered indicators of potential impairment, and as a result, the Company performed an interim goodwill impairment analysis as part of its quarterly close as of June 30, 2012. Prior to its goodwill impairment test, the Company first tested its long-lived assets for impairment and adjusted the carrying value of each asset group to its fair value and recorded the associated impairment charge in its consolidated statements of operations. The Company then performed its analysis of goodwill impairment using a two-step method as required by ASC 350. The first step of the impairment test compared the fair value of each reporting unit to its carrying value, including the goodwill related to the respective reporting units. At the time the impairment test was performed, the Company determined that it had six reporting units consisting of Hirsch, ID Solutions (formerly known as Multicard), payment solution and idOnDemand, which are the four components of the Identity Management segment, and ID Infrastructure and Transponders, which are the two components of the ID Products segment. The Company calculated the fair value of the reporting units using a combination of the market and income approaches. Based on the results of step one of the goodwill impairment analysis, it was determined that the Company s net adjusted carrying value exceeded its estimated fair value for the idOnDemand, Transponder and ID Solutions reporting units. As a result, the Company proceeded to the second step of the impairment test for these three reporting units to determine the implied fair value of goodwill and compare it to the carrying amount of that goodwill to determine impairment loss.

During the second step of the goodwill impairment review, management estimated the fair value of the Company s tangible and intangible net assets. The difference between the estimated fair value of each reporting unit and the sum of the fair value of the identified net assets results in the implied value of goodwill. Based on the results of step two of the goodwill impairment analysis, the Company concluded that the carrying value of goodwill for the idOnDemand, Transponder and ID Solutions reporting units was impaired and recorded an impairment charge of $27.1 million in its consolidated statements of operations during the year ended December 31, 2012. Future impairment indicators, including further declines in the Company s market capitalization or changes in forecasted future cash flows, could require additional impairment charges.

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Intangible Assets

The following table summarizes the gross carrying amount and accumulated amortization for the intangible assets resulting from acquisitions (in thousands):

	Order Backlog	Trade Secrets	Patents	Existing Technology	Customer Relationship	Trade Name	Total
Cost:							
Amortization period	0.25 - 1 year	1 - 2 years	12 years	6 - 15 years	4 - 15 years	1 - 10 years	Total
Balance at December 31, 2011	$ 948	$ 300	$ 790	$ 8,170	$ 24,795	$ 9,367	$ 44,370
Acquired as a part of payment solution acquisition	344			2,023	1,323	542	4,232
Impairment of intangible assets	(1,018)	(300)	(790)	(5,489)	(15,210)	(9,294)	(32,101)
Currency translation adjustment	3			(104)	(176)	(45)	(322)
Balance at December 31, 2012	$ 277	$	$	$ 4,600	$ 10,732	$ 570	$ 16,179
Currency translation adjustment	(8)				(11)		(19)
Balance at March 31, 2013	$ 269	$	$	$ 4,600	$ 10,721	$ 570	$ 16,160
Accumulated Amortization							
Balance at December 31, 2011	$ (948)	$ (120)	$ (44)	$ (1,295)	$ (5,924)	$ (38)	$ (8,369)
Amortization expense	(72)	(90)	(33)	(695)	(2,055)	(332)	(3,277)
Impairment of intangible assets	959	210	77	865	5,118	87	7,316
Currency translation adjustment	(10)				45	(2)	33
Balance at December 31, 2012	$ (71)	$	$	$ (1,125)	$ (2,816)	$ (285)	$ (4,297)
Amortization expense	(20)			(76)	(196)	(143)	(435)
Currency translation adjustment	3				8		11
Balance at March 31, 2013	$ (88)	$	$	$ (1,201)	$ (3,004)	$ (428)	$ (4,721)
Intangible Assets, net at March 31, 2013	$ 181	$	$	$ 3,399	$ 7,717	$ 142	$ 11,439
Intangible Assets, net at December 31, 2012	$ 206	$	$	$ 3,475	$ 7,916	$ 285	$ 11,882

Of the total intangible assets, certain acquired intangible assets are designated in a currency other than U.S. Dollars and are adjusted each reporting period for the change in foreign exchange rates between the balance sheet dates.

As noted above, the Company performed an interim goodwill impairment analysis as of June 30, 2012 and in conjunction also performed an impairment analysis for intangible assets. Management determined the estimated undiscounted cash flows and the fair value of the identified intangible assets to measure the impairment loss. The impairment analysis for intangible assets indicated that some of the identified intangible assets are not recoverable as the sum of its estimated future undiscounted cash flows were below the asset s carrying value. Accordingly, the Company estimated the fair value of these identified intangible assets using a discounted cash flow analysis to measure the impairment loss. As a result of this analysis, the Company concluded that certain of its intangible assets were impaired and recorded an impairment charge of $24.8 million in its consolidated statements of operations during the year ended December 31, 2012.

Intangible assets subject to amortization are amortized over their useful lives as shown in the table above. The Company evaluated its amortizable intangible assets for impairment as of March 31, 2013 and December 31, 2012 and concluded that no indicators of impairment existed as of the respective dates. The Company expects to recover the remaining balance of identified intangible assets of $11.4 million at March 31, 2013.

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The following table illustrates the amortization expense included in the consolidated statements of operations for the quarter ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cost of revenue	$ 96	$ 337
Selling and marketing	339	824
Total	$ 435	$ 1,161

The estimated future amortization expense of intangible assets for the next five years is as follows (in thousands):

March 31, 2013:	
2013 (remaining nine months)	$ 1,017
2014	1,074
2015	1,042
2016	997
2017	997
Thereafter	6,312
Total	$ 11,439

8. Related-Party Transactions

Prior to the Company s acquisition of Hirsch Electronics Corporation (Hirsch), effective November 1994, Hirsch had entered into a settlement agreement (the 1994 Settlement Agreement) with two limited partnerships: Secure Keyboards, Ltd. (Secure Keyboards) and Secure Networks, Ltd. (Secure Networks). Secure Keyboards and Secure Networks were related to Hirsch through certain common shareholders and limited partners, including Hirsch s then-president Lawrence Midland, who is now a senior vice president and a director of the Company. Following the acquisition of Hirsch, Mr. Midland continues to own 30% of Secure Keyboards and 9% of Secure Networks.

On April 8, 2009, Secure Keyboards, Secure Networks and Hirsch amended and restated the 1994 Settlement Agreement to replace the royalty-based payment arrangement under the 1994 Settlement Agreement with a new, definitive installment payment schedule with contractual payments to be made in future periods through 2020 (the 2009 Settlement Agreement). Prior to the acquisition of Hirsch by the Company, the Company was not a party to the 2009 Settlement Agreement. The Company has, however, provided Secure Keyboards and Secure Networks with a limited guarantee of Hirsch s payment obligations under the 2009 Settlement Agreement (the Guarantee). The 2009 Settlement Agreement and the Guarantee became effective upon the acquisition of Hirsch on April 30, 2009. Hirsch s annual payment to Secure Keyboards and Secure Networks in any given year under the 2009 Settlement Agreement is subject to increase based on the percentage increase in the Consumer Price Index during the prior calendar year.

The final payment to Secure Networks was due on January 30, 2012 and the final payment to Secure Keyboards is due on January 30, 2021. Hirsch s payment obligations under the 2009 Settlement Agreement will continue through the calendar year period ending December 31, 2020, unless Hirsch elects at any time on or after January 1, 2012 to earlier satisfy its obligations by making a lump-sum payment to Secure Keyboards.

The Company recognized $0.2 million and $0.2 million of interest expense for the interest accreted on the discounted liability amount during the three months ended March 31, 2013 and 2012, respectively, which is included as a component of interest expense, net in its condensed consolidated statements of operations. As of March 31, 2013 and December 31, 2012, approximately $7.2 million and $7.3 million, respectively, were outstanding for related-party liability in connection with Hirsch acquisition, of which approximately $1.1 million and $1.1 million, respectively, were shown as a current liability on the condensed consolidated balance sheets.

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The payment amounts for related-party liability in connection with the Hirsch acquisition for the next five years are as follows (in thousands):

March 31, 2013:	
2013 (remaining nine months)	$ 823
2014	1,131
2015	1,176
2016	1,223
2017	1,272
Thereafter	4,616
Present value discount factor	(3,081)
Total	$ 7,160

In connection with its acquisition of payment solution, through its majority-owned subsidiary, Bluehill ID AG, the Company assumed an unsecured loan payable to Mountain Partners AG, a significant shareholder of the Company. At the inception of the loan agreement, an amount of 250,000 was provided for working capital needs. An amount of 327,000, or approximately $0.4 million, was outstanding as of the payment solution acquisition date of January 30, 2012. The loan carries an interest rate of 8% per year. There are no specific payment terms and the amount outstanding under the loan agreement, including accrued interest, is due to be paid upon demand by Mountain Partners AG. The Company recorded interest expense on the loan of $9,000 during three months ended March 31, 2013 which is included as a component of interest expense, net, on the consolidated statements of operations. As of March 31, 2013 and December 31, 2012, approximately $0.5 million and $0.5 million, respectively, were outstanding under the loan, which is shown as a current liability on the condensed consolidated balance sheets.

9. Financial Liabilities

Financial liabilities consist of (in thousands):

	March 31, 2013	December 31, 2012
Current liabilities:		
Secured note	$ 3,230	$ 2,404
Acquisition debt note	209	418
Equipment financing liabilities	984	973
Bank loan	333	428
Bank line of credit	235	253
Mortgage loan payable to bank	55	56
Total current liabilities	$ 5,046	$ 4,532
Non-current liabilities:		
Secured note	$ 5,417	$ 6,167
Equipment financing liabilities	1,315	1,619
Bank loan	1,166	1,284
Mortgage loan payable to bank	692	725
Total non-current liabilities	$ 8,590	$ 9,795
Total	$ 13,636	$ 14,327

Secured Debt Facility

On October 30, 2012, the Company entered into a Loan and Security Agreement (the Loan Agreement) with Hercules Technology Growth Capital, Inc. (the Lender). The Loan Agreement provides for a term loan in aggregate principal amount of up to $10.0 million with an initial drawdown of $7.5 million and, provided certain financial and other requirements are met, an additional $10.0 million in loan advances, all upon the terms and conditions set forth in the Loan Agreement. The initial drawdown of $7.5 million is reflected in the Secured Term Promissory Note dated October 30, 2012 (the Secured Note). The obligations of the Company under the Loan Agreement and the Secured Note are secured by substantially all assets of the Company (Collateral). The Company received net proceeds of approximately $6.9 million after incurring approximately $0.6

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million in issuance costs related to the Secured Note. The issuance costs were accounted for in accordance with ASC Topic 835-30, *Imputation of Interest* (ASC 835-30). Amongst other commitments, the Loan Agreement requires the Company to maintain a certain amount of revenue, EBITDA, and current ratio on a consolidated basis (covenants). If any covenants are not met, the violation may constitute an event of default. Upon the occurrence and during the continuance of an event of default, the Lender may, at its option, do any of the following, including: accelerate and demand payment of all or any part of the secured obligations together with a prepayment charge, declare all obligations immediately due and payable, and release, hold, sell, lease, liquidate, collect, realize upon, or otherwise dispose of all or any part of the collateral and the right to occupy, utilize, process and commingle the Collateral. The agreement also provides for definitions and construction of the Loan Agreement, terms of payment, conditions of loans, creation of security interest, representations and warranties, affirmative and negative covenants, events of default, and the Lender s rights and remedies. In addition, under the terms of the Loan Agreement, the Company and its subsidiaries are restricted in their ability to declare or pay cash dividends or to make cash distributions, except that the Company s subsidiaries may pay dividends and make distributions to the Company. The Loan Agreement provides that, subject to the terms and conditions contained therein (including compliance with financial covenants), beginning October 1, 2013 and continuing until December 31, 2013, the Company may request an additional advance in an aggregate amount up to $2.5 million. After full drawdown of the $10.0 million term loan, the Company has the opportunity to secure additional advances up to a further $10.0 million subject to compliance with certain conditions and covenants as set out in the Loan Agreement or as may be otherwise required by the Lender. The Secured Debt Note matures on November 1, 2015 and bears interest at a rate of the greater of (i) the prime rate plus 7.75% and (ii) 11.00%. Interest on the Secured Note is payable monthly beginning on November 1, 2012, and the principal balance is payable in 30 equal monthly installments beginning on May 1, 2013. In connection with the initial advance, the Company paid a $150,000 facility charge to the Lender, of which 50% will be credited to the Company if all advances under the Loan Agreement are repaid on but not before maturity. The Company may prepay outstanding amounts under the Secured Note, subject to certain prepayment charges as set out in the Loan Agreement. The Company will also pay additional fees to the Lender in the aggregate of $1,000,000, payable in three equal annual installments beginning on October 30, 2013. The entire amount of these fees is immediately due and payable if the Company prepays all of its obligations under the Loan Agreement or if the Lender declares all obligations due and payable after an event of default thereunder. The Company recorded interest expense on the Secured Note of approximately $0.4 million during the three months ended March 31, 2013 in its condensed consolidated statements of operations. The Company initiated discussions with the Lender early in 2013 as it became apparent that certain of the covenant thresholds would prove difficult to maintain. The Company and the Lender entered into an amendment to the Loan Agreement on March 5, 2013 that reduced the monthly EBITDA requirement for the period January 1, 2013 through May 31, 2013. The Company entered into a second amendment to the Loan Agreement on April 22, 2013 that changes the period for the measurement of EBITDA to occur on a quarterly, rather than monthly basis. As of March 31, 2013, the Company was in compliance with all covenants.

Acquisition Debt Note

In connection with its acquisition of FCI Smartag Pte. Ltd. (Smartag) in November 2010, the Company issued a debt note with a face value of $2.2 million to FCI Asia Pte. Ltd. The debt note carries an interest rate of 6% per year, compounded daily, and is payable within 30 months from the closing date. The Company is obligated to pay the principal and accrued interest on a quarterly basis beginning February 19, 2011. The Company may at any time prepay the principal amount of this debt note, in whole or in part, together with accrued interest thereon, without penalty. The discount for prepayment shall be 10% on any remaining amount outstanding under the debt note. The debt note is secured by the grant of first-priority ranking legal security over all the shares and assets of Smartag. The Company recorded interest expense on the debt note of $5,000 and $18,000 during the three months ended March 31, 2013 and 2012, respectively in its condensed consolidated statements of operations.

Other Obligations

In connection with its acquisition of payment solution, through its majority-owned subsidiary Bluehill ID AG the Company acquired obligations for equipment financing liabilities, a bank loan and a revolving line of credit payable to a bank.

The equipment financing liabilities in connection with its acquisition of payment solution are partially secured by payment solution s systems installed in the stadiums to which they relate and will mature in 2014. Amounts outstanding under the equipment finance obligations accrue interest in the range of 8.6% to 18.6%, and interest is payable quarterly. payment solution was obligated to pay a quarterly sum of approximately $0.2 million in principal and interest during 2012. The repayments increased to approximately $0.3 million per quarter in 2013, with a final payment of approximately $0.8 million in October 2014. The Company recorded interest expense on the equipment financing obligations of approximately $102,000 and $72,000 during the three months ended March 31, 2013 and 2012, respectively in its condensed consolidated statements of operations.

The bank loan with Kreditbank fuer Wiederaufbau, Germany (KFW) assumed in connection with the acquisition of payment solution is secured by some of payment solution s tangible assets installed in the various stadiums and will mature in 2017.

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Amounts outstanding under the bank loan accrue interest at 11.15% and interest is payable quarterly. payment solution is obligated to pay a quarterly sum of approximately $0.1 million in principal and interest over the life of the loan. The Company recorded interest expense on the bank loan of approximately $51,000 and $36,000 during the three months ended March 31, 2013 and 2012, respectively in its condensed consolidated statements of operations.

The total amount that can be advanced under the revolving line of credit related to the acquisition of payment solution is approximately $0.2 million. The advances on the revolving line of credit accrue interest at a base rate of 6.25% up to 11.25%, payable quarterly. Any advances over the limit will accrue interest at 15.95%. The revolving line of credit is ongoing with no specific end date. Interest expense on the line of credit was approximately $3,000 and zero during the three months ended March 31, 2013 and 2012, respectively.

In connection with its acquisition of Bluehill ID, the Company acquired an obligation for a mortgage loan and a related revolving line of credit payable to a bank. The mortgage loan and the revolving line of credit are related to one of the 100%-owned subsidiaries of Bluehill ID and are secured by the land and building to which it relates as well as total inventory, machinery, stock, products and raw materials of the subsidiary. Amounts outstanding under the mortgage loan accrue interest at 5.50%, and interest is payable monthly. The mortgage loan will mature in 2026. The Company is obligated to pay a monthly amount of approximately $4,600 over the life of the mortgage loan towards the principal amount in addition to monthly interest payments. The total amount that can be advanced under the line of credit is approximately $0.3 million. The advances on the revolving line of credit accrue interest at a base rate determined by the bank plus 2%, payable quarterly. Any advances over the limit will accrue interest at 10.75%. The revolving line of credit is ongoing with no specific end date. The Company recorded interest expense of approximately $12,000 and $16,000 during the three months ended March 31, 2013 and 2012, respectively in its condensed consolidated statements of operations. There was no balance outstanding under the revolving line of credit as of March 31, 2013 and December 31, 2012.

The following table summarizes the Company s financial obligations for the next five years as of March31, 2013:

(in thousands)	**2013** (remaining nine months)	**2014**	**2015**	**2016**	**2017**	**Thereafter**	**Total**
Secured note	$ 2,481	$ 3,333	$ 2,833	$	$	$	$ 8,647
Acquisiton debt note	209						209
Equipment financing liabilities	724	1,575					2,299
Bank loan (KFW)	250	333	333	333	250		1,499
Mortgage loan payable to bank	41	55	55	55	54	487	747
Bank line of credit	235						235
	$ 3,940	$ 5,296	$ 3,221	$ 388	$ 304	$ 487	$ 13,636

10. Segment Reporting, Geographic Information and Major Customers

ASC Topic 280, *Segment Reporting* (ASC 280) establishes standards for the reporting by public business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the way that management organizes the operating segments within the Company for making operating decisions and assessing financial performance. An operating segment is defined as a component of an enterprise that engages in business activities from which it may earn revenue and incur expenses and about which separate financial information is available. The Company s chief operating decision makers (CODM) are considered to be its CEO and CFO.

The Company currently has two reportable business segments, both of which focus on providing secure identification solutions. In the Identity Management segment, the Company offers solutions, systems and services through four operating units: Identity Management & Cloud Solutions, under which the Company offers integrated access control systems and cloud-based credential management solutions; ID Solutions, under which the Company offers customized solutions for identity management, payment and other applications; the *Tagtrail* near field communication (NFC) content management platform; and the payment solution business, which provides card-based payment systems in sports stadiums and other venues. In the ID Products segment, the Company offers secure identification products through two operating units: ID Infrastructure, which provides smart card technology-based readers, terminals and other products and components; and Transponders, which provides radio frequency identification (RFID) and NFC inlays and inlay-based tags, labels and cards.

The CODM reviews financial information and business performance for each operating segment and also for the Identity Management and ID Products reportable segment. The Company evaluates the performance of its segments at the total revenue and total gross margin level. The company does not track revenue by products and services at segment level. The CODM does not review operating expenses or assert information for purposes of assessing performance or allocating resources.

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Summary information by segment is as follows (in thousands):

	Three Months Ended March 31,	
	2013	2012
Identity Management:		
Revenues from external customers	$ 11,071	$ 12,705
Intersegment revenue	2	3
Total Identity Management revenue	11,073	12,708
Elimination of intersegment revenues	(2)	(3)
Total revenue	$ 11,071	$ 12,705
Gross profit	$ 5,078	$ 5,887
Gross profit %	46%	46%
ID Products:		
Revenues from external customers	$ 9,993	$ 8,501
Intersegment revenue	99	147
Total ID Products revenue	10,092	8,648
Elimination of intersegment revenues	(99)	(147)
Total revenue	$ 9,993	$ 8,501
Gross profit	$ 3,093	$ 2,851
Gross profit %	31%	34%
Total:		
Net revenue	$ 21,064	$ 21,206
Gross profit	8,171	8,738
Gross profit %	39%	41%

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Geographic revenue is based on selling location. Information regarding revenue by geographic region is as follows (in thousands):

	Three Months Ended March 31,	
	2013	2012
Americas:		
United States	$ 10,035	$ 10,147
Other	226	59
Total Americas	10,261	10,206
Europe:		
Germany	5,539	4,813
Other	2,360	2,719
Total Europe	7,899	7,532
Asia-Pacific:		
Singapore	1,474	2,373
Other	1,430	1,095
Total Asia-Pacific	2,904	3,468
Total	$ 21,064	$ 21,206
Revenues:		
Americas	49%	48%
Europe	37%	36%
Asia-Pacific	14%	16%
Total	100%	100%

No customers exceeded 10% of total revenue during the three months ended March 31, 2013 or 2012. No customer represented 10% of the Company s accounts receivable balance at March 31, 2013 or December 31, 2012.

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The Company tracks assets by physical location. Long-lived assets by geographic location are as follows (in thousands):

	March 31, 2013	December 31, 2012
Property and equipment, net		
Americas:		
United States	$ 1,739	$ 1,071
Other	1	1
Total Americas	1,740	1,072
Europe:		
Germany	3,100	3,378
Netherlands	1,069	1,123
Other	449	412
Total Europe	4,618	4,913
Asia-Pacific		
Singapore	2,655	2,799
Other	128	108
Total Asia-Pacific	2,783	2,907
Total	$ 9,141	$ 8,892

11. Defined Benefit Plans

The Company assumed sponsorship of two statutory pension plans in Switzerland as part of the Bluehill ID acquisition on January 4, 2010, and assumed sponsorship of another Swiss statutory pension plan as part of the polyright SA acquisition on July 18, 2011. These pension plans are maintained by private insurance companies, and in accordance with Swiss law, the plans function as defined contribution plans whereby employee and employer contributions are defined based upon a percentage of an individual s salary, depending on the age of the employee, and using a minimum guaranteed interest rate, which is annually defined by the Swiss Federal Council and reviewed every two years. These plans are accounted for as defined benefit plans in accordance with ASC Topic 715, *Compensation-Retirement Benefits* (ASC 715).

The net periodic pension cost for the Company s pension plans includes the following components for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012 (1)
Service cost	$ 77	$
Interest cost	21	
Expected return on plan assets	(15)	
Amortization of prior service cost	6	
Amortization of transition obligation	13	
Net periodic pension cost	$ 102	$

(1) As stated in Note 1 to the Consolidated Financial Statements in its 2012 Annual Report on Form 10-K, the Company began accounting for its pension plans as defined benefit plans in the fourth quarter of 2012 as a correction of an error. Prior to that date, no amounts were recognized in the first three quarters of 2012.

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12. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (AOCI) by component, net of tax and noncontrolling interest, for the first quarter of 2013 are as follows (in thousands) :

	Foreign Currency Translation	Defined Benefit Pension Plans	Total
Balance as of December 31, 2012	$ 1,611	$ (232)	$ 1,379
Other comprehensive income before reclassifications	(120)		(120)
Amounts reclassified from AOCI		19	19
Net other comprehensive income (loss)	(120)	19	(101)
Balance as of March 31, 2013	$ 1,491	$ (213)	$ 1,278

The reclassifications out of AOCI for the three month period ended March 31, 2013, are as follows (in thousands, net of tax of nil):

Details about AOCI Components	Amount Reclassified from AOCI Three Months Ended March 31, 2013	Statement of Operations Presentation
Defined benefit pension plans:		
Amortization of prior service costs	$ 6	General and administrative expenses
Amortization of transition obligation	13	General and administrative expenses
Total reclassifications for the period	$ 19	

13. Commitments

The Company leases its facilities, certain equipment, and automobiles under non-cancelable operating lease agreements. Those lease agreements existing as of March 31, 2013 expire at various dates during the next five years.

The Company recognized rent expense of $0.5 million and $0.6 million in its condensed consolidated statements of operations for the three months ended March 31, 2013 and 2012, respectively.

Purchases for inventories are highly dependent upon forecasts of customer demand. Due to the uncertainty in demand from its customers, the Company may have to change, reschedule, or cancel purchases or purchase orders from its suppliers. These changes may lead to vendor cancellation charges on these purchases or contractual commitments. The following table summarizes the Company s principal contractual obligations as of March 31, 2013:

(in thousands)	Operating Leases	Purchase Commitments	Other Contractual Obligations	Total
2013 (remaining nine months)	$ 1,750	$ 9,424	$ 785	$ 11,959
2014	1,302	139	45	1,486
2015	792		40	832

2016	472		32	504
2017	367			367
Thereafter	29			29
Total	$ 4,712	$ 9,563	$ 902	$ 15,177

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The Company provides warranties on certain product sales, which range from 12 to 24 months, and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires the Company to make estimates of product return rates and expected costs to repair or to replace the products under warranty. The Company currently establishes warranty reserves based on historical warranty costs for each product line combined with liability estimates based on the prior 12 months sales activities. If actual return rates and/or repair and replacement costs differ significantly from the Company s estimates, adjustments to recognize additional cost of sales may be required in future periods. Historically the warranty accrual and the expense amounts have been immaterial.

14. Subsequent Events

On April 16, 2013, the Company entered into a purchase agreement (the Purchase Agreement) with Lincoln Park Capital Fund, LLC (LPC), pursuant to which the Company has the right to sell to LPC up to $20,000,000 in shares of the Company s common stock, par value $0.001 per share (Common Stock), subject to certain limitations and conditions set forth in the Purchase Agreement.

Pursuant to the Purchase Agreement, upon the satisfaction of all of the conditions to the Company s right to commence sales under the Purchase Agreement (the Commencement), LPC initially purchased $2,000,000 in shares of Common Stock at $1.14 per share on April 17, 2013. Thereafter, on any business day and as often as every other business day over the 36-month term of the Purchase Agreement, and up to an aggregate amount of an additional $18,000,000 (subject to certain limitations) in shares of Common Stock, the Company has the right, from time to time, at its sole discretion and subject to certain conditions to direct LPC to purchase up to 100,000 shares of Common Stock. The purchase price of shares of Common Stock pursuant to the Purchase Agreement will be based on prevailing market prices of Common Stock at the time of sales without any fixed discount, and the Company will control the timing and amount of any sales of Common Stock to LPC, but in no event will shares be sold to LPC on a day the Common Stock closing price is less than $0.50 per share, subject to adjustment. In addition, the Company may direct LPC to purchase additional amounts as accelerated purchases if on the date of a regular purchase the closing sale price of the Common Stock is not below $0.75 per share. The Company intends to use the net proceeds from this offering for working capital and other general corporate purposes.

All shares of Common Stock to be issued and sold to LPC under the Purchase Agreement will be issued pursuant to the Company s effective shelf registration statement on Form S-3 (Registration No. 333-173576), filed with the Securities and Exchange Commission in accordance with the provisions of the Securities Act of 1933, as amended, and declared effective on May 3, 2011, and the prospectus supplement thereto dated April 16, 2013.The Purchase Agreement contains customary representations, warranties and agreements of the Company and LPC, limitations and conditions to completing future sale transactions, indemnification rights and other obligations of the parties. There is no upper limit on the price per share that LPC could be obligated to pay for Common Stock under the Purchase Agreement. The Company has the right to terminate the Purchase Agreement at any time, at no cost or penalty. Actual sales of shares of Common Stock to LPC under the Purchase Agreement will depend on a variety of factors to be determined by the Company from time to time, including (among others) market conditions, the trading price of the Common Stock and determinations by the Company as to available and appropriate sources of funding for the Company and its operations.

As consideration for entering into the Purchase Agreement, the Company agreed to issue to LPC 251,799 shares of Common Stock and is required to issue up to 323,741 additional shares of Common Stock pro rata as the Company requires LPC to purchase the Company s shares under the Purchase Agreement over the term of the agreement. The Company will not receive any cash proceeds from the issuance of these 251,799 shares or the 323,741 shares that may be issued if subsequent funding is received by the Company. The issuance of additional shares had no impact to the loss per share as of March 31, 2013.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements for purposes of the safe harbor provisions under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements, other than statements of historical facts, include statements on our ability to execute our growth strategy, expand our business, leverage our opportunities, enter new markets, capitalize on the growth in our industries, develop and improve new technology, and similar statements regarding our strategy, future operations, financial position, projected results, estimated revenues or losses, projected costs, prospects, plans, market trends, competition and objectives of management. In some cases, you can identify forward-looking statements by terms such as will, believe, could, should, would, may, anticipate, intend, plan, estimate, expect, project or the negative of these terms or other similar expressions. Although we believe that our expectations reflected in or suggested by the forward-looking statements that we make in this Quarterly Report on Form 10-Q are reasonable, we cannot guarantee future results, performance or achievements. You

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should not place undue reliance on these forward-looking statements. All forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our expectations change, whether as a result of new information, future events or otherwise.

We also caution you that such forward-looking statements are subject to risks, uncertainties and other factors, not all of which are known to us or within our control, and that actual events or results may differ materially from those indicated by these forward-looking statements. Such factors include our ability to successfully integrate strategic businesses that we acquire, our ability to reduce costs associated with strategic acquisitions, our ability to anticipate product demand, our ability to obtain supplies for products in a timely manner, and our ability to retain key personnel, as well as those additional factors listed in the Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2012. These cautionary statements qualify all of the forward-looking statements included in this Quarterly Report on Form 10-Q that are attributable to us or persons acting on our behalf.

The following information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto set forth in Part I Item 1 of this Quarterly Report on Form 10-Q and with the audited financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

Overview

Identive Group, Inc. (Identive, the Company , we and us) provides secure identification (Secure ID) solutions that allow people to gain acces buildings, networks, information, systems and services while ensuring that the physical facilities and digital assets of the organizations they interact with are protected. We leverage core identification technologies, including smart card-based security encryption and radio frequency identification (RFID) contactless communication, to offer a comprehensive range of Secure ID products, systems and services that help to manage the identification and granting of defined privileges to people: as consumers, employees, students or citizens. Our offerings include hardware products, software and integrated systems as well as services to address Secure ID applications including identity management, physical and logical/cyber access control, customized ID solutions and a host of RFID and near field communication (NFC) -enabled applications. We serve a global customer base in the government, enterprise, consumer, education, healthcare and transportation sectors. Our business model is principally based on strong technology-driven organic growth, supported by disciplined acquisitive expansion. Our common stock is listed on the NASDAQ Global Market in the U.S. under the symbol INVE and the Frankfurt Stock Exchange in Germany under the symbol INV.

We operate in two segments, Identity Management Solutions & Services (Identity Management) and Identification Products & Components (ID Products):

In our Identity Management segment we design, supply, implement and manage integrated solutions, systems and services in diverse markets that enable the secure management of credentials used for the identification of people and the granting of rights and privileges based on defined policies. Our Identity Management offerings include: integrated physical and logical (i.e., PC, network or cyber) access control and security systems and cloud-based credential management systems, which we refer to collectively as our Identity Management & Cloud Solutions; customized ID Solutions that include multi-function IDs, cashless and mobile payment systems and other solutions; and our *Tagtrail* NFC content management platform. Our Identity Management end-customers operate in the government, education, enterprise and commercial markets and can be found in multiple vertical market segments including public services administration, law enforcement, healthcare, banking, industrial, retail and critical infrastructure. Our Identity Management solutions primarily are offered under the *Identive* brand. We use *HIRSCH* and *idOnDemand* as product sub brands, *Multicard* as our brand for regional ID solutions offerings in select markets, and *payment solutions* and *JustPay* for our payment offerings in the sports stadium and festival markets.

In our ID Products segment we design and manufacture both standard and highly specialized smart card technology-based products and components (which we refer to as ID Infrastructure products) and RFID products and components, including NFC offerings (which we refer to as Transponder products), which are used in the government, enterprise and consumer markets for a number of identity-related applications, including logical access, physical access, eHealth, eGovernment, electronic ID, mobile payment, loyalty schemes, mobile advertising, and transportation and event ticketing. Our ID Infrastructure offerings include readers and terminals based on both contact and contactless smart card technology as well as readers for RFID and NFC applications, all of which are sold under the *Identive* brand. Our Transponder products include RFID and NFC inlays and inlay-based tags, labels, stickers and cards. Collectively, we refer to our ID Infrastructure and Transponder offerings as Identification Products, which we sell under the *Identive*

brand and under some product specific brands, including *ChipDrive*, *SmartCore* and *Smartag*.

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We primarily conduct our own sales and marketing activities in each of the markets in which we compete, utilizing our own sales and marketing organization to solicit prospective channel partners and customers, provide technical advice and support with respect to products, systems and services, and manage relationships with customers, distributors and OEMs. We sell our Identification Products directly to end users and utilizing indirect sales channels that may include OEMs, dealers, systems integrators, value added resellers, resellers or Internet sales. We sell our Identity Management & Cloud Solutions directly to end users and through a channel of systems integrators, dealers and value added local partners. We sell and deliver our customized ID Solutions primarily through a direct sales effort. We sell our *Tagtrail* mobile content delivery service directly to end customers and through channel partners such as mobile service operators. We also maintain an online marketplace for our NFC products at www.IdentiveNFC.com.

Our corporate headquarters are located in Santa Ana, California and our European and operational headquarters are located in Ismaning, Germany, where our financial reporting process is performed. We maintain facilities in Chennai, India for research and development and in Australia, Canada, Germany, Hong Kong, Japan, The Netherlands, Singapore, Switzerland and the U.S. for local operations and sales. The Company was founded in 1990 in Munich, Germany and incorporated in 1996 under the laws of the State of Delaware.

Recent Trends and Strategies for Growth

Identive is focused on building the world s signature company in Secure ID, and our goal is to build a lasting business of scale and technology to both enable and capitalize on the growth of established identity management applications and the adoption of NFC, converged access and other emerging trends. We work to leverage our expertise in smart card-based security, RFID and other core identification technologies to create a comprehensive range of offerings that span the value chain of Secure ID, from products to fully integrated systems, as well as services.

Our business strategy is focused on technology-driven organic growth based on both established markets and emerging opportunities for Secure ID. We work to enhance our ability to address our market opportunities and extend our product and solutions offerings through ongoing research and development programs. For example, during 2012 we completed a significant, multi-year update to our access control software and hardware platforms, made additional enhancements to our software systems for cashless payment systems and continued to develop and extend our smart card reader offerings. Additionally, to meet increasing customer demand for RFID inlays and finished transponder products such as tags, labels and cards, we continue to add new manufacturing and production equipment and lines at our facilities in Germany and Singapore.

In order to position the Company to participate in emerging, potentially very high-growth market opportunities, we have invested and continue to invest in new products and solutions in a number of areas. For example, in anticipation of the launch of new smartphones that include NFC technology, we created a dedicated Mobility & NFC Solutions group that is responsible for guiding our NFC technology development and market activities. This has resulted in the release of several new NFC tags, readers and development kits that address trending NFC applications and markets. We also developed and in November 2012 launched *Tagtrail*, our cloud-based mobile services platform that enables delivery of dynamic, personalized content to consumers smartphones via NFC tags. In addition, we maintain an online market to sell our NFC products and services at www.identiveNFC.com. To take advantage of the growing market trend towards the convergence (or integration) of physical and cyber access systems, we created a new group focused on the market for converged access products. Additionally, to meet the growing demand for cloud-based credential issuance and management, we continue to invest in the development of Identity as a Service software solutions and capabilities.

During 2012 we consolidated our various Transponder and ID Infrastructure business activities into a single Identification Products organization and moved the majority of our product brands under a single market brand, *Identive*. We also combined our Hirsch and idOnDemand operations into a single organization focused on Identity Management & Cloud Solutions. Currently we are engaged in combining our most recent acquisitions, polyright and payment solutions, into our global ID Solutions operations.

Trends in our Business

Sales Trends

Sales in the first quarter of 2013 were $21.1 million, relatively unchanged compared with $21.2 million in the first quarter of 2012. First quarter 2013 sales included $0.2 million of incremental revenue from the acquired payment solution business. Our first quarter 2013 results reflect a significant decline in sales of our access control systems and services to U.S. Government

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customers as a result of across-the-board budget cuts associated with sequestration. This decline was largely offset by strong sales of our smart card readers and transponder products, with overall ID Solutions sales remaining relatively unchanged compared with the previous year. Sales of our smart card readers to support citizen ID and employee ID applications grew year over year in what is typically a seasonally weaker period, primarily related to customers and projects in the Middle East, the U.S. and Japan, while European demand remained subdued due to continuing economic concerns related to the Euro Zone. In our Transponders business, the resumption of previously delayed projects and the receipt of significant new orders fueled higher sales of RFID and NFC inlays and tags. Capacity constraints however reduced the amount of transponder products we were able to produce and therefore ship during the quarter.

Gross profit margin declined to 39% in the first quarter of 2013, compared with 41% in the same period of 2012, primarily as a result of lower sales of our higher-margin access control systems and services. Gross margins remained steady for our ID Solutions business and margins in our Transponders business improved year over year, while ID Infrastructure (smart card reader) margins were negatively impacted by one large reader project for a citizen ID application in the Middle East region.

Sales in the Americas. Sales in the Americas were $10.3 million in the first quarter of 2013, accounting for 49% of total revenue and relatively unchanged compared with $10.2 million in the first quarter of 2012. Sales of products and systems for employee ID programs within various U.S. Government agencies comprise a significant proportion of our revenues in the Americas region, which also includes Canada and Latin America.

Sales of our access control systems and services in the Americas decreased by approximately 17% in the first quarter of 2013 compared with the same period of the previous year, primarily as a result of project delays related to the U.S. Government s budget sequestration and its impact on our federal agency customers. As a general trend, U.S. federal agencies continue to be subject to security improvement mandates under programs such as Homeland Security Presidential Directive-12 (HSPD-12) and reiterated in memoranda from the Office of Management and Budget (OMB M-11-11). We believe that our access control systems remain among the most attractive offerings in the market to help agencies move towards compliance with federal directives and mandates. However, the outlook for our U.S. Government business remains uncertain in the near term as the impact of sequestration continues to be felt by our customers. We anticipate that the furlough of federal employees beginning in the 2013 second quarter may contribute to further project delays as agencies re-prioritize project activities. To offset project and budget delays in the U.S. Government market, in recent quarters we have expanded our focus on the utility and enterprise sectors as well as on further developing our opportunities in international markets.

Sales of smart card readers and other ID Infrastructure products in the Americas were relatively unchanged in the first quarter of 2013 compared with the first quarter of 2012 and orders to support cybersecurity and network access projects at U.S. Government agencies appeared unaffected by sequestration. Americas sales of RFID and NFC inlays and tags in the first quarter of 2013 more than tripled over the same period of the prior year, primarily due to large NFC orders for machine to machine applications for new customers.

Sales in Europe and the Middle East. Sales in Europe and the Middle East (EMEA) were $7.9 million in the first quarter of 2013, accounting for 37% of total revenue and up 5% from $7.5 million in the first quarter of 2012. EMEA sales of smart card readers grew 9% in the first quarter of 2013 compared with the same period of the prior year, primarily due to a large Citizen ID project in the Middle East. Smart card reader sales in Europe continued to be somewhat weak as citizen ID and other eGovernment programs continue to be deferred in light of continuing economic uncertainty. European RFID inlay and tag sales were relatively unchanged in the 2013 first quarter compared with the prior year and included orders for ticketing and other applications. European sales in our ID Solutions business grew 11% in the first quarter of 2013 compared with the same period of the prior year, benefiting from $0.2 million incremental revenue and additional growth from payment solution, which we acquired in January 2012.

Sales in Asia/Pacific. Sales in the Asia/Pacific region were $2.9 million in the first quarter of 2013, accounting for 14% of total revenue and down 17% from $3.5 million in the first quarter of 2012. Smart card reader sales grew slightly and reflected increased demand for readers to support e-government applications in Japan. Transponder sales to Asia/Pacific customers fell 33% due to the timing of orders received, some of which were pushed out into future periods. Additionally, sales in our ID Solutions business in Australia were 16% lower in the 2013 first quarter compared with the prior year as a result of variability in the size and timing of orders in this business from period to period.

Looking forward, we expect demand will continue to increase across our markets for products, systems and solutions that address emerging applications such as converged access control, NFC tag deployment and management, mobile payment schemes and ID programs for citizens, consumers and employees. The trends towards the convergence of cyber and physical access and the marriage of contactless payment technology with mobile devices are beginning to be realized and to drive new activity from governments, enterprises and consumer applications around the world. We believe that our unique portfolio of technology, products, solutions, systems and experience position Identive to address these emergent trends and benefit from their growth.

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Seasonality and Other Factors. In our business overall, we may experience significant variations in demand for our products quarter to quarter, and overall we typically experience a stronger demand cycle in the second half of our fiscal year. Sales of our access control systems to U.S. Government agencies are subject to government budget cycles and generally are highest in the third quarter of each year. Sales of our smart card readers and chips for government programs are impacted by testing and compliance schedules of government bodies as well as roll-out schedules for application deployments, both of which contribute to variability in demand from quarter to quarter. Further, this business is typically subject to seasonality based on commercial and governmental budget cycles, with lowest sales in the first half, and in particular the first quarter of the year, and highest sales in the second half of each year. In our global ID Solutions business, a variety of local market factors including government budget cycles and seasonal sporting event schedules typically result in stronger demand in the second half of the year. Typically, sales of our RFID inlays and transponders also are marginally stronger in the second half of the year.

In addition to the general seasonality of demand, overall U.S. Government expenditure has a significant impact on demand for our products due to the significant portion of our revenues that we believe comes from U.S. Government agencies. Therefore, any significant reduction in U.S. Government spending could adversely impact our financial results and could cause our operating results for the second quarter of 2013 to fall below any guidance we provide to the market or below the expectations of investors or securities analysts.

Operating Expense Trends

Our base operating expenses (research and development, sales and marketing, and general and administrative expenses) decreased 18% in the first quarter of 2013 compared with the same period of 2012, primarily as a result of a reduction in amortization arising from the impairment review undertaken in the second quarter of 2012, and more significantly, as a consequence of expense reductions taken under our 2012 restructuring plan as described below and an ongoing focus on reducing general and administrative spending. Going forward, we expect to modestly reduce spending in 2013 in terms of absolute dollars as compared with 2012.

As further described below, we have made and continue to make significant investments in the development of products and solutions to position the Company to benefit from the expected growth of the emerging markets for NFC, payment and cloud-based identity management. As these markets do not yet offer significant revenue opportunities, our sales in these areas currently are relatively small and not yet able to compensate for the level of investment required to participate in these markets. In recent periods this has contributed significantly to our operational losses.

2012 Restructuring Plan. In June 2012 we announced a series of cost reduction measures designed to align our business operations with the current market and macroeconomic conditions. Cost reduction measures have included acceleration of the elimination of duplicate expenses at newly acquired companies, reductions in other general and administrative expenses, the consolidation of facilities, a reduction in the Company s global workforce, and nearly $0.5 million of temporary reductions in executive and management salaries and Board fees. All restructuring actions were completed in the fourth quarter of 2012.

Research and Development. Despite our decreased level of spending overall, we continue to invest in the development of core technology, new solutions offerings and sales and marketing capabilities to address emerging opportunities within the secure identification market that we believe hold significant long-term potential for Identive. To address the growing opportunities for NFC-enabled systems, we have developed a cloud-based NFC mobile services platform, Tagtrail, which provides NFC tag content management and business analytics for organizations seeking to create dynamic engagement with consumers and other groups, and we continue to invest in this platform. We are also investing in trusted identity solutions and capabilities for our cloud-based credential issuance and management (idOnDemand) offerings, and in enhancements to our cashless payment and ID Solutions software systems. Following the launch of next generation software and hardware access control platforms in 2012, we continue to enhance our access control offerings to reinforce and extend our customer base and accommodate new market trends such as secure mobile access. On an ongoing basis, we invest in the development of new contactless readers, tokens and modules, new physical access readers to enable converged physical and logical/cyber access, and in the extension of our contactless platforms. In addition, we continue to invest in enhancing and broadening our RFID inlay designs and technology in the areas of NFC, payment, tag on metal, card manufacturing and medical/pharmaceutical tracking applications. Across our business we have a significant number of new patent applications and new inventions in process. We attempt to balance our investments in new technologies, products and services with careful management of our development resources so that our increased development activities do not result in unexpected or significant changes in our overall spending on research and development.

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Results of Operations

The comparability of our operating results in the three months ended March 31, 2013 with the three months ended March 31, 2012 is impacted by our acquisition of payment solution on January 30, 2012. Results of the payment solution business have been included since its acquisition date.

Revenue

Summary information about our revenue by type and by business segment for the three months ended March 31, 2013 and 2012 is shown below (in thousands):

	Three Months Ended March 31,		% change period to period
	2013	2012	
Products			
Revenues	$ 16,890	$ 17,501	(3%)
% of total revenue	80%	83%	
Services			
Revenues	$ 4,174	$ 3,705	13%
% of total revenue	20%	17%	
Identity Management:			
Revenues	$ 11,071	$ 12,705	(13%)
% of total revenue	53%	60%	
Gross profit	$ 5,078	$ 5,887	
Gross profit %	46%	46%	
ID Products:			
Revenues	$ 9,993	$ 8,501	18%
% of total revenue	47%	40%	
Gross profit	$ 3,093	$ 2,851	
Gross profit %	31%	34%	
Total			
Revenues	$ 21,064	$ 21,206	(1%)
Gross profit	$ 8,171	$ 8,738	
Gross profit %	39%	41%	

Total revenue for the first quarter of 2013 was $21.1 million, down $0.1 million, or 1% compared with $21.2 million for the first quarter of 2012. Revenue in the 2013 first quarter reflected higher sales of our ID Products and lower sales of our Identity Management solutions compared with the same period of the previous year, as well as $0.2 million of incremental revenue from the payment solution business. Excluding the impact of this incremental revenue, organic revenue in the first quarter of 2013 fell 1% compared with the first quarter of 2012.

Product revenue includes sales of all non-service related products, software and systems. Services revenue includes sales of payment-related services, professional consulting services and annual maintenance contracts. Services comprise a higher proportion of our revenues in the first quarter of 2013 compared with the same period of the prior year, primarily as a result of the addition of new payment-related and maintenance services revenue from our acquisition of payment solution.

In our Identity Management segment we provide solutions and services that enable the secure management of credentials in diverse markets. Our Identity Management segment includes the operations of our Identity Management & Cloud Solutions division and our ID Solutions division, both of which specialize in the design and manufacturing of highly secure, integrated systems that can enhance security and better meet compliance and regulatory requirements while providing users the benefits and convenience of simple and secure solutions. The majority of sales in our Identity Management segment are made to customers in

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the government, education, enterprise and commercial markets and encompass vertical market segments including payment, healthcare, banking, industrial, retail and critical infrastructure. Because of the complex nature of the problems we address for our Identity Management customers, pricing pressure is not prevalent in this segment.

Revenue in our Identity Management segment was $11.1 million in the first quarter of 2013, down 13% from $12.7 million for the first quarter of 2012. Excluding $0.2 million of incremental revenue from payment solution, organic revenue in our Identity Management segment was 14% lower in the first quarter of 2013 compared with the same period of the prior year. This decrease primarily was due to a 24% decline in sales of our access control systems and services in the 2013 first quarter as a result of security project delays and deferrals within our federal agency customer base, due to uncertainty about the impact and timing of budget cuts under U.S. Government sequestration. Outside the U.S. Government sector, some business customers also slowed project decisions or activities as they waited to see what the impact of sequestration might have on the economy as a whole. Sales levels in our ID Solutions business were relatively unchanged in the first quarter of 2013 compared with the previous year.

In our ID Products segment we design and manufacture RFID products and components that are used for a number of identity-based and related applications in the government, enterprise, transportation and financial markets. Our ID Products segment includes sales of ID Infrastructure products including smart card, RFID and NFC readers and terminals as well as software development kits, and Transponder products including RFID and NFC inlays and inlay-based cards, tags, labels and stickers. Sales of our ID Infrastructure products are made to original equipment manufacturers (OEMs), system integrators, and increasingly to end users both directly or through distribution channels. These sales are subject to pricing pressure as embedded readers, which have a lower average selling price than external readers, grow as an overall component of ID Infrastructure shipments. We sell our Transponder products primarily to OEMs and electronic ticket printers, with an increasing percentage of sales coming from end users. In our Transponder business, there is a trend towards a higher overall average selling price as we sell a higher proportion of complete tickets and tags in addition to our inlays.

Sales in our ID Products segment were $10.0 million in the first quarter of 2013, up 18% from sales of $8.5 million in the first quarter of 2012. This increase came from higher sales of both smart card readers and transponder products. Smart card reader sales grew 18%, primarily as a result of a large order for a national ID program in the Middle East, while sales levels in the Americas and in Asia were up slightly. Transponder product sales grew 17% in the 2013 first quarter compared with the prior year, primarily as a result of large NFC orders for new customers.

Gross Profit

Gross profit for the first quarter of 2013 was $8.2 million, or 39% of revenue, compared with $8.7 million, or 41% of revenue in the first quarter of 2012. Lower gross margin in the 2013 first quarter primarily resulted from lower sales of our higher-margin access control systems and services.

By segment, gross profit margin for our Identity Management segment was $5.1 million, or 46% of revenue in the first quarter of 2013, compared with $5.9 million, or 46% of revenue in the first quarter of 2012. The stability of gross profit margin in this segment was largely due to consistent margins in our access control business, despite lower sales.

Gross profit margin for our ID Products segment was $3.1 million, or 31% of revenue for the first quarter of 2013, compared to $2.9 million, or 34% of revenue in the first quarter of 2012. The decrease in gross profit margin primarily was due to a single smart card reader project within our ID Solutions business, which had lower margins and higher shipping costs than our typical orders. Gross profit margin in our Transponders business continued to improve compared with prior periods as capacity was fully utilized and product mix was favorable.

We expect there will be some variation in our gross profit from period to period, as our gross profit has been and will continue to be affected by a variety of factors, including, without limitation, competition, the volume of sales in any given quarter, manufacturing volumes, product configuration and mix, the availability of new products, product enhancements, software and services, risk of inventory write-downs and the cost and availability of components.

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Research and Development Expenses

(In thousands)	Three months ended March 31, 2013	2012	% change period to period
Expenses	$ 2,010	$ 2,491	(19)%
Percentage of total revenues	10%	12%	

Research and development expenses consist primarily of employee compensation and fees for the development of hardware, software and firmware products. We focus the bulk of our research and development activities on the continued development of existing products and the development of new offerings for emerging market opportunities.

Research and development expenses in the first quarter of 2013 were $2.0 million, or 10% of revenue, compared with $2.5 million, or 12% of revenue in the first quarter of 2012, a decrease of 19%. Lower research and development expenses in the 2013 first quarter resulted from lower amortization charges, the capitalization of costs related to new software releases, the completion of some project activities and the timing of other, and the movement of some activities to lower cost regions. There were no incremental costs from payment solution in research and development expenses in the first quarter of 2013.

We expect to maintain our current level of investment in research and development in terms of absolute spending in 2013, although some expenses associated with this activity may be capitalized or incurred in lower cost regions.

Selling and Marketing Expenses

(In thousands)	Three months ended March 31, 2013	2012	% change period to period
Expenses	$ 5,719	$ 7,008	(18)%
Percentage of total revenues	27%	33%	

Selling and marketing expenses consist primarily of employee compensation as well as tradeshow participation, advertising and other marketing and selling costs. We focus a significant proportion of our sales and marketing activities on new and emerging market opportunities.

Selling and marketing expenses in the first quarter of 2013 were $5.7 million, or 27% of revenue, compared with $7.0 million, or 33% of revenue in the first quarter of 2012, a decrease of 18% as a result of the corporate cost-reduction program we initiated in June 2012, as well as lower amortization charges. Incremental costs from payment solution in selling and marketing expenses in the first quarter of 2013 were negligible.

We expect to modestly reduce spending in sales and marketing on an absolute basis in 2013.

General and Administrative Expenses

(In thousands)	Three months ended March 31 2013	2012	% change period to period
Expenses	$ 4,604	$ 5,524	(17)%
Percentage of total revenues	22%	26%	

General and administrative expenses consist primarily of compensation expenses for employees performing administrative functions, and professional fees arising from legal, auditing and other consulting services. Due to the timing of the acquisition, only two months of results for 2012 (February March) are included for payment solution.

In the first quarter of 2013, general and administrative expenses were $4.6 million, or 22% of revenue, compared with $5.5 million, or 26% of revenue in the first quarter of 2012, a decrease of 17%. Incremental costs from payment solution in general and administrative expenses in the first quarter of 2013 were negligible. General and administrative expenses fell 17% in the 2013 first quarter compared with the same period of the prior year as a result of ongoing efforts to reduce general and administrative expenses, lower amortization charges and our cost reduction program put in place in the second quarter of 2012.

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We expect to modestly increase general and administrative spending on an absolute basis in 2013, due to the addition of accruals for performance-based incentive compensation.

Re-measurement of Contingent Consideration

For the first quarter of 2012, we recorded $0.4 million as an expense for re-measurement of contingent consideration related to the polyright and idOnDemand acquisitions as a result of passage of time (reduced impact of discounting). Please see Item 1, Financial Statements, Note 3 of Notes to Condensed Consolidated Financial Statements, Fair Value Measurements, for more detailed information.

Interest Expense, Net

Interest expense, net consists of interest accretion expense for liabilities to a related party and interest on financial liabilities, offset by interest earned on invested cash. Interest expense, net was $0.7 million and $0.3 million in the first quarter of 2013 and the first quarter of 2012, respectively. Approximately $0.4 million of net interest expense in the 2013 first quarter relates to our loan with Hercules and approximately $0.2 million of net interest expense in both periods relates to interest accretion expense for a liability to a related party in the Hirsch business. Interest expense, net in both periods also includes interest paid on other financial liabilities. Please see Item 1, Financial Statements, Note 9 of Notes to Condensed Consolidated Financial Statements, Financial Liabilities, for more detailed information. Interest income in the first quarter of 2013 and the first quarter of 2012 was immaterial.

Foreign Currency Losses, Net

We recorded a foreign currency loss of $0.2 million in the first quarter of 2013 and a foreign currency gain of $0.2 million in the first quarter of 2012. Changes in currency valuation in the periods presented mainly were the result of exchange rate movements between the U.S. dollar and the Euro, Swiss Franc, and the British pound and their impact on the valuation of intercompany transaction balances. Accordingly, they are predominantly non-cash items. Our foreign currency gains primarily result from the valuation of current assets and liabilities denominated in a currency other than the functional currency of the respective entity in the local financial statements. Accordingly, these foreign currency losses are predominantly non-cash items.

Income Taxes

We recorded a benefit from income taxes of $0.1 million and $0.2 million, reflecting effective tax rates of 2.24% and 9.75% for the three months ended March 31, 2013 and 2012, respectively.

The effective tax rates for the three-month periods ended March 31, 2013 and March 31, 2012 differ from the federal statutory rate of 34% primarily due to a change in valuation allowance and, the benefit of taxable earnings in certain foreign jurisdictions, which are subject to lower tax rates.

Liquidity and Capital Resources

As of March 31, 2013, our working capital, which we have defined as current assets less current liabilities, was $(4.9) million, a decrease of approximately $4.8 million compared to $(0.1) million as of December 31, 2012. The decrease in working capital reflects a $4.0 million net decrease in cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, as well as a $2.5 million net increase in accounts payable, accrued compensation and related benefits, financial liabilities, deferred revenue, and other accrued expenses, offset by a $1.6 million increase in inventory, and a $0.1 million decrease in liability to related party and liability for consumer cards.

Cash and cash equivalents were $5.5 million as of March 31, 2013, a decrease of approximately $1.9 million compared to $7.4 million as of December 31, 2012 as a result of cash of $0.5 million used in operations, a cash payment of approximately $0.6 million used for capital expenditures, $1.0 million cash payments on financial liabilities, offset by $56,000 cash proceeds from the issuance of common stock under our employee stock purchase plan and an exchange rate effect of $0.1 million on cash and cash equivalents.

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The following summarizes our cash flows for the three months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended March 31,	
	2013	2012
Cash used in operating activities	$ (463)	$ (2,381)
Cash used in investing activities	(568)	(908)
Cash used in financing activities	(970)	(707)
Effect of exchange rate changes on cash and cash equivalents	108	96
Decrease in cash and cash equivalents	(1,893)	(3,900)
Cash and cash equivalents at beginning of period	7,378	17,239
Cash and cash equivalents at end of period	$ 5,485	$ 13,339

Significant commitments that will require the use of cash in future periods include obligations under operating leases, liability to a related party, a secured note, an acquisition debt note, a mortgage bank loan, bank loan, equipment financing liabilities, pension plan obligations, inventory purchase commitments and other contractual agreements. Gross committed operating lease obligations are approximately $4.7 million, liability to related party is approximately $10.7 million, the equipment financing liabilities are approximately $2.7 million, the bank loan is approximately $1.9 million, the secured note is approximately $10.0 million, the acquisition debt note is approximately $0.2 million, the mortgage bank loan is approximately $1.0 million, the bank line of credit is approximately $0.2 million, pension plan obligations are $0.5 million, and inventory and other purchase commitments are approximately $10.5 million at March 31, 2013. Total commitments due within one year are approximately $20.2 million and due thereafter are approximately $22.2 million at March 31, 2013.

Cash used in investing activities reflects approximately $0.6 million spent for capital expenditures, including costs for capitalized software development.

Cash used in financing activities primarily reflects approximately $1.0 million paid for financial liabilities, which consist of equipment financing liabilities, a bank loan, a secured note, a mortgage loan and a debt note.

On October 30, 2012, we entered into a Loan and Security Agreement (the Loan Agreement) with Hercules Technology Growth Capital, Inc. The Loan Agreement provides for a term loan in aggregate principal amount of up to $10.0 million with an initial drawdown of $7.5 million and, provided certain financial and other requirements are met, an additional $10.0 million in loan advances, all upon the terms and conditions set forth in the Loan Agreement. The initial drawdown of $7.5 million is reflected in the Secured Term Promissory Note dated October 30, 2012 (the Secured Note). Our obligations under the Loan Agreement and the Secured Note are secured by substantially all of our assets. We received net proceeds of approximately $6.9 million after incurring approximately $0.6 million in issuance costs related to the Secured Note. Among others, the Loan Agreement requires us to maintain a certain amount of revenue, EBITDA, and current ratio on a consolidated basis (covenants). If any covenants are not met, the violation may constitute an event of default. Upon the occurrence and during the continuance of an event of default, the lender may, among other things, accelerate the loan and seize collateral or take other actions of a secured creditor. See Item 1, Financial Statements, Note 9 of Notes to Condensed Consolidated Financial Statements, Financial Liabilities, for more information.

We have historically incurred operating losses and negative cash flows from operating activities, and we expect to continue to incur losses for the foreseeable future. As of March 31, 2013, we have total accumulated deficit of approximately $290.8 million. During the quarter ended March 31, 2013, we sustained consolidated net losses of $5.0 million. Our working capital reduced significantly as of March 31, 2013 as compared to December 31, 2012. These factors, among others, including the recent effects of the U.S. Government sequester and related budget uncertainty on certain parts of our business, have raised significant doubt about our ability to continue as a going concern. We expect to use a significant amount of cash in our operations over the next twelve months for our operating activities and servicing of financial liabilities, including investment in new technologies in anticipation of future significant revenues following wider adoption of these products and services. These investments are in the area of research and development and sales and marketing on NFC, Identity as a Service and various access control, smart card reader and transponder technologies and products. Our current plan anticipates increased revenues and improved profit margins for the twelve-month period, which we expect will reduce the levels of cash required for our operating activities as compared to historical levels of use. In April 2013 we secured an additional source of financing with our entry into a purchase agreement with Lincoln Park Capital Fund, LLC, under which we have the right to sell up to $20.0 million of shares of our common stock over the next three years. On April 17, 2013, Lincoln Park purchased $2.0 million of our shares under this agreement. Further, we are in the process of improving our working capital, including reduction in the levels of accounts receivable and discussion with

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several key suppliers to further reduce the levels of inventory and improve payment terms. Based on our current projections and estimates, we believe our current capital resources, including existing cash, cash equivalents, anticipated cash flows from operating activities, savings from our continued cost reduction activities, and available borrowings and sources of financing, should be sufficient to meet our operating and capital requirements through at least the next twelve months.

Our condensed consolidated financial statements have been prepared under the assumption that we will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Our continuation as a going concern is contingent upon our ability to generate revenue and cash flow to meet our obligations on a timely basis and our ability to raise financing or dispose of certain noncore assets as required. Our plans may be adversely impacted if we fail to realize our assumed levels of revenues and expenses or savings from our cost reduction activities. For example, our financial results for the first quarter of 2013 were adversely impacted by the recent effects of the U.S. Government sequester on our U.S. Government business. If, in the future, factors such as the sequester cause a significant adverse impact on our revenues, expenses or savings from our cost reduction activities, we may need to delay, reduce the scope of, or eliminate one or more of our development programs or obtain funds through collaborative arrangements with others that may require us to relinquish rights to certain of our technologies, or programs that we would otherwise seek to develop or commercialize ourselves, and to reduce personnel related costs. We may resort to contingency plans to make these needed cost reductions upon determination that funds will not be available in a timely matter. These contingency plans include consolidating certain functions, including integration of newly acquired entities into the group and elimination of duplicate general and administration expenses by expanding the scope of shared services in the Americas and European regions, or disposing of non-performing or underperforming assets. We may also need to raise additional funds through public or private offerings of additional debt or equity during the course of the year or in the near term as we may deem appropriate. The sale of additional debt or equity securities may cause dilution to existing stockholders. However, there can be no assurance that we will be able to raise such funds if and when they are required. Failure to obtain future funding when needed or on acceptable terms would adversely affect our ability to fund operations.

Contractual Obligations

The following summarizes expected cash requirements for contractual obligations as of March 31, 2013 (in thousands):

	Total	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating leases	$ 4,712	$ 2,075	$ 1,887	$ 750	$
Liability to related party	10,691	1,548	2,329	2,519	4,295
Equipment financing liabilities	2,729	1,291	1,438		
Bank loan	1,898	487	862	549	
Secured Note	9,971	3,985	5,986		
Acquisition debt note	210	210			
Mortgage loan payable to bank	1,033	95	180	168	590
Bank line of credit	235	235			
Expected payments for pension plans	465	18	68	98	281
Purchase commitments and other obligations	10,465	10,255	186	24	
Total obligations	$ 42,409	$ 20,199	$ 12,936	$ 4,108	$ 5,166

The secured debt facility relates to a loan and security agreement entered into by us on October 30, 2012 with Hercules Technology Growth Capital, Inc. The acquisition debt note was issued in connection with our acquisition of Smartag in November 2010. Equipment financing liabilities and a bank loan were acquired in connection with our acquisition of payment solution in January 2012. The mortgage loan payable to bank was acquired in connection with our acquisition of Bluehill ID in January 2010. See Item 1, Financial Statements, Note 9 of Notes to Condensed Consolidated Financial Statements, Financial Liabilities, for more information about the financing liabilities listed in the table above.

Our liability to related party was acquired in connection with our acquisitions of Hirsch and payment solution. See Item 1, Financial Statements, Note 8 of Notes to Condensed Consolidated Financial Statements, Related-Party Transactions, for more information about this liability, which is listed in the table above.

Purchases for inventories are highly dependent upon forecasts of customer demand. Due to the uncertainty in demand from our customers, we may have to change, reschedule, or cancel purchases or purchase orders from our suppliers. These changes may lead to vendor cancellation

charges on these purchases or contractual commitments. See Item 1, Financial Statements, Note 13 of Notes to Condensed Consolidated Financial Statements, Commitments, for more information about the contractual obligations listed in the table above.

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The Company s condensed consolidated balance sheet consists of other long-term liability which includes gross unrecognized tax benefits, and related gross interest and penalties. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years in connection with these tax liabilities; therefore, such amounts are not included in the contractual obligation table above.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of these financial statements requires management to establish accounting policies that contain estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. These policies relate to revenue recognition, inventory, income taxes, goodwill, intangible and long-lived assets, stock-based compensation and defined benefit plans.

We have other important accounting policies and practices; however, once adopted, these other policies either generally do not require us to make significant estimates or assumptions or otherwise only require implementation of the adopted policy and not a judgment as to the policy itself. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Despite our intention to establish accurate estimates and assumptions, actual results may differ from these estimates under different assumptions or conditions.

During the three months ended March 31, 2013, management believes there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012.

Recent Accounting Pronouncements

See Note 1, *Basic of Presentation,* the Notes to condensed consolidated financial statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for a full description of recent accounting pronouncements, including the actual and expected dates of adoption and estimated effects on our consolidated results of operations and financial condition, which is incorporated herein by reference.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no significant change in our exposure to market risk during the three months ended March 31, 2013. For discussion of the Company s exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Attached as exhibits to this report are certifications of our principal executive officer and principal financial officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This Controls and Procedures section includes information concerning the controls and related evaluations referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

As of the end of the three months ended March 31, 2013, we carried out an evaluation, as required in Rule 13a-15(b) under the Exchange Act, under the supervision and with the participation of members of our senior management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act.

Based on that evaluation, our principal executive officer and principal financial officer concluded that, due to the material weaknesses in our control over financial reporting disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012, our internal disclosure controls and procedures were not effective as of the end of the period covered by this report.

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Based on additional analysis and other post-closing procedures designed to ensure that our consolidated financial statements will be presented in accordance with generally accepted accounting principles, management believes, notwithstanding the material weaknesses, that the consolidated financial statements included in this report fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the U.S. (GAAP).

Remediation of Material Weaknesses

As disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012, our management identified material weaknesses in our internal control over financial reporting as of December 31, 2012, namely that we had an insufficient review and oversight of the recording of complex and non-routine transactions. We continue to improve our policies and procedures relating to internal controls over financial reporting, including putting in place an increased level of accounting and reporting oversight and controls at the corporate level. We expect to complete the implementation of remediation measures, and as a result remediate the existing material weaknesses described above, by the end of 2013.

In addition, under the direction of the Audit Committee, management will continue to review and make necessary changes to the overall design of the Company s internal control environment, as well as to policies and procedures to improve the overall effectiveness of internal control over financial reporting. Management believes the foregoing efforts will effectively remediate the material weaknesses. However, the material weaknesses will not be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively, which we expect to occur within the current fiscal year.

Changes in Internal Controls over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We note that management continued its remediation efforts during the first quarter of 2013 related to the above-described material weaknesses.

A control system, no matter how well designed and operated, can only provide reasonable assurances that the objectives of the control system are met. Because there are inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we could be subject to claims arising in the ordinary course of business or be a defendant in lawsuits. While the outcome of such claims or other proceedings cannot be predicted with certainty, our management expects that any such liabilities, to the extent not provided for by insurance or otherwise, will not have a material effect on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

Our business and results of operations are subject to numerous risks, uncertainties and other factors that you should be aware of, some of which are described below. The risks, uncertainties and other factors described in these risk factors are not the only ones facing our company. Additional risks, uncertainties and other factors not presently known to us or that we currently deem immaterial may also impair our business operations. Any of the risks, uncertainties and other factors could have a materially adverse effect on our business, financial condition, results of operations, cash flows or product market share and could cause the trading price of our common stock to decline substantially.

Business and Strategic Risks

Uncertain economic conditions, particularly in Europe, may adversely affect overall demand and profitability in our business.

In recent times global economies have been impacted by disruptive financial events, economic uncertainty and continuing concerns about the economic stability of certain countries in the Economic and Monetary Union (EMU or Euro Zone). In particular, certain countries in Europe are working through a debt crisis that has led to an economic slowdown, or in some cases, a recession. If macroeconomic conditions deteriorate further or spread to additional countries in the region, it could adversely affect our results of operations and financial condition. The possibility

that one or more member countries could leave the Euro Zone or that the currency union could break apart could raise legal, practical and procedural issues between the Company and our

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European customers, which comprise approximately one-third of our revenues. The continuation or deterioration of current global market conditions, including economic instability and uncertainty in Europe, could be accompanied by decreased demand for our customers products and solutions and weakness in our customers businesses that could result in decreased demand for our products and solutions. In addition, some of our customers may require substantial financing in order to fund their operations and make purchases from us, and volatility in the capital and credit markets may limit the availability of such financing for our customers. The inability of these customers to obtain sufficient credit to finance purchases of our products and meet their payment obligations to us, or possible insolvencies of our customers, could result in decreased customer demand, an impaired ability for us to collect on outstanding accounts receivable, significant delays in accounts receivable payments, and significant write-offs of accounts receivable, each of which could adversely impact our financial results.

We are exposed to credit risk on our accounts receivables.

We are exposed to credit risk in our accounts receivable, and this risk is heightened in times of economic weakness. We distribute our products both through third-party resellers and directly to certain customers and a majority of our outstanding trade receivables are not covered by collateral or credit insurance. We may not be able to monitor and limit our exposure to credit risk on our trade and non-trade receivables, and we may not be effective in limiting credit risk and avoiding losses.

Continuing weakness in global markets may adversely impact our suppliers.

Our ability to meet customers demands depends, in part, on our ability to obtain timely and adequate delivery of quality materials, parts and components or products from our suppliers. Certain of our components are available only from a single source or limited sources. If certain key suppliers were to become capacity constrained or insolvent for any reason, including a weak economic environment, it could result in a reduction or interruption in supplies or a significant increase in the price of supplies, each of which would adversely impact our financial results. In addition, credit constraints at key suppliers could result in accelerated payment of accounts payable by us, impacting our cash flow.

Our markets are highly competitive and technology is rapidly evolving.

The markets for our products are competitive and characterized by rapidly changing technology. Additionally, the demand for higher security environments, including rapid certification of identity authentication, has led to new standards, driving the need for new technology solutions. We believe that the principal competitive factors affecting the markets for our products and solutions include:

- the extent to which products and systems must support evolving industry standards and provide interoperability;
- the extent to which standards are widely adopted and product and system interoperability is required within industry segments;
- the extent to which products are differentiated based on technical features, quality and reliability, ease of use, strength of distribution channels and price;
- the ability of suppliers to quickly develop new products and integrated solutions to satisfy new market and customer requirements;
- the total cost of ownership including installation, maintenance and expansion capability of systems; and
- the ability to commercialize custom solutions for common customer requests.

We currently experience competition from a number of companies in each of our target market segments and we believe that competition in our markets is likely to intensify as a result of anticipated increased demand for secure identification products, systems and solutions. We may not be successful in competing against offerings from other companies and could lose business as a result.

We also experience indirect competition from certain of our customers who currently offer alternative products or solutions or are expected to introduce competitive offerings in the future. For example, in our ID Infrastructure business, we sell our various reader products to 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. In our access control business, many of our dealer channel partners act as system integrators, providing

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installation and service, and therefore carry competitive lines of products and systems. This is a common practice within the industry as the integrators need access to multiple lines in order to support all potential service and user requirements. Depending on the technical competence of their sales forces, comfort level of their technical staff with our systems and price pressure from customers, these integrators may choose to offer a competitive system. There is also business pressure to provide some level of sales to all vendors to maintain access to a range of products and systems.

We may, in the future, face competition from these and other parties that develop secure identification products based upon approaches similar to or different from those employed by us. In addition, the market for secure identification products and solutions may ultimately be dominated by approaches other than the approaches marketed by us.

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 or solutions and may be able to deliver competitive products or solutions 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 or solutions 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.

Our future success will depend on our ability to keep pace with technological change and meet the needs of our target markets and customers. If we are unable to introduce new products and solutions, we may experience a decrease in sales or lose customers.

As noted above, the markets for our products are characterized by rapidly changing technology and the need to meet market requirements and to differentiate our products and solutions through technological enhancements, and in some cases, price. Our customers needs change, new technologies are introduced into the market, and industry standards continue to evolve. As a result, product life cycles are often short and difficult to predict, and frequently we must develop new products quickly in order to remain competitive in light of new market requirements. Rapid changes in technology, or the adoption of new industry standards, could render our existing products obsolete and unmarketable. Changes in market requirements could render our existing solutions obsolete or could require us to expend more on research and development efforts.

Our future success will depend upon our ability to enhance our current products and solutions and to develop and introduce new offerings with clearly differentiated benefits 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 or solutions based on features or capabilities that are still under development, we must be able to complete our design, delivery and implementation process on a timely basis, or risk losing current and any future revenue from those offerings. In developing our offerings, 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, and we could lose sales. We expect that our product development efforts will continue to require substantial investments and we may not have sufficient resources to make the necessary investments.

In some cases, we depend upon partners who provide one or more components of the overall solution for a customer in conjunction with our products. If our partners do not adapt their products and technologies to new market or distribution requirements, or if their products do not work well, then we may not be able to sell our products into certain markets.

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 ability to remain competitive by quickly developing new products and technologies depends on continuing investments in research and development depends on our ability to generate adequate capital resources to fund such activities. If we reduce such investment, our financial result could be adversely affected.

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In order to remain competitive and rapidly adapt to changing conditions in our industry, we may require additional investments in research and development. As noted in the Liquidity and Capital Resources section of Part I, Item 2, if we fail to realize our current plan anticipating increased revenues and improved profit margins for at least the next twelve months, we may be required to curtail investments in research and development activities. If we are required to reduce our investment in research and development, we may be unable to compete effectively with newer products and technologies, and our financial results would be adversely affected

Our sales depend on the widespread adoption of our products and solutions and on diversifying and expanding our customer base in new markets and geographic regions.

We sell a significant proportion of our products, systems and services to address emerging applications that have not yet reached a stage of mass adoption or deployment. For example, in our ID Solutions business, we provide customized solutions are used in various identity-based programs, such as cashless payment, smart city offerings, and national and regional IDs, all of which are applications that are not yet widely implemented. We are also focused on sales of products and solutions for the emerging near field communication (NFC) market, which is expected to grow as a result of the availability of NFC-enabled mobile phones. As NFC phones are not yet widely deployed, this market for our products is also still at an early stage. Additionally, we are investing in cloud-based solutions, also known as Software as a Service (SaaS), which also are at an early phase of adoption.

Because the markets for our products and solutions are still emerging, demand for our offerings is subject to variability from period to period. There is no assurance that demand will become more predictable as additional identity-based programs, NFC applications or SaaS solutions demonstrate success. If demand for our products and solutions does not develop further and grow sufficiently, our revenue and gross profit margins could decline or fail to grow. We cannot predict the future growth rate, if any, or size or composition of the market for any of our offerings. Our target markets have not consistently grown or developed as quickly as we have expected, and we have experienced delays in the development of new products designed to take advantage of new market opportunities. Since new target markets are still evolving, it is difficult to assess the competitive environment or the size of the market that may develop. The demand and market acceptance for our offerings, as is common for new technologies, is subject to high levels of uncertainty and risk and may be influenced by various factors, including, but not limited to, the following:

- our ability to demonstrate to our potential customers and partners the value and benefits of new products;
- the ability of our competitors to develop and market competitive solutions for emerging applications in our target markets and our ability to win business in advance of and against such competition;
- the adoption and/or continuation of industry or government regulations or policies requiring the use of products or solutions such as our smart card readers or access control solutions;
- the timing of large scale security programs involving smart cards, RFID and related technology by governments, banks and enterprises;
- the ability of financial institutions, corporate enterprises, the U.S. Government and other governments to agree on industry specifications and to develop and deploy security applications that will drive demand for products and solutions such as ours;
- the widespread availability of certain technologies, such as NFC-enabled mobile phones, that is required to spur demand for our products, such as our NFC tags and readers; and
- general economic conditions, for example economic uncertainty.

Acquisitions and strategic investments expose us to significant risks.

A component of our ongoing business strategy is to seek to buy businesses, products and technologies that complement or augment our existing businesses, products and technologies. Acquiring and integrating acquired businesses into our business exposes us to certain risks. The combination of companies is a complex, costly and time-consuming process. As a result, we must devote significant management attention and resources to finalizing transaction terms and to integrating the diverse business practices and operations of the acquired companies. These processes may divert the attention of our executive officers and management from day-to-day operations and disrupt our business and, if implemented ineffectively, preclude realization of the full benefits expected from the transactions. Failure to meet the challenges involved in successfully integrating another company s operations with ours or otherwise to realize any of the anticipated benefits of an acquisition could cause an interruption of, or a loss of momentum in, the activities of our combined company and could adversely affect our results of operations. In addition, the integration of acquired companies may result in unanticipated problems, expenses, liabilities, competitive responses and loss of customer relationships, may cause dilution of shareholder value, and may cause our stock price to decline.

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Any future acquisition could expose us to additional significant risks, including, without limitation:

- the use of our limited cash balance or potentially dilutive stock offerings to fund such acquisitions;
- costs of any necessary financing, which may not be available to us on reasonable terms or at all;
- accounting charges we might incur in connection with such acquisitions, including the future write-down or write-off of goodwill or intangible assets;
- the difficulty and expense of integrating personnel, technologies, customer, supplier and distributor relationships, marketing efforts and facilities acquired through acquisitions;
- integrating internal controls over financial reporting; discovering and correcting deficiencies in internal controls and other regulatory compliance, data adequacy and integrity, product quality and product liabilities;
- diversion of management resources;
- failure to realize anticipated benefits of the acquisition;
- costly fees for legal and transaction-related services; and
- the unanticipated assumption of liabilities.

Any of the foregoing could have a material adverse effect on our financial condition and results of operations. We may not be successful with any such acquisition. Acquisitions and strategic investments may also lead to substantial increases in non-current assets, including goodwill. Write-downs of these assets due to unforeseen business developments may materially and adversely impact our financial condition and results of operations.

Additionally, we have in the past acquired or made, and from time to time in the future may acquire or make, investments in companies, products and technologies that we believe are complementary to our existing businesses, products and technologies. These investments may not yield positive results.

Our loan covenants may affect our liquidity or limit our ability to incur debt, make investments, sell assets, merge or complete other significant transactions.

In October 2012, we entered into a Loan and Security Agreement with Hercules Technology Growth Capital, Inc. The loan agreement includes provisions that place limitations on a number of our activities, including our ability to incur additional debt, create liens on our assets or make guarantees, make certain investments or loans, pay dividends or dispose of or sell assets or enter into a merger or similar transaction. The loan agreement also contains financial covenants that require the Company to achieve certain levels of financial performance as measured periodically in terms of our EBITDA, revenues and current ratio. If an event of default in such covenants occurs and is continuing, the lender may, among other things, accelerate the loan and seize collateral or take other actions of a secured creditor. If the loan is accelerated, we could face a substantial liquidity problem and may be forced to dispose of material assets or operations, seek to obtain equity capital, or restructure or refinance our indebtedness. Such alternative measures may not be available or successful. Also, our loan covenants may limit our ability to dispose of material assets or operations or to restructure or refinance our indebtedness. Even if we are able to restructure or refinance our indebtedness, the economic terms may not be favorable to us. All of the foregoing could have serious consequences to our financial condition

and results of operations. Our ability to generate cash to meet scheduled payments with respect to our debt depends on our financial and operating performance, which in turn, is subject to prevailing economic and competitive conditions and the other factors discussed in this Risk Factors section. If our cash flow and capital resources are insufficient to fund our debt service obligations, we could face substantial liquidity problems and may be forced to dispose of material assets or operations, seek to obtain equity capital, or restructure or refinance our indebtedness as noted above. Such alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

If we are not able to secure additional financing when needed, our business could be adversely affected.

We may seek or need to raise additional funds for general corporate and commercial purposes or for acquisitions. Our ability to obtain financing depends on our historical and expected future operating and financial performance, and is also subject to prevailing economic conditions and to financial, business and other factors beyond our control. If we are unable to secure

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additional financing when desired, our ability to fund our business operations, make capital expenditures, pursue additional expansion or acquisition opportunities, or make another discretionary use of cash could be limited, and this could adversely impact our financial results. There can be no assurance that additional capital will be available to us on favorable terms or at all. The sale of additional debt or equity securities may cause dilution to existing stockholders.

We may not recognize anticipated benefits from the strategic disposition or divestiture of portions of our business.

Our business strategy may also contemplate divesting portions of our business from time to time, if and when we believe we would be able to realize greater value for our stockholders in so doing. We have in the past sold, and may from time to time in the future sell, one or more portions, or all of our business. Any divestiture or disposition could expose us to significant risks, including, without limitation, costly fees for legal and transaction-related services; diversion of management resources; loss of key personnel; and reduction in revenue. Further, we may be required to retain or indemnify the buyer against certain liabilities and obligations in connection with any such divestiture or disposition and we may also become subject to third-party claims arising out of such divestiture or disposition. In addition, we may not achieve the expected price in a divestiture transaction. Failure to overcome these risks could have a material adverse effect on our financial condition and results of operations.

Operational Risks

There are doubts about our ability to continue as a going concern. If we fail to generate revenue as forecast, improve our margins, realize savings from our cost reduction activities or are unable to obtain additional capital necessary to fund our operations, our financial results, financial condition and our ability to continue as a going concern will be adversely affected.

As discussed in Liquidity and Capital Resources in Part 1, Item 2 of this report, as of March 31, 2013, we have a total accumulated deficit of approximately $290.8 million, and during the year ended December 31, 2012, we sustained a consolidated net loss of $53.6 million, of which $51.9 million related to impairment of goodwill and long-lived assets. These factors, among others, including the recent effects of the U.S. Government sequester and related budget uncertainty on a substantial part of our business, have raised significant doubt about our ability to operate as a going concern.

Our consolidated financial statements have been prepared assuming that we will continue as a going concern. We have historically incurred operating losses and negative cash flows from operating activities, and we expect to continue to incur losses for the foreseeable future. Based on our current plans, we believe our current capital resources, including cash, cash equivalents, anticipated cash flow from operating activities, savings from cost reduction activities and available borrowings, should be sufficient to fund our operating expenses and capital requirements through the next twelve months.

However, there can be no assurance that we will be successful with our plans or that our future results of operations will improve. If revenue trends do not improve, our available liquidity from cash flows from operations will be adversely affected. We may need to resort to contingency plans, including further cost reductions or disposals of non-strategic activities. We may also need to raise additional debt or equity financing through public or private offerings over the next 12 months, including in the near term. There can be no assurance that we will be able to improve cash flows from operations, or that we will be able to access additional capital if and when required or on acceptable terms to us. Therefore, there can be no guarantee that our existing and anticipated capital resources will be adequate to meet our liquidity requirements. If we are unable to address our liquidity challenges, then our financial results and financial condition would be adversely affected.

We have incurred and may in the future incur significant costs associated with acquisitions, which reduces the amount of capital available to fund our business.

We have incurred, and in the future may continue to incur, significant costs associated with acquisitions. These costs may include investment banking fees, legal fees, accounting fees, printing and mailing of stockholder materials, integration, earn-outs, restructuring charges, and other costs, as well as past and possible future outlays of cash to support the business until its synergies are realized and sustainable. We may also incur costs related to potential future acquisitions, including expenditures on acquisition opportunities that do not result in completed transactions. As a result, the capital available to fund our activities has been and may in the future be further reduced. If we are unsuccessful in securing expected synergies from our acquisitions within a reasonable time period, then we will likely require additional cash to fund our operations.

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A material impairment in the carrying value of goodwill, intangible assets or other long-lived assets could negatively affect our consolidated operating results and net worth.

A significant portion of our assets consists of goodwill and other intangible assets relating to acquisitions. We review goodwill, other intangible assets and long-lived assets on an annual basis and whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the asset is considered impaired, it is reduced to its fair value, resulting in a non-cash charge to earnings during the period in which any impairment is determined.

During the second quarter of 2012, because of a significant decline in our stock price and revised forecasts regarding revenue, gross margin and operating profit, we undertook an interim review for potential impairment of our goodwill, intangible assets and other long-lived assets in connection with the second quarter close and recorded a goodwill impairment charge of $27.1 million in our consolidated statement of operations for the year ended December 31, 2012. In conjunction with our goodwill impairment test, we also tested our long-lived assets for impairment and adjusted the carrying value of each asset group to its fair value and recorded the associated impairment charge of $24.8 million in consolidated statements of operations for the year ended December 31, 2012. We will continue to monitor relevant market and economic conditions that could result in impairment, including a sustained drop in the market price of our common stock, increased competition or loss of market share, product innovation or obsolescence, or a decline of our business related to acquired companies. It is possible that conditions could deteriorate due to these factors, resulting in the need to adjust our estimates or to take additional impairment charges in the future. As a result, our operating results and stockholders equity could be materially and adversely affected.

We may experience quarterly fluctuations in our operating results due to a number of factors which make our future results difficult to predict and could cause our operating results to fall below any guidance we might issue or the expectations of public market analysts and investors.

Our quarterly and annual operating results have varied greatly in the past and will likely vary greatly in the future depending upon a number of factors, many of which are beyond our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. If our revenue or operating results fall below any guidance we may provide to the market or below the expectations of investors or securities analysts, the price of our common stock could decline.

In addition to other risk factors listed in this Risk Factors section, factors that may affect our quarterly operating results, business and financial condition include the following:

- business and economic conditions overall and in our markets;
- the timing and amount of orders we receive from our customers that may be tied to annual or other budgetary cycles, seasonal demand, product plans or program roll-out schedules;
- the recent effects of the U.S. Government sequester and related budget uncertainty on certain parts of our business;
- cancellations or delays of customer orders or the loss of a significant customer;
- our ability to obtain an adequate supply of quality components on a timely basis;
- the absence of significant backlog in our business;
- our inventory levels and the inventory levels of our customers and indirect sales channels;

competition;

new product announcements or introductions;

our ability to develop, introduce, market and deliver new products and product enhancements on a timely basis, if at all;

our ability to successfully market and sell our products and solutions into new geographic or market segments;

the sales volume, product configuration and mix of offerings that we sell;

technological changes in the markets for our products and solutions;

the rate of adoption of industry-wide standards;

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- the rate of development of emerging markets such as NFC-based mobile applications and cashless payment;
- reductions in the average selling prices that we are able to charge due to competition or other factors;
- strategic acquisitions, sales and dispositions;
- fluctuations in the value of foreign currencies against the U.S. dollar;
- the timing and amount of marketing and research and development expenditures;
- loss of key personnel;
- costs related to events such as dispositions, organizational restructuring, headcount reductions; and
- litigation or write-off of investments or goodwill.

Due to these and other factors, our revenues may not increase or even remain at their current levels. Because a majority of our operating expenses are fixed, a small variation in our revenues can cause significant variations in our operational results 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.

Based upon all of the factors described above, we have a limited ability to forecast with certainty the amount and mix of future revenues and expenses, and it is possible that at some time our operating results will fall below our estimates or any guidance we may provide to the market or the expectations of public market analysts and investors.

The unpredictable purchase patterns of customers in our ID Products segment impact our budgeting process and may adversely affect our results if orders are not placed in line with expectations.

In our Identity Management segment, sales tend to be relatively linear (regularly spaced throughout the quarter), as orders are tied to projects with relatively predictable timelines. In our ID Products segment, we sell our smart card readers primarily through a channel of distributors who place orders on an ongoing basis depending on their customers requirements. As a result, the size and timing of these orders can vary from quarter to quarter. This makes it difficult to predict revenues both in our smart card reader business, and for the company overall. In addition, the increasing use of RFID technology in the marketplace is resulting in larger program deployments of transponder products and components. Accordingly, changes in ordering patterns, including delays or reductions in orders from our Transponder customers also can have a significant effect on our business. Across both our segments, the timing of closing larger orders increases the risk of quarter-to-quarter fluctuation in revenues. 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. In addition, from time to time, we may experience unexpected increases or decreases in demand for our products resulting from fluctuations in our customers budgets, purchasing patterns or deployment schedules. These occurrences are not always predictable and can have a significant impact on our results in the period in which they occur.

If we do not accurately anticipate the correct mix of products that will be sold, we may be required to record charges related to excess inventories.

Due to the unpredictable nature of the demand for our products, we are required to place orders with our suppliers for components, finished products and services in advance of actual customer commitments to purchase these products. Significant unanticipated fluctuations in demand could result in costly excess production or inventories. In order to minimize the negative financial impact of excess production, we may be required to significantly reduce the sales price of the product to increase demand, which in turn could result in a reduction in the value of the

original inventory purchase. If we were to determine that we could not utilize or sell this inventory, we may be required to write down its value, which we have done in the past. Writing down inventory or reducing product prices could adversely impact our cost of revenues and financial condition.

We are subject to a lengthy sales cycle and additional delays could result in significant fluctuations in our quarterly operating results.

In much of our business, the initial sales cycle for a new customer usually takes a minimum of six to nine months, and even in the case of established customers, it may take up to a year for us to receive approval for a given purchase from the customer. In the case of emerging market areas such as NFC and cloud-based identity management services, this cycle may be longer and less predictable, as demand from our customers end markets may not be predictable. During the sales cycle, we may expend

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substantial financial and managerial resources with no assurance that a sale will ultimately result. The length of a new customer s sales cycle depends on a number of factors, many of which 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 could delay or reduce our receipt of new revenue and could cause us to expend more resources to obtain new customer wins. If we are unsuccessful in managing sales cycles, our business could be adversely affected.

Our business could be adversely affected by reductions or delays in the purchase of our products or services for government security programs in the United States and other countries.

We derive a substantial portion of our revenues from indirect sales to U.S. federal, state and local governments and government agencies, as well as from subcontracts under federal government prime contracts. Large government programs are an important market for our business, as higher security systems employing smart cards, RFID or other access control technologies are increasingly used to enable applications ranging from authorizing building and network access for federal employees to paying taxes online, to citizen identification, to receiving health care. We believe that the success and growth of our business will continue to be influenced by our successful procurement of government business either directly or through our indirect sales channels. Accordingly, changes in government purchasing policies or government budgetary constraints could directly affect our financial performance. Sales to government agencies and customers primarily serving the U.S. Government, including further sales pursuant to existing contracts, may be adversely affected by factors outside our control, such as the sequestration or other Congressional actions in addressing budget concerns, current economic uncertainty, downgrading of U.S. Government debt, the political climate in the U.S. focusing on cutting or limiting budgets and their effect on government budgets, limits on federal borrowing capacity, changes in procurement policies, budgetary considerations including Congressional delays in completing appropriation bills, domestic crises, international developments such as the downgrading of European debt, delays in developing technology standards related to government security programs, the adoption of new laws or regulations or changes to existing laws or regulations pertaining to electronic security, and changes in political or social attitudes with respect to security or electronic identification issues. In addition, our efforts to obtain new business may be hindered as budgetary or economic factors distract the attention of governments or impair the ability of governments to hear or act upon our value proposition due to reduced personnel or turnover. These same factors may also jeopardize our renewal or rebid opportunities on existing contracts. If current market and economic conditions persist or deteriorate, we may experience adverse impacts on our business, results of operations, cash flows, and financial condition. If agencies and departments of the United States or other governments were to stop, reduce or delay their use and purchases of our products and services, our revenue and operating results would be adversely affected.

Moreover, government orders are frequently awarded only after a formal competitive bidding process, which typically is protracted and dependent upon necessary funds being available to the public agency. We may not be awarded orders for which we bid directly and our dealers may not be successful in their bids that would utilize our offerings. In some cases, unsuccessful bidders for government agency orders are provided the opportunity to formally protest certain order awards through various agency, administrative and judicial channels. The protest process may substantially delay a successful bidder s award or result in cancellation of the order entirely. Furthermore, local government agency awards may be contingent upon availability of matching funds from federal or state entities and law enforcement and other government agencies are subject to political, budgetary, purchasing and delivery constraints. Any of these factors can make it difficult to predict our quarterly and annual revenues and operating results.

Additionally, we anticipate that an increasingly significant portion of our future revenues will come from government programs outside the U.S., such as national electronic identity, eGovernment, eHealth and others applications. We currently supply smart card readers, RFID stickers and credential management solutions for various government programs in Europe and Asia and are actively targeting additional programs in these areas as well as in Latin America. However, the timing of government smart card programs is not always certain and delays in program implementation are common. The delay of government projects in any country for any reason could negatively impact our sales.

The actions of the U.S. Government, the Federal Reserve and the U.S. Treasury may materially and adversely affect our business.

The U.S. Government, the Federal Reserve, the U.S. Treasury and other governmental and regulatory bodies have taken and continue to take various actions to address the recent financial crisis. There can be no assurance that such actions will have a beneficial impact on the U.S. economy. Additionally, the U.S. Congress and/or various states and local legislatures may enact additional legislation or regulatory action designed to address the current economic climate or for other purposes, which could have a material adverse effect on our ability to continue to execute our business strategies. To the extent the market does not respond favorably to these initiatives or they do not function as intended, they may not have a positive impact on our business.

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Our U.S. Government business is dependent upon receipt of certain governmental approvals or certifications, and failure to receive such approvals or certifications could have a material adverse effect on our sales in those market segments for which such approvals or certifications are customary or required.

While we are not able to quantify the amount of sales made to the U.S. Government due to the indirect nature of our selling process, we believe that orders for U.S. Government agencies represent a significant portion of our revenues. Failing to obtain certain government approvals or certifications could have a material adverse effect in those environments for which such approvals or certifications are customary or required. As newer versions of existing products, or new products in development are released, they may require certifications or approvals. In addition, the U.S. Government may introduce new requirements that some existing products will be required to meet. If we fail to obtain any required approvals or certifications for our products, our business will suffer.

Our business could be adversely affected by negative audits by government agencies; we could be required to reimburse the U.S. Government for costs that we have expended on government orders; and our ability to compete successfully for future orders could be materially impaired.

Government agencies in the U.S. and other countries may audit our business as part of their routine audits and investigations of government orders. As part of an audit, these agencies may review our performance on orders, cost structures and compliance with applicable laws, regulations and standards. These agencies may also review the adequacy of, and our compliance with, our own internal control systems and policies, including our purchasing, property, estimating, compensation and management information systems. If any of our costs are found to be improperly allocated to a specific order, the costs may not be reimbursed and any costs already reimbursed for such order may have to be refunded. An audit could materially affect our business competitive position and result in a material adjustment to our financial results or statements of operations. If a government agency audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of orders, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with the federal government. In addition, our business could suffer serious harm to its reputation if allegations of impropriety were made against us.

While our business has never had a negative audit by a governmental agency, we cannot assure you that one will not occur. If we were suspended or barred from supplying solutions to the federal government generally, or if our reputation or relationships with our distribution channel or government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenues and prospects would be materially harmed.

A significant portion of our sales is made through an indirect sales channel, and the loss of dealers, systems integrators, resellers, or other channel partners could result in decreased revenue.

We currently use an indirect sales channel that includes dealers, systems integrators, value added resellers and resellers to sell a significant portion of our products and solutions, primarily into markets or customers where the channel partner may have closer relationships or greater access than we do. Some of these channel partners also sell our competitors products, and if they favor our competitors products for any reason, they may fail to market our products as effectively or to devote resources necessary to provide effective sales, which would cause our sales to suffer. Indirect selling arrangements are intended to benefit both us and the channel partner, and may be long- or short-term relationships, depending on market conditions, competition in the marketplace and other factors. If we are unable to maintain effective indirect sales channels, there could be a reduction in the amount of product we are able to sell, and our revenues could decrease.

Our business could suffer if our third-party manufacturers cannot meet production requirements.

Many of our products are manufactured outside the U.S. by contract manufacturers. Our reliance on foreign manufacturing poses a number of risks, including, but not limited to:

- difficulties in staffing;
- currency fluctuations;
- potentially adverse tax consequences;

unexpected changes in regulatory requirements;

tariffs and other trade barriers;

export controls;

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political and economic instability;

lack of control over the manufacturing process and ultimately over the quality of our products;

late delivery of our products, whether because of limited access to our product components, transportation delays and interruptions, difficulties in staffing, or disruptions such as natural disasters;

capacity limitations of our manufacturers, particularly in the context of new large contracts for our products, whether because our manufacturers lack the required capacity or are unwilling to produce the quantities we desire; and

obsolescence of our hardware products at the end of the manufacturing cycle.

The use of contract manufacturing requires us to exercise strong planning and management in order to ensure that our products are manufactured on schedule, to correct specifications and to a high standard of quality. If any of our contract manufacturers cannot meet our production requirements, we may be required to rely on other contract manufacturing sources or identify and qualify new contract manufacturers. We may be unable to identify or qualify new contract manufacturers in a timely manner or at all or with reasonable terms and these new manufacturers may not allocate sufficient capacity to us in order to meet our requirements. Any significant delay in our ability to obtain adequate supplies of our products from our current or alternative manufacturers would materially and adversely affect our business and operating results. In addition, if we are not successful at managing the contract manufacturing process, the quality of our products could be jeopardized or inventories could be too low or too high, which could result in damage to our reputation with our customers and in the marketplace, as well as possible write-offs of excess inventory.

We have a limited number of suppliers of key components, and may experience difficulties in obtaining components for which there is significant demand.

We rely upon a limited number of suppliers for some key components of our products. For example, we currently utilize the foundry services of external suppliers to produce our ASICs for smart cards readers and inlays, and we use chips and antenna components from third-party suppliers in our contactless smart card readers. Our reliance on a limited number of suppliers may expose us to various risks including, without limitation, an inadequate supply of components, price increases, late deliveries and poor component quality. In addition, some of the basic components used in our reader products, such as semiconductors, may at any time be in great demand. This could result in components not being available to us in a timely manner or at all, particularly if larger companies have ordered more significant volumes of those components, or in higher prices being charged for components. Disruption or termination of the supply of components or software used in our products 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 are required to comply with regulations regarding the use of conflict minerals , and the difficulty of tracking the source of materials used in our products and components exposes us to risks that could adversely affect our business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires us to track and disclose the source of certain metals used in manufacturing which may stem from minerals (so called conflict minerals) which originate in the Democratic Republic of the Congo or adjoining regions. These metals, which include tantalum, tin, gold and tungsten, are central to the technology industry and may be present in some of our products as component parts. In most cases no acceptable alternative material exists which has the necessary properties. It may not be possible to determine the source of the metals by analysis; instead, a good faith description of the source of the intermediate components and raw materials must be obtained. The components which incorporate those metals may originate from many sources and we purchase components such as ASICs from manufacturers who may have a long and difficult process to trace the supply chain. As the price of these materials varies, producers of the metal intermediates can be expected to change the mix of sources used, and components and assemblies which we buy may have a mix of sources as their origin. We are required by SEC rules to carry out a diligent effort to determine and disclose the source of these materials in our products, with the first report due May 31, 2014. There can be no assurance we can obtain this information from intermediate producers who are unwilling or unable to provide this information or further identify their sources of supply or to notify us if these sources change. We will incur additional costs in order to comply with the SEC rules. In addition, our sourcing, supply and pricing of component parts may be adversely affected. We may face reputational challenges if we are unable to verify the sources of our materials as conflict-free .

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

Many of the systems we sell manage private personal information and protect information involved in sensitive government functions. A cybersecurity breach in one of these systems could cause serious harm to our business as a result of negative publicity and could prevent us from having further access to such systems or other similarly sensitive areas for other governmental clients.

As part of our technical support services, we agree, from time to time, to possess all or a portion of the security system database of our customers. This service is subject to a number of risks. For example, despite our security measures our systems may be vulnerable to cyber attacks by hackers, physical break-ins and service disruptions that could lead to interruptions, delays or loss of data. If any such compromise of our security were to occur, it could be very expensive to correct, could damage our reputation and could discourage potential customers from using our services. Although we have not experienced attempted cyber or physical attacks, we may experience such attempts in the future. Our systems also may be affected by outages, delays and other difficulties. Our insurance coverage may be insufficient to cover losses and liabilities that may result from such events.

Failure to properly manage the implementation of customer projects in our business may result in costs or claims against us, and our financial results could be adversely affected.

In our business, deployments of our solutions often involve large-scale projects. The quality of our performance on such projects depends in large part upon our ability to manage relationships with our customers and to effectively manage the implementation of our solutions in such projects and to deploy appropriate resources, including our own project managers and third-party subcontractors, in a timely manner. Any defects or errors or failures to meet clients expectations could result in damage to our reputation or even claims for substantial monetary damages against us. In addition, we sometimes provide guarantees to customers that we will complete a project by a scheduled date or that our solutions will achieve defined performance standards. If our solutions experience a performance problem, we may not be able to recover the additional costs we incur in our remedial efforts, which could materially impair profit derived from a particular project. Moreover, a portion of our revenues are derived from fixed price contracts.

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 costly litigation or liability.

Products such as our smart card readers, access control panels and RFID inlays may contain defects for many reasons, including defective design or manufacture, defective material or software inoperability issues. Often, these defects are not detected until after the products have been shipped. If any of our products contain defects or perceived defects or have reliability, quality or compatibility problems or perceived problems, our reputation might be damaged significantly, we could 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. In the event of an actual or perceived defect or other problem, we may need to invest significant capital, technical, managerial and other resources to investigate and correct the potential defect or problem and potentially divert these resources from other development efforts. If we are unable to provide a solution to the potential defect or problem that is acceptable to our customers, we may be required to incur substantial product recall, repair and replacement and even litigation costs. These costs could have a material adverse effect on our business and operating results.

We provide warranties on certain product sales, which range from 12 to 24 months, and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or to replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line combined with liability estimates based on the prior 12 months sales activities. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to recognize additional cost of sales may be required in future periods.

In addition, because our customers rely on our smart card readers to prevent unauthorized access to PCs, networks or facilities, a malfunction of or design defect in our products (or even a perceived defect) could result in legal or warranty claims against us for damages resulting from security breaches. If such claims are adversely decided against us, the potential liability could be substantial and have a material adverse effect on our business and operating results. Furthermore, the possible publicity associated with any such claim, whether or not decided against us, could adversely affect our reputation. In addition, a well-publicized security breach involving smart card-based or 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. Any of the foregoing events could cause demand for our products to decline, which would cause our business and operating results to suffer.

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Our global operations require significant financial, managerial and administrative resources and our results could be adversely affected if we are unable to manage them efficiently.

Our business model includes the management of separate product lines that address disparate market opportunities that are geographically dispersed. While there is some shared technology across our products, each product line requires significant research and development efforts to address the evolving needs of our customers and markets. To support our development and sales efforts, we maintain company offices and/or business operations in several locations around the world, including Australia, Canada, Germany, Hong Kong, India, Japan, The Netherlands, Singapore, Switzerland and the U.S. We also maintain manufacturing facilities in Germany, Singapore and California and manage contract manufacturers in multiple countries, including China and Singapore. Managing our various development, sales, administrative and manufacturing operations places a significant burden on our financial systems and has contributed to a level of operational spending that is disproportionately high compared to our current revenue levels.

Operating in diverse geographic locations also 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 in different geographic areas and time zones, who are from diverse cultural backgrounds and who speak different languages;
- travel between our different company offices;
- maintain sufficient internal financial controls in multiple geographic locations that may have different control environments;
- 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.

Any failure to effectively manage our operations globally could have a material adverse effect on our business and operating results.

We conduct a significant portion of our operations outside the U.S. and economic, political, regulatory and other risks associated with international sales and operations could have an adverse effect on our results of operation.

We conduct a substantial portion of our business in Europe and Asia. Approximately 48% of our revenue in 2012 and 52% of our revenue in the first quarter of 2013 was derived from customers located outside the U.S.

Because a significant number of our principal customers are located in other countries, we anticipate that international 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 risks associated with foreign operations, any of which could impact our sales and/or our operational performance. These risks include, but are not limited to:

- changes in foreign currency exchange rates;
- changes in a specific country s or region s political or economic conditions and stability, particularly in emerging markets;

unexpected changes in foreign laws and regulatory requirements;

export controls;

potentially adverse tax consequences;

longer accounts receivable collection cycles;

difficulty in managing widespread sales and manufacturing operations; and

less effective protection of intellectual property.

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Fluctuations in the valuation of foreign currencies could impact costs and/or revenues we disclose in U.S. dollars, and could result in foreign currency losses.

A significant portion of our business is conducted in foreign currencies, principally the Euro. Fluctuations in the value of foreign currencies relative to the U.S. Dollar will continue to cause currency exchange gains and losses. If a significant portion of operating expenses are incurred in a foreign currency such as the Euro, and revenues are generated in U.S. Dollars, exchange rate fluctuations might have a positive or negative net financial impact on these transactions, depending on whether the U.S. Dollar devalues or revalues compared to the Euro. In addition, the valuation of current assets and liabilities that are denominated in a currency other than the functional currency can result in currency exchange gains and losses. For example, when one of our subsidiaries uses the Euro as the functional currency, and this subsidiary has a receivable in U.S. Dollars, a devaluation of the U.S. Dollar against the Euro of 10% would result in a foreign exchange loss of the reporting entity of 10% of the value of the underlying U.S. Dollar receivable. We cannot predict the effect of exchange rate fluctuations upon future quarterly and annual operating results. The effect of currency exchange rate changes may increase or decrease our costs and/or revenues in any given quarter, and we may experience currency losses in the future. To date, we have not adopted a hedging program to protect against risks associated with foreign currency fluctuations.

Personnel Risks

Our key personnel and directors 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 were to leave and not be replaced with sufficiently qualified and experienced personnel, our business could be adversely affected.

We also believe that our future success will depend in large part on our ability to attract and retain highly qualified technical and management personnel. However, competition for such personnel is intense. 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.

Likewise, as a small, publicly-traded company, we are challenged to identify, attract and retain experienced professionals with diverse skills and backgrounds who are qualified and willing to serve on our Board of Directors. The increased burden of regulatory compliance under the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act creates additional liability and exposure for directors. Financial losses in our business and lack of growth in our stock price make it difficult for us to offer attractive director compensation packages. If we are not able to attract and retain qualified board members, our ability to practice a high level of corporate governance could be impaired.

Qualified management, marketing, and sales personnel are difficult to locate, hire and train, and if we cannot attract and retain qualified personnel, it will harm the ability of our business to grow.

The success of our company depends, in part, on the continued service of key managerial, marketing and sales personnel. Competition for qualified management, technical, sales and marketing employees is intense. We cannot assure you that we will be able to attract, retain and integrate employees to develop and continue our business and successfully implement strategic acquisitions.

Risks of Financial and Capital Markets

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

Over the past few years, the NASDAQ Stock Market and the Frankfurt Stock Exchange have experienced significant price and volume fluctuations that have particularly affected the market prices of the stocks of technology companies. Volatility in our stock price on either or both exchanges may result from a number of factors, including, among others:

low volumes of trading activity in our stock;

variations in our or our competitors financial and/or operational results;

the fluctuation in market value of comparable companies in any of our markets;

expected, perceived or announced relationships or transactions with third parties;

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announcements of significant contract wins or losses;

comments and forecasts by securities analysts;

trading patterns of our stock on the NASDAQ Stock Market or the Frankfurt Stock Exchange;

the inclusion or removal of our stock from market indices, such as groups of technology stocks or other indices;

loss of key personnel;

announcements of technological innovations or new products by us or our competitors;

announcements of dispositions, organizational restructuring, headcount reductions, litigation or write-off of investments;

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.

If we fail to comply with the listing requirements of The NASDAQ Global Market, the price of our common stock and our ability to access the capital markets could be negatively impacted.

Our common stock currently is listed on The NASDAQ Global Market. There are a number of continuing requirements that must be met in order for our common stock to remain listed on The NASDAQ Global Market, and the failure to meet these listing standards could result in the delisting of our common stock from NASDAQ. On August 16, 2012, we received notification from NASDAQ that the Company no longer met the requirement for continued listing under NASDAQ s listing rules because the minimum bid price of our common stock was below $1.00 over a period of 30 consecutive trading days. On October 18, 2012, NASDAQ notified us that because the closing bid price of our common stock was above the minimum $1.00 per share price for ten consecutive trading days, we had regained compliance with the listing rules. However, should our common stock price again fall below the $1.00 minimum bid price for 30 consecutive trading days, we may fail to comply with NASDAQ listing rules and be required to take action to improve the price of our common stock, for example by seeking approval for a reverse stock split. If our common stock ceases to be listed for trading on The NASDAQ Global Market for any reason, it may harm our stock price, increase the volatility of our stock price, decrease the level of trading activity and affect our ability to access the capital markets.

You may experience dilution of your ownership interests due to the future issuance of additional shares of our stock, and future sales of shares of our common stock could have an adverse effect on our stock price.

We have issued a significant number of shares of our common stock, together with warrants to purchase shares of our common stock, in connection with a number of financing transactions and acquisitions in recent years. In April 2013 we issued 2,038,559 shares of Identive common stock in a private transaction with Lincoln Park Capital Fund, LLC (LPC), and entered into an agreement with LPC that enables us to sell additional shares in the future. In May 2011 we issued approximately 7.8 million shares of Identive common stock in an underwritten public offering. Additionally, as of March 31, 2013, warrants to purchase approximately 8.6 million shares of Identive common stock were outstanding. From time to time, in the future we also may issue additional previously authorized and unissued securities, resulting in the dilution of the ownership interests of our current stockholders. We are currently authorized to issue up to 130,000,000 shares of common stock. As of April 30, 2013, 62,298,139 shares of common stock were outstanding, excluding 618,400 shares held in treasury.

In addition, the Company maintains various incentive plans under which equity may be issued. As of March 31, 2013, an aggregate of approximately 10.6 million shares of common stock are reserved for future grants and 4.2 million shares are reserved for future issuance pursuant to outstanding equity awards under our various equity incentive plans. In addition, as of March 31, 2013, an aggregate of approximately 3.3 million shares of common stock are reserved for future issuance in connection with the Company s acquisition of Bluehill ID AG. We may issue additional shares of our common stock or other securities that are convertible into or exercisable for shares of common stock in connection with the hiring of personnel, future acquisitions, future private placements, or future public offerings of our securities for capital raising or for other business purposes. If we issue additional securities, the aggregate percentage ownership of our existing stockholders will be reduced. In addition, any new securities that we issue may have rights senior to those of our common stock.

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The issuance of additional shares of common stock or preferred stock or other securities, or the perception that such issuances could occur, may create downward pressure on the trading price of our common stock.

One of our directors indirectly holds significant amounts of our common stock and could have significant influence over the outcome of corporate actions requiring board and stockholder approval.

As of April 30, 2013, Mountain Partners AG, together with its affiliates (collectively Mountain Partners), had the right to vote approximately 12% of the outstanding shares of our common stock. Daniel Wenzel, a director of our Company, is a co-founder of Mountain Partners. As of April 30, 2013, the directors and officers of Identive Group collectively held approximately 7% of our common stock. Accordingly, our directors and officers could have influence over the outcome of corporate actions requiring board and stockholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction.

Provisions in our charter documents and Delaware law may delay or prevent the acquisition of Identive by another company, which could decrease the value of your shares.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us or enter into a material transaction with us without the consent of our Board of Directors. These provisions include a classified Board of Directors and limitations on actions by our stockholders by written consent. Delaware law imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. These provisions will apply even if the offer were to be considered adequate by some of our stockholders. Because these provisions may be deemed to discourage a change of control, they may delay or prevent the acquisition of our Company, which could decrease the value of our common stock.

Legal and Regulatory Risks

Our business could be adversely affected by changes in laws or regulations pertaining to security.

The U.S. federal government, suppliers to the federal government and certain industries in the public sector currently fall, or may in the future fall, under particular regulations pertaining to security. Some of the laws, regulations, certifications or requirements that may stimulate new security systems sales include the following:

Homeland Security Presidential Directive (HSPD) 12 and Federal Information Processing Standards (FIPS) 201 produced by National Institute of Standards and Technology (NIST);

Federal Information Security Management Act (FISMA);

Transportation Security Administration s (TSA) Transportation Worker Identification Credential (TWIC) program;

Sarbanes-Oxley Act of 2002 (also known as the Public Company Accounting Reform and Investor Protection Act);

Dodd-Frank Act;

Health Insurance Portability and Accountability Act (HIPAA);

Gramm-Leach Bliley Act of 1999 (GLBA, a.k.a., the Financial Modernization Act);

Customs-Trade Partnership Against Terrorism (C-TPAT);

Free and Secure Trade Program (FAST);

Chemical Facility Anti Terrorism Standards (CFATS); and

various codes of the Code of Federal Regulations (CFR).

Discontinuance of, changes in, or lack of adoption of laws or regulations pertaining to security could adversely affect our performance.

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We are subject to extensive government regulation, and any failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.

Our business is affected by and must comply with various government regulations that impact our operating costs, profit margins and our internal organization and operations. Furthermore, our business may be audited to assure compliance with these requirements. Any failure to comply with applicable regulations, rules and approvals could result in the imposition of penalties, the loss of government orders or the removal of our products from the GSA approved list, any of which could adversely affect our business, financial condition and results of operations. Among the most significant regulations affecting our business are the following:

- the Federal Acquisition Regulations, or the FAR, and agency regulations supplemental to the FAR, which comprehensively regulate the formation and administration of, and performance under government contracts;
- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;
- the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under cost-based government contracts;
- the Foreign Corrupt Practices Act; and
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

These regulations affect how our customers can do business with us, and, in some instances, the regulations impose added costs on our business. Any changes in applicable laws and regulations could restrict our ability to conduct our business. Any failure to comply with applicable laws and regulations could result in contract termination, price or fee reductions or suspension or debarment from contracting with the federal government generally.

If we are unable to continue to obtain U.S. Government authorization regarding the export of our products, or if current or future export laws limit or otherwise restrict our business, we could be prohibited from shipping our products to certain countries, which could cause our business, financial condition and results of operations to suffer.

In our business, we must comply with U.S. and European Union (EU) laws, among others, regulating the export of our products. In some cases, explicit authorization from the U.S. or an EU government is needed to export our products. The export regimes and the governing policies applicable to our business are subject to changes. We cannot be certain that such export authorizations will be available to us or for our products in the future. In some cases, we rely upon the compliance activities of our prime contractors, and we cannot be certain they have taken or will take all measures necessary to comply with applicable export laws. If we or our prime contractor partners cannot obtain required government approvals under applicable regulations, we may not be able to sell our products in certain international jurisdictions.

We face risks from future claims of third parties and litigation.

From time to time, we may be subject to claims of third parties, possibly resulting in litigation, which could include, among other things, claims regarding infringement of the intellectual property rights of third parties, product defects, employment-related claims, and claims related to acquisitions, dispositions or restructurings. Any such claims or litigation may be time-consuming and costly, divert management resources, cause product shipment delays, require us to redesign our products, require us to accept returns of products and to write off inventory, or have other adverse effects on our business. Any of the foregoing could have a material adverse effect on our results of operations and could require us to pay significant monetary damages.

We expect the likelihood of intellectual property infringement and misappropriation claims may increase as the number of products and competitors in our markets grows and as we increasingly incorporate third-party technology into our products. As a result of infringement

claims, we could be required to license intellectual property from a third party or redesign our products. Licenses may not be offered when we need them or on acceptable terms. If we do obtain licenses from third parties, we may be required to pay license fees or royalty payments or we may be required to license some of our intellectual property to others in return for such licenses. If we are unable to obtain a license that is necessary for us or our third-party manufacturers to manufacture our allegedly infringing 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 also be unsuccessful in redesigning our products. Our suppliers and customers may be subject to infringement claims based on intellectual property included in our products. We have historically agreed to indemnify our suppliers and customers for patent infringement claims relating to our products. The scope of

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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.

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, which afford only limited protection. We may not be successful in protecting 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, and from time to time we may be required to use litigation to protect our proprietary technology. This may result in our incurring substantial costs and we may not be successful in any such litigation.

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 without authorization. In addition, the laws of some foreign countries do not protect proprietary and intellectual property rights to the same extent as do the laws of the U.S. Because many of our products are sold and a significant portion of our business is conducted outside the U.S., our exposure to intellectual property risks may be higher. Our means of protecting our proprietary and intellectual property rights may not be adequate. There is a risk that our competitors will independently develop similar technology or duplicate our products or design around patents or other intellectual property rights. If we are unsuccessful in protecting our intellectual property or our products or technologies are duplicated by others, our business could be harmed.

Changes in tax laws or the interpretation thereof, adverse tax audits and other tax matters may adversely affect our future results.

A number of factors may impact our tax position, including:

- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

Any of these factors could make it more difficult for us to project or achieve expected tax results. An increase or decrease in our tax liabilities due to these or other factors could adversely affect our financial results in future periods.

We have identified material weaknesses in our internal control over financial reporting. We will continue to incur costs to remediate these weaknesses and to maintain effective internal controls over financial reporting. If we are unable to remediate these material weaknesses, and if additional weaknesses are discovered in the future, our business, results of operations and investors confidence in us could be materially affected.

Under Sections 302 and 404 of the Sarbanes-Oxley Act of 2002, our management is required to make certain assessments and certifications regarding our disclosure controls and internal controls over financial reporting. We have dedicated, and expect to continue to dedicate, significant management, financial and other resources in connection with our compliance with Section 404 of the Sarbanes-Oxley Act. The process of maintaining and evaluating the effectiveness of these controls is expensive, time-consuming and requires significant attention from our management and staff. During the course of our evaluation, we may identify areas requiring improvement and may be required to design enhanced processes and controls to address issues identified through this review. This could result in significant delays and costs to us and require us to divert substantial resources, including management time from other activities.

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As described in Controls and Procedures in Part I, Item 4 of this report, in connection with the audit of our financial statements as of and for the year ended December 31, 2012, we identified material weaknesses in internal control over financial reporting. Specifically, we determined that there was insufficient review and oversight of the recording of complex and non-routine transactions. While we expect to complete the implementation of remediation measures and remediate our existing material weaknesses by the end of 2013, there can be no assurance that such remediation efforts will be successful or that our internal control over financial reporting will be effective as a result of these efforts. In addition, we may in the future identify additional internal control deficiencies that could rise to the level of a material weakness or uncover errors in financial reporting.

In addition, all internal control systems, no matter how well designed and operated, can only provide reasonable assurance that the objectives of the control system are met. Because there are inherent limitations in all control systems, no evaluation of control can provide absolute assurance, that all control issues and instances of fraud, if any, within the Company have been or will be detected. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Any failure of our internal control systems to be effective could adversely affect our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits are listed on the Exhibit Index at the end of this Quarterly Report. The exhibits required by Item 601 of Regulation S-K, listed on such Index in response to this Item, are incorporated herein by reference.

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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.

IDENTIVE GROUP, INC.

May 10, 2013

By: /s/ AYMAN S. ASHOUR
Ayman S. Ashour
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer and Director)

May 10, 2013

By: /s/ DAVID WEAR
David Wear
Chief Financial Officer and Secretary
(Principal Financial Officer)

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EXHIBIT INDEX

Exhibit Number	DESCRIPTION OF DOCUMENT
10.1	Purchase Agreement dated as of April 16, 2013, by and between Identive Group, Inc. and Lincoln Park Capital Fund LLC (Filed previously as an exhibit to the Company s Current Report on Form 8-K, filed April 16, 2013 (SEC File No. 000-29440).)
10.2	Second Amendment to Loan and Security Agreement dated April 22, 2013 among Identive Group, Inc., certain of its subsidiaries, and Hercules Technology Growth Capital, Inc. (Filed previously as an exhibit to the Company s Current Report on Form 8-K, filed April 23, 2013 (SEC File No. 000-29440).)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS *	XBRL Instance Document
101.SCH *	XBRL Taxonomy Extension Schema Document
101.CAL *	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF *	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB *	XBRL Taxonomy Extension Label Linkbase Document
101.PRE *	XBRL Taxonomy Extension Presentation Linkbase Document

* Pursuant to Rule 401T of Regulation S-T, the interactive files on Exhibit 101 are deemed not filed or part of a registration statement of prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.