IDENTIVE GROUP, INC.
Form 10-Q
November 09, 2010
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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 September 30, 2010

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 ¨ No ¨

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

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

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

At November 8, 2010, 44,002,764 shares of common stock were outstanding, including 618,400 shares held in treasury.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net revenue	$ 23,296	$ 13,334	$ 59,820	$ 29,450
Cost of revenue	13,173	6,657	33,116	14,803
Gross profit	10,123	6,677	26,704	14,647
Operating expenses:				
Research and development	1,035	1,252	3,513	3,175
Selling and marketing	4,823	3,795	14,877	8,763
General and administrative	5,341	4,384	16,201	10,706
Restructuring			337	
Gain on sale of assets		(1,168)		(1,417)
Total operating expenses	11,199	8,263	34,928	21,227
Loss from operations	(1,076)	(1,586)	(8,224)	(6,580)
Loss on equity investments		(225)		(795)
Interest expense, net	(208)	(193)	(654)	(292)
Foreign currency gains (losses), net	388	121	(174)	287
Loss from continuing operations before income taxes and noncontrolling interest	(896)	(1,883)	(9,052)	(7,380)
(Provision) benefit for income taxes	(39)	(433)	866	1,307
Loss from continuing operations	(935)	(2,316)	(8,186)	(6,073)
Less: Net loss attributable to noncontrolling interest	109		526	
Loss from continuing operations attributable to Identive Group, Inc.	(826)	(2,316)	(7,660)	(6,073)
Gain (loss) from discontinued operations, net of income taxes	(79)	39	(69)	190
Gain on sale of discontinued operations, net of income taxes	55	40	138	115
Net loss attributable to Identive Group, Inc.	$ (850)	$ (2,237)	$ (7,591)	$ (5,768)
Basic and diluted net loss per share attributable to Identive Group, Inc.:				

Loss from continuing operations	$ (0. 02)	$ (0. 09)	$ (0.18)	$ (0.29)
Income from discontinued operations	$ 0.00	$ 0.00	$ 0.00	$ 0.01
Net loss per share	$ (0.02)	$ (0.09)	$ (0.18)	$ (0.28)
Weighted average shares used to compute basic and diluted loss per share	43,279	25,135	41,901	20,972
Consolidated net loss:				
Net loss attributable to Identive Group, Inc.	$ (850)	$ (2,237)	$ (7,591)	$ (5,768)
Net loss attributable to noncontrolling interest	(109)		(526)	
Consolidated net loss	$ (959)	$ (2,237)	$ (8,117)	$ (5,768)

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(unaudited)

	September 30, 2010	December 31, 2009 (A)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,171	$ 4,836
Accounts receivable, net of allowances	13,049	6,739
Inventories, net	8,220	5,379
Income taxes receivable	546	274
Other current assets	2,872	1,647
Total current assets	30,858	18,875
Property and equipment, net	4,426	683
Goodwill	46,923	21,895
Intangible assets, net	34,843	22,082
Other assets	376	1,036
Total assets	$ 117,426	$ 64,571
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 11,605	$ 5,530
Bank line of credit	424	
Liability to related party	1,046	1,027
Accrued compensation and related benefits	2,593	2,884
Mortgage loan payable to bank	58	
Other accrued expenses and liabilities	12,772	5,132
Income taxes payable		188
Total current liabilities	28,498	14,761
Long-term liability to related party	7,692	7,899
Long-term mortgage loan payable to bank	877	
Deferred tax liability	6,860	3,515
Long-term income taxes payable	724	456
Total liabilities	44,651	26,631
Commitments and contingencies (see Notes 12 and 13)		
Equity:		
Identive Group, Inc. Stockholders equity:		
Common stock, $0.001 par value: 110,000 shares authorized; 43,915 and 25,753 shares issued as of September 30, 2010 and December 31, 2009, respectively	44	26
Additional paid-in capital	295,983	253,910
Treasury stock, 618 as of September 30, 2010 and December 31, 2009	(2,777)	(2,777)

Accumulated deficit	(223,969)	(216,378)
Other accumulated comprehensive (loss) income	1,186	3,159
Total Identive Group, Inc. Stockholders equity	70,467	37,940
Noncontrolling interest	2,308	
Total Equity	72,775	37,940
Total liabilities and equity	$ 117,426	$ 64,571

(A) The condensed consolidated balance sheet has been derived from the audited consolidated financial statements at December 31, 2009 but does not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE LOSS

Year Ended December 31, 2009 and Nine Months Ended September 30, 2010

(unaudited)

	Identive Group, Inc. Stockholders								
	Common Stock					Other Accumulated			
(In thousands)	Shares	Amount	Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity	Comprehensive Loss
Balances, December 31, 2008	16,362	$ 16	$ 229,788	$ (2,777)	$ (202,199)	$ 3,298	$	$ 28,126	
Issuance of common stock in connection with acquisition	9,391	10	23,775					23,785	
Stock-based compensation expense			347					347	
Comprehensive loss:									
Net loss					(14,179)			(14,179)	$ (14,179)
Foreign currency translation adjustment						(139)		(139)	(139)
Comprehensive loss									$ (14,318)
Balances, December 31, 2009	25,753	$ 26	$ 253,910	$ (2,777)	$ (216,378)	$ 3,159	$	$ 37,940	
Issuance of common stock in connection with Bluehill ID acquisition	15,300	15	34,562					34,577	
Issuance of common stock in connection with RockWest acquisition	2,600	3	4,196					4,199	
Issuance of stock options in connection with Bluehill ID acquisition			3,007					3,007	
Repurchase of Identive treasury stock in connection with Bluehill ID acquisition				(2,880)				(2,880)	
Issuance of common stock			(402)	2,880				2,478	
Issuance of common stock for executive bonus	81		135					135	
Issuance of common stock to affiliates for conversion of loan	181		291					291	
Noncontrolling interest in a subsidiary							3,057	3,057	

Stock-based compensation expense			284					284	
Comprehensive loss:									
Net loss					(7,591)		(526)	(8,117)	$ (8,117)
Foreign currency translation adjustment						(1,973)	(223)	(2,196)	(2,196)
Comprehensive loss									$ (10,313)
Balances, September 30, 2010	43,915	$ 44	$ 295,983	$ (2,777)	$ (223,969)	$ 1,186	$ 2,308	$ 72,775	

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net loss	$ (8,117)	$ (5,768)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain from discontinued operations	(69)	(305)
Deferred income taxes	(223)	(1,986)
Depreciation and amortization	3,475	711
Gain on disposal of property and equipment		(1,264)
Accretion of liability to related party discount	581	
Interest on bank line of credit and mortgage loan	56	
Stock-based compensation expense	1,018	203
Loss on equity investments		795
Changes in operating assets and liabilities:		
Accounts receivable	(3,053)	2,582
Inventories	(919)	383
Other assets	(853)	104
Income taxes receivable	(272)	194
Accounts payable	2,822	(283)
Liability to related party	(829)	71
Accrued expenses	1,946	(211)
Other liabilities		(76)
Income taxes payable	(316)	125
Net cash used in operating activities from continuing operations	(4,753)	(4,725)
Net cash (used in) provided by operating activities from discontinued operations	(778)	(128)
Net cash used in operating activities	(5,531)	(4,853)
Cash flows from investing activities:		
Capital expenditures	(638)	(271)
Cash paid for Hirsch acquisition		(14,167)
Cash acquired in acquisitions	4,881	3,275
Proceeds from sale of assets, net		2,087
Maturities of short-term investments	1,015	
Net cash provided by (used in) investing activities	5,258	(9,076)
Cash flows from financing activities:		
Payment on mortgage loan	(40)	
Payment on bank line of credit, net	(52)	
Issuance of common stock	1,936	

Net cash provided by financing activities	1,844	
Effect of exchange rates on cash and cash equivalents	(236)	(459)
Net increase (decrease) in cash and cash equivalents	1,335	(14,388)
Cash and cash equivalents at beginning of period	4,836	20,550
Cash and cash equivalents at end of period	$ 6,171	$ 6,162

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Identive Group, Inc. (Identive or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of Company s unaudited condensed consolidated financial statements have been included. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 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, 2009. The preparation of unaudited condensed consolidated financial statements necessarily requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

On April 30, 2009, the Company acquired Hirsch Electronics Corporation (Hirsch), a privately-held California corporation that designs, engineers, manufactures and markets software, hardware and services in the security management system/physical access control market. The results for the acquired Hirsch business are included in the Company s consolidated statements of operations since April 30, 2009. On January 4, 2010, the Company acquired Bluehill ID AG (Bluehill ID), a Swiss industrial holding group focused on the radio frequency identification (RFID)/identification and security industries. The results for the acquired Bluehill ID business are included in the Company s consolidated statements of operations since January 4, 2010. On April 14, 2010, the Company acquired RockWest Technology Group (RockWest), a privately held provider of identification and security solutions based in Denver, Colorado. The results for the acquired RockWest business are included in the Company s consolidated statements of operations since April 14, 2010. As a result of the timing of these acquisitions, the Company s operating results for the periods presented are not directly comparable.

Reclassifications

During the three and nine months ended September 30, 2010, the Company reclassified certain general and administration costs, that were previously recorded as cost of revenues. Accordingly, $0.3 million and $0.6 million of costs reported in the three and nine months ending September 30, 2009, respectively, have been reclassified from cost of revenues to general and administration to conform to the current period s presentation. In addition, the Company reclassified certain amounts of research and development and sales and marketing to general and administration for the three and nine months ended September 30, 2009 to conform to the current period s presentation. The reclassification did not impact the Company s previously reported net revenues, operating income, net income, or earnings per share.

Prior to January 4, 2010, the Company operated in two business segments, Security and Identity Solutions and Digital Media and Connectivity. Following the Company s acquisition of Bluehill ID on January 4, 2010, the Company now operates in two different business segments that reflect the Company s current organizational structure and focus on providing secure identification solutions. The Company s new reportable segments are Identity Management Solutions & Services (ID Management) and Identification Products & Components (ID Products). Due to change in the segments in 2010, prior period amounts have been reclassified to conform to the new segments in 2010 as discussed in Note 11.

Discontinued Operations

The financial information related to the Company s former Digital Television solutions (DTV solutions) business and retail Digital Video and Digital Media Reader business is reported as discontinued operations for all periods presented as discussed in Note 8.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

Recent Accounting Pronouncements and Accounting Changes

In October 2009, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) No. 2009-14, *Software (Topic 985) Certain Arrangements That Contain Software Elements a consensus of the FASB Emerging Issues Task Force* (EITF) (ASU 2009-14), which amends the scope of software revenue guidance in ASC Subtopic 985-605, *Software-Revenue Recognition,* to exclude tangible products containing software and non-software components that function together to deliver the product s essential functionality.

In October 2009, FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements a consensus of the FASB EITF* (ASU 2009-13), which eliminates the residual method of allocation and requires the relative selling price method when allocating deliverables of a multiple-deliverable revenue arrangement. ASU 2009-13 specifies the best estimate of a selling price is consistent with that used to determine the price to sell the deliverable on a standalone basis.

ASU 2009-14 and ASU 2009-13 are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, and must be adopted in the same period using the same transition method. If adoption is elected in a period other than the beginning of a fiscal year, the amendments in these standards must be applied retrospectively to the beginning of the fiscal year. Full retrospective application of these amendments to prior fiscal years is optional. The Company is currently assessing the timing of adoption and effects that ASU 2009-14 and ASU 2009-13 will have on its consolidated results of operations and financial condition.

2. Acquisitions

Acquisition of RockWest (Multicard U.S.)

The Company completed the acquisition of RockWest on April 14, 2010 (the RockWest acquisition date), pursuant to a Share Purchase Agreement between the Company, RockWest and certain sellers of RockWest dated March 30, 2010 and amended April 9, 2010 (the Share Purchase Agreement). Subsequently, RockWest was integrated into the Company s Multicard business in September 2010 and adopted the name Multicard U.S. . RockWest provides ID management solutions and services to the education, government, corporate, casino and healthcare markets in the United States and is included in the Company s ID Management segment. The business is based in Denver, Colorado and has branch offices in California, Arizona and New Mexico. The Company believes the focus of RockWest on identity credential issuance and personalization and identification system integration complements the Company s focus on providing identity management solutions.

Under the Share Purchase Agreement, the Company issued an aggregate of 2.6 million restricted shares of its common stock to George Levy, Matt McDaniel, Hugo Garcia and Stan McKinney (the Sellers) as consideration for the acquisition. The shares issued to the Sellers are subject to a 24-month lock-up from the closing date of the acquisition. Additionally, the Sellers are eligible to receive limited earn-out payments, subject to the satisfaction of conditions specified in the Share Purchase Agreement, in the form of cash and shares of common stock subject to an 18-month lock-up period.

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

Fair value of common stock	$ 4,199
Fair value of earn-out contingent consideration	298
Fair value of total consideration transferred	4,497
Fair value of RockWest net identifiable assets acquired	(1,589)
Goodwill	$ 2,908

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

The fair value of the shares of the Company s common stock issued in connection with the acquisition was determined using the closing market price of the Company s common stock as of the RockWest acquisition date of $1.90 per share and then discounted to reflect the restriction on the resale or transfer of shares under the Securities Act of 1933. The fair value of the earn-out consideration was based on achieving certain revenue and profit targets as defined under the Share Purchase Agreement. These contingent payments were probability weighted and also discounted to reflect the restriction on the resale or transfer of shares.

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

Assets acquired and liabilities assumed as of April 14, 2010 (in thousands):

Cash and cash equivalents	$ 615
Accounts receivable	482
Inventories	463
Other assets	11
Property and equipment	43
Accounts payable	(711)
Deferred revenue	(731)
Note payable to bank	(56)
Accrued expenses and other liabilities	(162)
Amortizable intangible assets:	
Customer relationships	2,210
Order backlog	30
Deferred tax liabilities in connection with acquired intangible assets and inventory fair value adjustment, net	(605)
Fair value of RockWest net identifiable assets acquired	$ 1,589

In connection with the measurement of net assets, the Company estimates the fair value of the deferred revenue obligations assumed. The estimated fair value of the support obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin. The estimated costs to fulfill the obligations are based on the historical costs related to fulfilling the obligations.

Intangible assets of $2.2 million consist primarily of customer relationships, which relate to RockWest s ability to sell its products and services to its existing customers. The customer relationships were valued using the income approach on earnings before income tax (EBIT) based on discounted cash flow (DCF). The discount rate used in the present value calculations was derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset s characteristics. Based on these factors, a discount rate of 22.0% was deemed appropriate for valuing the intangible assets. The intangible assets of $2.2 million are subject to amortization and the Company expects to amortize customer relationships on a straight-line basis over their expected useful life of approximately six years.

Of the total purchase consideration, $2.9 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 RockWest acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company s ID Management reportable segment in accordance with ASC Topic 350 *Intangibles Goodwill and Other* (ASC 350). None of the goodwill recorded as part of the RockWest acquisition will be deductible for United States federal income tax purposes.

Deferred tax assets and liabilities resulting from the acquisition of RockWest have been netted, where applicable. As a result, deferred tax liabilities of $0.6 million have been considered in the purchase price allocation. Following the RockWest acquisition, RockWest has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $0.6 million, as described above, has been netted with the Company s existing deferred tax assets. The carrying value of the Company s net deferred tax assets reflects that the Company has been unable to generate sufficient taxable income in certain tax jurisdictions. A valuation allowance is provided for deferred tax assets if it is more likely than not that the benefits of such items

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

will not be realized. As a result of netting the deferred tax liability of $0.6 million with the Company s existing deferred tax assets, there is a $0.6 million release of the Company s valuation allowance. In accordance with ASC 805, the release of the valuation allowance was booked as a tax benefit in the 2010 second quarter financial statements.

The Company recognized zero and $0.1 million of acquisition-related costs that were expensed in the three and nine months ended September 30, 2010, respectively. These costs are included as part of general and administration costs in the condensed consolidated statement of operations.

The amounts of revenue and earnings of RockWest included in the Company s condensed consolidated statement of operations from the RockWest acquisition date through September 30, 2010 are as follows (in thousands):

Revenues	$ 4,659
Net income (loss)	$ 38

Acquisition of Bluehill ID

The Company completed the acquisition of Bluehill ID on January 4, 2010 (the Bluehill acquisition date), in accordance with the Business Combination Agreement dated as of September 20, 2009, as amended (the Business Combination Agreement). The results of Bluehill ID s operations have been included in the consolidated financial statements since that date. Bluehill ID is a leading provider of automatic identification and radio frequency identification (RFID) technologies, products, services and solutions used in the fields of security, identification, tracking and further growing applications. The majority of Bluehill ID sales are to customers in Europe. As a result of the acquisition the Company is a provider of leading-edge products and solutions in the areas of physical and logical access control, identity management and RFID systems to governments, commercial and industrial enterprises and consumers. The Company expects to achieve significant synergies and cost reductions as a result of eliminating redundant processes and facilities.

Pursuant to the Business Combination Agreement, the Company made an offer to the Bluehill ID shareholders to acquire all of the Bluehill ID shares and issued 0.52 new shares of the Company s common stock for every one share of Bluehill ID tendered (the Bluehill ID acquisition). A total of 29,422,714, or approximately 92% of Bluehill ID shares outstanding were tendered in the offer and exchanged for a total of 15,299,797 new shares of the Company s common stock. The issuance of the shares of the Company s common stock to the former shareholders of Bluehill ID was approved by the stockholders of the Company at a special meeting held on December 18, 2009. Immediately following the close of the transaction, approximately 38% of the outstanding shares of the Company were held by the former Bluehill ID shareholders.

Prior to the acquisition, Bluehill ID had granted to BH Capital Management AG (BHCM), a company controlled and owned by Ayman S. Ashour and Mountain Partners AG, an option to purchase up to 3,914,790 bearer shares in Bluehill ID at an exercise price of CHF 1.00 per share exercisable until June 30, 2014 pursuant to a Call Option Agreement dated September 8, 2009. Mr. Ashour is the former chief executive officer of Bluehill ID and the current Chairman and chief executive officer of the Company; Mountain Partners AG is a significant stockholder of the Company and an affiliate of Daniel S. Wenzel, a former director of Bluehill ID and currently a director of the Company. Pursuant to the terms of the Business Combination Agreement, these options were converted at the closing of the transaction into an option to purchase up to 2,035,691 shares of the Company s common stock at an exercise price of euro 1.28 per share.

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

Subsequent to the filing of the Company s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, the Company received new information related to the deferred tax asset accounts, which are comprised mainly of net operating losses by entity within different tax jurisdictions. As stated below, in its preliminary acquisition accounting, the Company had not provided a valuation allowance, but rather had netted the deferred tax assets against deferred tax liabilities. However, after further investigation, the Company concluded that certain deferred tax assets cannot be offset. Therefore, the Company revised its presentation of deferred tax assets and liabilities based on the new information regarding the tax jurisdictions. In addition, the Company believes that such deferred tax assets will not be realizable in future periods and therefore a 100% valuation allowance

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

is required for such deferred tax assets. As a result, the carrying amounts of the deferred tax assets and deferred tax liabilities were decreased by $2.6 million and $0.5 million, respectively as of September 30, 2010, with a corresponding increase to goodwill. The following table summarizes the consideration paid for Bluehill ID, the total remeasured fair value of net identifiable assets acquired at the Bluehill acquisition date, the fair value of the noncontrolling interest in Bluehill ID and the resulting goodwill recorded (in thousands):

Fair value of common stock	$ 34,577
Fair value of options converted	3,007
Fair value of total consideration transferred	37,584
Fair value of noncontrolling interest	3,057
Fair value of controlling and noncontrolling interest	40,641
Fair value of Bluehill ID net identifiable assets acquired	(17,384)
Goodwill	$ 23,257

The fair value of the shares of the Company s common stock issued in connection with the acquisition was determined using the closing market price of the Company s common stock as of the Bluehill acquisition date of $2.26 per share. The options were valued using the Black-Scholes option pricing model with the inputs of 0.8 for volatility, 4.5 years for expected life, 2.1% for the risk-free interest rate and a market value of the Company of $2.26 per share as of the Bluehill acquisition date. The acquisition-date fair value of the noncontrolling interests is derived by determining the fair value of the acquired business as a whole and then subtracting the consideration transferred by the Company for its controlling interest in Bluehill ID.

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

Assets acquired and liabilities assumed as of January 4, 2010 (in thousands):

Cash and cash equivalents	$ 4,266
Short-term investments	1,080
Accounts receivable	2,914
Inventories	1,554
Other current assets	623
Property and equipment	4,136
Mortgage loan and line of credit payable to bank	(1,382)
Accounts payable	(2,653)
Capital lease obligations	(753)
Liability to related party	(357)
Accrued expenses and other liabilities	(5,188)
Income taxes payable	(548)
Amortizable intangible assets:	

Developed technology	784
Customer relationships	10,918
Order backlog	734
Intangible assets with indefinite lives (not subject to amortization):	
Trade names	1,491
Deferred tax liabilities in connection with acquired intangible assets and inventory fair value adjustment, net	(3,115)
	14,504
Fair value of Bluehill s investment in the Company s common stock	2,880
Fair value of Bluehill ID net identifiable assets acquired	$ 17,384

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

Intangible assets of $13.9 million consist primarily of developed technology, customer relationships, order backlogs and trade names. Developed technology relates to Bluehill ID s technology which is currently generating revenue. Customer relationships relate to Bluehill ID s ability to sell existing, in-process and future versions of its products to its existing customers. Trade names represent future value to be derived associated with the use of existing trade names. Order backlog represents future revenue to be derived from confirmed orders. Developed technology and trade names were valued using the relief from royalty method based on DCF. The customer relationships and order backlog were valued using the multi-period excess earnings approach (Meem-approach) on EBIT based on DCF. The discount rate used in the present value calculations was derived from a WACC analysis, adjusted to reflect additional risks related to each asset s characteristics. Based on these factors, a discount rate of 18.0% was deemed appropriate for valuing the intangible assets. Of the $13.9 million of acquired intangible assets, $1.5 million was preliminarily assigned to registered trade names that are not subject to amortization. The remaining amount of $12.4 million of acquired intangible assets is subject to amortization. The Company expects to amortize developed technology and customer relationships on a straight-line basis over their expected useful life of four to 10 years and order backlog over the expected useful life of one year.

Of the total purchase consideration, $23.3 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 Bluehill ID acquisition is largely attributable to the synergies expected to be realized. Bluehill ID s results are included in both of the Company s two reportable segments, ID Management and ID Products. Of the total goodwill of $23.3 million, the Company assigned $14.0 million of goodwill to the ID Management segment and $9.3 million of goodwill was assigned to the ID Products segment in accordance with ASC Topic 350. None of the goodwill recorded as part of the Bluehill ID acquisition will be deductible for United States federal income tax purposes.

The Company recognized $0.2 million and $1.2 million of acquisition-related costs that were expensed in the three and nine months ended September 30, 2010, respectively. These costs are included as a part of general and administration costs in the condensed consolidated statement of operations.

Deferred tax assets and liabilities resulting from the acquisition of Bluehill ID have been netted, where applicable. As the identified intangible asset trade names has an indefinite life, the deferred tax liability of $0.4 million relating to the value of the trade names cannot be offset with deferred tax assets with a definite life. As a result, deferred tax liabilities of $2.7 million after netting with deferred tax assets and $0.4 million deferred tax liabilities relating to the indefinite life intangible asset have been considered in the acquisition accounting.

Utilization of net operating loss carryforwards, credit carryforwards, and other tax attributes may be subject to a substantial annual limitation due to ownership change limitations provided by the relevant jurisdictional tax laws and regulations. A substantial portion of the deferred tax assets acquired through the Bluehill ID acquisition is comprised of net operating losses. The future utilization of the Company s net operating loss carryforwards to offset future taxable income may be subject to an annual limitation as a result of ownership changes that may have occurred prior to, or in connection with, the Company s acquisition of Bluehill ID. The Company has determined that there was a change in ownership event with respect to Bluehill ID, effective January 2010, and is currently analyzing the impact on the financial statements. Although this may have an impact on the Company s ability to utilize some or all of the net operating loss carryforwards, the Company believes any effect on the financial statements, as a result of this analysis, would be minimal.

The amounts of revenue and earnings of Bluehill ID included in the Company s condensed consolidated statement of operations from the Bluehill acquisition date to the period ending September 30, 2010 are as follows (in thousands):

Revenues	$ 14,650
Net income (loss)	$ (6,470)

Acquisition of Hirsch

The Company completed the acquisition of Hirsch on April 30, 2009 (the Hirsch acquisition date). In exchange for all of the outstanding capital stock of Hirsch, the Company paid approximately $14.2 million in cash, issued approximately 9.4 million shares of the Company s common stock, and issued warrants to purchase approximately 4.7 million shares of the Company s common stock at an exercise price of $3.00 with a five-year term. In addition, each warrant to purchase shares of Hirsch common stock outstanding immediately prior to the effective date of the Hirsch acquisition was converted into a warrant to purchase shares of the Company s common stock. Hirsch s results are included in the Company s reportable segment, ID Management.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

The Hirsch acquisition was accounted for under the acquisition method of accounting under ASC 805. The total purchase consideration was determined to be $38.0 million as of the Hirsch acquisition date. The Company recognized identifiable intangible assets of $22.8 million which consisted of core technology, trade names and customer relationships and goodwill of $21.9 million was allocated to the Hirsch reporting unit which is included in the ID Management reporting segment. The Company expects to amortize developed technology and customer relationships on a straight-line basis over their expected useful life of 15 years.

Deferred tax assets and liabilities resulting from the acquisition of Hirsch have been netted, where applicable. As the identified intangible asset trade names has an indefinite life, the deferred tax liability of $3.0 million relating to the value of the trade names cannot be offset with deferred tax assets with a definite life. As a result, deferred tax liabilities of $1.7 million after netting with deferred tax assets and $3.0 million deferred tax liabilities relating to the indefinite life intangible asset have been considered in the acquisition accounting.

Following the Hirsch acquisition, Hirsch Electronics LLC has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $1.7 million, as described above, has been netted with the Company s existing deferred tax assets. As a result of netting the deferred tax liability of $1.7 million with the Company s existing deferred tax assets, there is a $1.7 million release of the Company s valuation allowance. In accordance with ASC 805, the release of the valuation allowance was booked as a tax benefit in the 2009 second quarter financial statements.

The amounts of revenue and earnings of Hirsch included in the Company s condensed consolidated statement of operations from the Hirsch acquisition date through the period ending September 30, 2009 are as follows (in thousands):

Revenues	$ 11,332
Net income (loss)	$ 1,884

Pro forma financial information:

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

Pro forma results of operations for the three and nine months ended September 30, 2010 and 2009 are as follows (in thousands, unaudited):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009

Revenues	$ 23,296	$ 20,887	$ 61,232	$ 56,522
Net loss attributable to Identive Group, Inc.	(850)	(3,081)	(8,057)	(17,708)
Weighted average common shares outstanding used in loss per common share - basic and diluted	43,279	43,035	41,901	38,872
Net loss per common share - basic and diluted	$ (0.02)	$ (0.07)	$ (0.19)	$ (0.46)

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September 30, 2010

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. Fair value is defined as the price that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. 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. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value: ASC Topic 820 *Fair Value Measurement and Disclosures* (ASC 820):

Level 1 Quoted prices for identical instruments in active markets;

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

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

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

Cash equivalents include highly liquid debt investments (money market fund deposits, commercial paper and treasury bills) with maturities of three months or less at the date of acquisition. These financial instruments are classified in Level 1 of the fair value hierarchy.

Assets that are measured and recognized at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of September 30, 2010 and December 31, 2009 were as follows (in thousands):

	September 30, 2010				December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market fund deposits	$ 79	$	$	$ 79	$ 1,327	$	$	$ 1,327

Money market fund deposits are included in cash and cash equivalents on the Company s consolidated balance sheets.

Non-financial assets that are measured and recognized at fair value on a non-recurring basis as of September 30, 2010 are as follows (in thousands):

	September 30, 2010				December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**

Goodwill	$	$	$ 46,923	$ 46,923	$	$	$ 21,895	$ 21,895
Acquired intangibles			34,843	34,843			22,082	22,082
Total:	$	$	$ 81,766	$ 81,766	$	$	$ 43,977	$ 43,977

The valuation of the acquired intangible assets is classified as a Level 3 measurement, because it was based on significant unobservable inputs and involved management judgment and assumptions about market participants and pricing. In determining the fair value of the acquired intangible assets, the Company determined the appropriate unit of measure, the exit market and the highest and best use for the assets, in accordance with ASC Topic 820 *Fair Value Measurement and Disclosures* (ASC 820). The fair value of acquired trade names and existing technology was determined using the relief from royalty approach and the fair value of the acquired company s customer relationships was determined using the income approach. See Note 2 for further discussion on the acquisitions. The discount rate used in the valuation of the intangible assets was derived from a weighted average cost of capital analysis.

As of September 30, 2010 and December 31, 2009, there were no liabilities that are measured and recognized at fair value on a recurring basis.

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

4. Shareholders Equity of Identive Group, Inc.

Stock Option Plans

The Company has a stock-based compensation program that provides its Board of Directors (the Board) discretion in creating employee equity incentives. This program includes incentive and non-statutory stock options under various plans, the majority of which are stockholder approved. Stock options 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 $^{1}/12^{th}$ per month over one year; some vesting 100% after one year; and some vesting $^{1}/12^{th}$ per month, commencing four years from the date of grant.

The Company had a Director Option Plan and a 1997 Stock Option Plan, both of which expired in March 2007, and as a result, options can no longer be granted under these plans. As of September 30, 2010, an aggregate of approximately 0.4 million granted options were outstanding under these two plans which remain exercisable in accordance with the terms of the original grant agreements. In addition, the Company has a 2000 Stock Option Plan, pursuant to which options to purchase 0.4 million shares of the Company s common stock may be granted. As of September 30, 2010, 0.3 million granted options were outstanding under the 2000 Stock Option Plan. In November 2007, the Company s Board and stockholders approved the 2007 Stock Option Plan, pursuant to which options to purchase 1.5 million shares of the Company s common stock may be granted. In October 2009, stockholders approved an increase of 2.0 million shares to the number of shares of common stock reserved for issuance under the 2007 Stock Option Plan, resulting in an aggregate of 3.5 million shares available for grant. As of September 30, 2010, 1.1 million granted options were outstanding under the 2007 Stock Option Plan.

A summary of the activity under the Company s stock option plans for the nine months ended September 30, 2010 is as follows:

	Available for Grant	Number of Options Outstanding	Weighted Average Exercise Price per share	Aggregate Intrinsic Value	Average Remaining Contractual Life (in years)
Balance at December 31, 2009	2,487,374	2,345,271	$ 4.57	$ 21,736	5.48
Options granted	(64,250)	64,250	$ 1.90		
Options cancelled or expired	527,920	(575,610)	$ 7.36		
Balance at September 30, 2010	2,951,044	1,833,911	$ 3.60	$ 12,290	4.88
Vested or expected to vest at September 30, 2010		1,753,006	$ 3.65	$ 10,552	4.81
Exerciseable at September 30, 2010		1,055,428	$ 4.26	$ 2,108	4.18

The weighted-average grant date fair value per option for options granted during the three and nine months ended September 30, 2010 was $0.16 and $0.95, respectively. The weighted-average grant date fair value per option for options granted during the three and nine months ended September 30, 2009 was $1.55 and $1.35, respectively. During the three and nine months ended September 30, 2010 and 2009, no options were exercised. At September 30, 2010, there was $0.8 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 2.1 years.

Stock Bonus and Incentive Plans

In June 2010, Identive s stockholders approved the 2010 Bonus and Incentive Plan (the 2010 Plan) under which cash and equity-based awards may be granted to executive officers 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 (the Committee) of the Board. The 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. For performance-based incentive awards, the performance criteria considered by the Committee may include any one or more of the following business measurements: (i) total stockholder return, (ii) economic value added, (iii) return on capital employed, (iv) revenues, (v) sales, (vi) net income, (vii) operating income, (viii) EBITDA, (ix) EBITDA margin, (x) profit margin, (xi) earnings per share, including in comparison to selected indexes and comparable companies, (xii) return on equity, (xiii) cash flow, (xiv) operating margin, (xv) net worth, (xvi) stock price, or (xvii) in the case of any incentive award, other than an incentive award to certain employees, any other criteria that may be determined as appropriate by the Committee from time to time.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

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September 30, 2010

An aggregate of 3.0 million shares of the Company s common stock may be issued under the 2010 Plan as equity-based awards, including shares, nonqualified stock options, restricted stock or deferred stock awards. The shares issued pursuant to equity awards granted under this 2010 Plan may be shares that are authorized and unissued or shares that were reacquired by the Company, including shares purchased in the open market. During the three and nine months ending September 30, 2010, 20,885 shares and 80,885 shares, respectively were issued pursuant to the 2010 Plan as disclosed in the statements of equity.

In addition, in connection with its acquisition of Bluehill ID AG in January 2010, the Company assumed the Bluehill ID AG Executive Share Option Plan and the Bluehill ID AG Executive Bonus Plan (the Bluehill Plans). An aggregate of 2.1 million shares of the Company s common stock may be issued under the Bluehill Plans to executives, key employees and other service providers to Bluehill ID, 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.

Stock-Based Compensation Expense

The following table illustrates the stock-based compensation expense resulting from stock options included in the unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Cost of revenue	$ 3	$ (4)	$ 13	$ 9
Research and development	(48)	(14)	(16)	13
Selling and marketing	59	25	179	99
General and administrative	(19)	5	108	82
Stock-based compensation expense before income taxes	$ (5)	$ 12	$ 284	$ 203
Income tax benefit	0	0	0	0
Stock-based compensation expense after income taxes	$ (5)	$ 12	$ 284	$ 203

During the second quarter of 2010, the Committee granted incentive bonus awards to certain executive officers, including the CEO and CFO, and other key employees under the 2010 Plan. These awards provide the executives and employees with the opportunity to earn shares of common stock depending on the extent to which certain performance goals are met. For services rendered, the executives shall be paid an incentive bonus to be received 50% in cash and 50% in shares of the Company with certain lock-up periods. In addition, the executives and employees are entitled to receive a grant of a number of non-qualified stock options equal to 20% of the number of U.S. dollars in the Participant s Base Salary. During the three and nine months ended September 30, 2010, the Company recognized $243,000 and $404,000, respectively for the 50% portion of the bonus payable in shares as stock-based compensation expense and $243,000 and $404,000, respectively for the 50% portion of the bonus payable in cash, pursuant to the 2010 Plan and Bluehill Plans described above. In addition, the Company recognized $330,000 in stock-based compensation expense as it relates to Participants eligibility to receive stock options awards as described above. Since the award of share-based payments described above represents an obligation to issue a variable number of 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 Topic 480 - *Distinguishing*

Liability from Equity (ASC 480) and is marked to market at each reporting period. The bonus amounts have been included in general and administration expenses in the condensed consolidated statement of operations.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

Comprehensive Loss Attributable to Identive Group, Inc.

Comprehensive loss consists of the following (in thousands):

	Three Months Ended September 30 2010	Three Months Ended September 30 2009	Nine Months Ended September 30 2010	Nine Months Ended September 30 2009
Net loss	$ (959)	$ (2,237)	$ (8,117)	$ (5,768)
Other comprehensive loss				
Change in foreign currency translation adjustment	$ 2,744	$ 173	$ (2,196)	$ (244)
Total comprehensive loss	$ 1,785	$ (2,064)	$ (10,313)	$ (6,012)
Less: comprehensive loss attributable to noncontrolling interest	(127)		749	
Comprehensive loss attributable to Identive Group, Inc.	$ 1,658	$ (2,064)	$ (9,564)	$ (6,012)

5. Inventories

Inventories consist of (in thousands):

	September 30, 2010	December 31, 2009
Raw materials	$ 4,381	$ 1,434
Work-in-process	230	665
Finished goods	3,609	3,280
Total	$ 8,220	$ 5,379

6. Goodwill and Intangible Assets

Goodwill

The changes in the carrying amount of goodwill during the nine months ended September 30, 2010 are as follows (in thousands):

Balance as of December 31, 2009	$ 21,895
Goodwill acquired during the period	26,165
Foreign currency translation	(1,137)

Balance as of September 30, 2010	$ 46,923

Goodwill of $21.9 million as of December 31, 2009 was acquired as a result of the acquisition of Hirsch. During the nine months ended September 30, 2010, the Company recorded goodwill of $26.2 million, of which $23.3 million is related to its acquisition of Bluehill ID and $2.9 million is related to its acquisition of RockWest, described in Note 2. The goodwill amount related to the Bluehill acquisition was adjusted as of September 30, 2010 for the difference in foreign exchange rates between the acquisition date and quarter end. Of the total goodwill of $46.9 million as of September 30, 2010, the Company assigned $38.1 million to the ID Management reporting segment and $8.8 million to the ID Product reporting segment, as required by ASC 350.

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. The Company performed its annual impairment test for the Hirsch reporting unit on December 1, 2009 (which was the only reporting unit to have recorded goodwill at that time) and determined that there was no impairment of goodwill. Management did not identify any impairment indicators during the three and nine months ended September 30, 2010.

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September 30, 2010

Intangible Assets

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

(In thousands)	Order Backlog	Existing Technology	Customer Relationships	Trade Name	Total
Cost:					
Amortization period	1 year	10 - 15 years	4 - 15 years	Indefinite life	
Balance at December 31, 2009	$	$ 4,600	$ 10,350	$ 7,800	$ 22,750
Acquired as a part of Bluehill acquisition	734	784	10,918	1,491	$ 13,927
Acquired as a part of RockWest acquisition	30		2,210		$ 2,240
Currency translation adjustment	(36)	(38)	(533)	(73)	$ (680)
Balance at September 30, 2010	$ 728	$ 5,346	$ 22,945	$ 9,218	$ 38,237
Accumulated Amortization:					
Balance at December 31, 2009	$	$ 208	$ 460	$	$ 668
Amortization expense	543	285	1,861		$ 2,689
Currency translation adjustment	11	2	24		$ 37
Balance at September 30, 2010	$ 554	$ 495	$ 2,345	$	$ 3,394
Intangible assets, net at September 30, 2010	$ 174	$ 4,851	$ 20,600	$ 9,218	$ 34,843

As discussed in Note 2, during the nine months ended September 30, 2010, intangible assets increased by $16.1 million, of which $2.2 million was related to the acquisition of RockWest (RockWest intangibles) in the three months ended June 30, 2010 and $13.9 million was related to the acquisition of Bluehill ID (Bluehill intangibles) in the three months ended March 31, 2010. RockWest intangibles of $2.2 million are related to order backlog and customer relationships and are subject to amortization. Of the Bluehill intangibles, $12.4 million are related to order backlog, existing technology and customer relationships and are subject to amortization, and $1.5 million are related to trade names which are determined to have an indefinite useful life. Bluehill intangibles were partly offset by the foreign currency translation adjustment for the difference in foreign exchange rates between the acquisition date and quarter end.

Intangible assets subject to amortization will be amortized over their useful lives. Amortization expense of these acquired intangible assets for the three months ended September 30, 2010 and 2009 was $0.9 million and $0.2 million, respectively, of which $0.3 million and $0.1 million, respectively, was included in cost of revenue and $0.6 million and $0.1 million was included in selling and marketing expense in the condensed consolidated statements of operations for the three months ended September 30, 2010 and 2009, respectively. Amortization expense of these acquired intangible assets for the nine months ended September 30, 2010 and 2009 was $2.7 million and $0.4 million, respectively, of which $0.8 million and $0.1 million was included in cost of revenue and $1.9 million and $0.3 million was included in selling and marketing expense in the condensed consolidated statements of operations for the nine months ended September 30, 2010 and 2009, respectively.

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

Year ending December 31:	
2010 (remaining three months)	$ 905
2011	3,130
2012	3,130
2013	3,130
2014	2,171
2015 and thereafter	13,159
Total	$ 25,625

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

7. Related-Party Transactions

Prior to the acquisition of Hirsch by the Company, 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). Under the terms of the 1994 Settlement Agreement, Hirsch was making payments (royalty payments) to Secure Keyboards and Secure Networks, calculated as a percentage of revenue, against the exclusive rights to certain patents and technology which it had purchased from Secure Keyboards and Secure Networks.

Secure Keyboards and Secure Networks were related to Hirsch through certain common shareholders and limited partners, including Hirsch s President Lawrence Midland, who is now an Executive Vice President and a director of the Company. Following the acquisition, 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). Hirsch s initial annual payment to Secure Keyboards and Secure Networks under the 2009 Settlement Agreement for the period from January 1, 2009 through December 31, 2009 was $986,000, with subsequent annual payments subject to increase based on the percentage increase in the Consumer Price Index during the prior calendar year.

The final payment to Secure Networks is 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 amount of the lump-sum payment will be based on an assumed growth rate of the remaining annual payments of 4%, in lieu of the percentage increase in the Consumer Price Index, and a discount rate of 9%.

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. In connection with its acquisition of Hirsch, the Company assumed this related party liability which now represented the fixed amount of royalty payments, subject to increase based on the percentage increase in the Consumer Price Index.

The Company recognized $0.2 million and $0.6 million expense during the three and nine months ending September 30, 2010, respectively, and $0.2 million and $0.3 million expense during the three and nine months ending September 30, 2009, respectively, in its condensed consolidated statements of operations for the interest accreted on the discounted liability amount.

The payment amounts for related party liability for the next five years is as follows (in thousands):

Year ending December 31:	
2010 (remaining three months)	$ 256
2011	1,070
2012	1,119
2013	1,170
2014	1,224
2015 and thereafter	8,748

Present value discount factor	(4,849)
Total	$ 8,738

In August 2008, Mountain Partners AG (Mountain Partners), through an affiliate, provided a loan to Bluehill ID, which was assumed by the Company upon acquisition of Bluehill ID. In May 2010, upon recommendation of the Audit Committee, the Company s Board of Directors approved a loan conversion agreement (Agreement) between Bluehill ID and Mountain Partners. An amount of EUR 235,000 remained outstanding as of the date of conversion. Under the agreement, Mountain Partners agreed to accept 180,769 shares of common stock as payment in full for the outstanding balance.

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

8. Discontinued Operations

During 2003, the Company completed two transactions to sell its retail Digital Video and Digital Media Reader business. During 2006, the Company completed the sale of substantially all the assets and some of the liabilities associated with its Digital TV solutions business. In accordance with ASC Topic 360 *Property, Plant and Equipment* (ASC 360), for the three months ended March 31, 2010 and 2009, the operating results of these businesses have been presented as discontinued operations in the condensed consolidated statements of operations and cash flows.

9. Mortgage Loan and Line of Credit Payable to Bank

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. The mortgage loan and the line of credit 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 term of the mortgage loan will mature in 2026. The Company is obligated to pay a monthly amount of 3,500 or approximately $4,400 over the life of the mortgage loan towards principal amount in addition to monthly interest payments. The total amount that can be advanced under the line of credit is 240,000 or $300,000. The advances on the revolving line of credit accrue interest at a base rate determined by the bank plus 2% (6.75% at September 30, 2010), 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 14,000, or approximately $18,000, and 40,000, or approximately $53,000, during the three and nine months ended September 30, 2010, respectively. As of September 30, 2010, approximately 687,000, or approximately $935,000, was outstanding under the mortgage loan and 126,000, or approximately $172,000, in advances were outstanding under the revolving line of credit.

In addition, one of Company s subsidiaries, Multicard U.S. (formerly known as RockWest, the Borrower) has a revolving line of credit payable to a bank. The total amount that can be advanced under the line of credit is $230,000. The advances on the revolving line of credit accrue interest at a floating rate per annum equal to the Prime Rate plus 1.25% (5% as of September 30, 2010), payable monthly. The revolving line of credit has been renewed from time to time and will mature on March 10, 2011. Multicard U.S., as Grantor, granted and pledged to bank a first security interest in all the personal property owned by the Borrowers. The Company recorded interest expense of $3,000 during the three and nine months ended September 30, 2010. As of September 30, 2010, approximately $206,000 was outstanding under the revolving line of credit.

10. Restructuring and Other Charges

In 2010, the Company implemented a restructuring plan (the 2010 Restructuring Plan) in an effort to better align its business operations with the current market and macroeconomic conditions. The 2010 Restructuring Plan included a worldwide workforce reduction, the restructuring of certain business functions and the closure of certain facilities. The Company incurred restructuring charges of zero and $0.3 million and paid $0.3 million and $0.6 million for severance and facilities-related charges associated with the 2010 Restructuring Plan during the three and nine months ended September 30, 2010, respectively.

Accrued liabilities related to restructuring actions and other activities during the nine months ended September 30, 2010 and during the year ended December 31, 2009 consist of the following (in thousands):

	Lease/Contract Commitments	Other Costs	Total

Balances as of January 1, 2009	$ 1,230	$ 330	$ 1,560
Changes in estimates	(157)		(157)
Payments and other changes in 2009	(394)	10	(384)
Balances as of December 31, 2009	679	340	1,019
Provision during 2010	321	16	337
Changes in estimates	(139)		(139)
Payments and other changes 2010	(564)	(25)	(589)
Balances as of September 30, 2010	$ 297	$ 331	$ 628

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

11. Segment Reporting, Geographic Information and Major Customers

ASC Topic 280 *Segment Reporting* 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 executive staff, consisting of the CEO, CFO, Executive Vice President Transponders & Components, Executive Vice President for Transition Management & Acquisition Integration, Executive Vice President of Technology and Product Management, Executive Vice President and President, Hirsch business, and Executive Vice President and CEO, SCM Microsystems business.

Prior to January 4, 2010, the Company operated in two business segments, Security and Identity Solutions and Digital Media and Connectivity. Following the Company s acquisition of Bluehill ID on January 4, 2010, the Company now operates in two different business segments that reflect the Company s current organizational structure and focus on providing secure identification solutions. The Company s new reportable segments are ID Management and ID Products. Each business segment is comprised of two or more businesses within the Company that focus on specific markets and technologies. Businesses in the ID Management segment include Hirsch and Multicard ; businesses in the ID Products segment include SCM Microsystems, TagStar Systems, ACiG Technology and Syscan ID.

The CODM reviews financial information and business performance along the ID Management and ID Products segments. The Company evaluates the performance of its segments at the revenue and gross margin level. The Company s reporting systems do not track or allocate operating expenses by segment. The CODM does not evaluate operating segments using discrete asset information. The Company does not include intercompany transfers between these two business segments for the purpose of assessing financial performance.

Summary information by segment for the three and nine months ended September 30, 2010 and 2009 is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
ID Management:				
Net revenue	$ 12,231	$ 6,759	$ 33,572	$ 11,332
Gross profit	6,174	3,856	17,451	6,803
Gross profit %	50%	57%	52%	60%
ID Products:				
Net revenue	$ 11,065	$ 6,575	$ 26,248	$ 18,118
Gross profit	3,949	2,821	9,253	7,844
Gross profit %	36%	43%	35%	43%
Total:				
Net revenue	$ 23,296	$ 13,334	$ 59,820	$ 29,450
Gross profit	10,123	6,677	26,704	14,647
Gross profit %	43%	50%	45%	50%

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenue				
Europe and Middle-East	$ 8,502	$ 2,903	$ 18,836	$ 7,544
Americas	12,749	8,865	35,336	17,518
Asia-Pacific	2,045	1,566	5,648	4,388
Total	$ 23,296	$ 13,334	$ 59,820	$ 29,450
% of net revenue				
Europe and Middle-East	36%	22%	32%	26%
Americas	55%	66%	59%	59%
Asia-Pacific	9%	12%	9%	15%

Long-lived assets by geographic location as of September 30, 2010 and December 31, 2009, are as follows (in thousands):

	September 30, 2010	December 31, 2009
Property and equipment, net:		
Americas	$ 405	$ 242
Europe and Middle East	3,867	385
Asia-Pacific	154	56
Total	$ 4,426	$ 683

12. Commitments

The Company leases its facilities, certain equipment, and automobiles under non-cancelable operating lease agreements. Those lease agreements existing as of September 30, 2010 expire at various dates during the next four years.

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 September 30, 2010:

(In thousands)	Operating Lease	Purchase Commitments	Other Contractual Obligations	Total
2010 (remaining three months)	$ 851	$ 12,174	$ 326	$ 13,351
2011	2,387		72	$ 2,459
2012	1,455		48	$ 1,503
2013	722			$ 722
2014 and thereafter	201			$ 201
	$ 5,616	$ 12,174	$ 446	$ 18,236

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2010

13. Legal Proceedings

From time to time, the Company 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, the Company s management expects that any such liabilities, to the extent not provided for by insurance or otherwise, will not have a material adverse effect on the Company s financial condition, results of operations or cash flows.

14. Subsequent Events

On October 29, 2010, Identive Group, Inc. and its wholly owned subsidiary SCM Microsystems (Asia) Pte. Ltd. (together, the Company) entered into a Share Purchase Agreement with FCI Asia Pte. Ltd., FCI SA and FCI Connectors Singapore Pte. Ltd. (collectively, FCI) under which the Company will acquire all the shares and intellectual property of FCI Smartag Pte. Ltd. (Smartag) in a cash and debt transaction (the Share Purchase Agreement).

Smartag is a Singapore-based manufacturer of high frequency (HF) and ultra high frequency (UHF) radio frequency identification (RFID) inlays and inlay-based solutions including labels and tags used for asset tracking, cards and stickers used for e-payment and ticketing transactions, and near field communication (NFC) labels used to enable secure payments with mobile devices.

Under the Share Purchase Agreement, the Company will pay FCI approximately $4.1 million, consisting of a one-time payment at the close of the transaction of approximately $1.0 million and a promissory note for approximately $3.1 million. The promissory note carries an interest rate of 6% per year and is payable within 30 months from the closing date. The transaction is expected to close in November 2010, subject to various customary closing conditions.

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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. For example, statements, other than statements of historical facts, regarding our strategy, future operations, financial position, projected results, estimated revenues or losses, projected costs, prospects, plans, market trends, competition and objectives of management constitute forward-looking statements. 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 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 section of this Quarterly Report on Form 10-Q and of our Annual Report on Form 10-K for the year ended December 31, 2009. 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. We also urge readers to review and consider our disclosures describing various factors that could affect our business, including the disclosures under Part II - Item 1A., Risk Factors in this Quarterly Report on Form 10-Q and the audited financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

Overview

Identive Group, Inc. (Identive, the Company, we and us) is an international technology company focused on building the world s signature gro in secure identification-based technologies. The businesses within Identive have deep industry expertise and are well-known global brands in their individual markets, providing leading-edge products and solutions in the areas of physical and logical access control, identity management and radio frequency identification (RFID) systems to governments, commercial and industrial enterprises, healthcare and consumers. Our growth model is based on a combination of strong technology-driven organic growth from the businesses within the group and disciplined acquisitive expansion.

At the beginning of 2010, we acquired Bluehill ID AG (Bluehill ID), a Swiss industrial holding group focused on technologies within the high-growth RFID / contactless smart card technology and identity management markets. As a result of this business combination, we have put in place a new organizational structure, enhanced and broadened our management team, and changed the name of the Company from SCM Microsystems, Inc. to Identive Group, Inc, which reflects our focus on providing secure identification systems and solutions. Following the acquisition of Bluehill ID we also changed our stock trading symbols to reflect our new name. 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.

Following our acquisition of Bluehill ID in January 2010, we now operate in two segments, Identity Management Solutions & Services (ID Management) and Identification Products & Components (ID Products). Each segment is comprised of two or more business units within the group that focus on specific products, markets and channels.

Business units in our ID Management segment provide solutions and services that enable the secure management of credentials in diverse markets. These credentials are used for the identification of people and the granting of rights and privileges based on defined security policies. The businesses in our ID Management segment specialize in the design, manufacturing, supply and servicing of products and 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. ID Management customers operate in government, commercial, enterprise and consumer markets and can be found in multiple vertical market segments including healthcare, finance, industrial, retail and critical infrastructure. The businesses in our ID Management segment include Hirsch and Multicard. Sales in this segment are typically made to high level dealer / integrators, and less frequently, directly to end users.

Business units in our ID Products segment design and manufacture both standard and highly specialized products and components that help identify people, animals and objects in a multitude of applications and markets. Products and components in our ID Products segment include semiconductors, cards, tags, inlays, readers and terminals that are used by original equipment manufacturers and system integrators to deliver identity based systems and solutions. These products are used for applications such as eHealth, eGovernment, mobile banking, loyalty schemes, transportation and event ticketing, corporate identification, logical access, physical access and passport control in the government, enterprise and financial markets. Within this segment we also offer commercial digital media readers that are used in digital kiosks to transfer digital content to and from various flash media. Businesses in our ID Products segment include SCM Microsystems, TagStar Systems, ACiG Technology and Syscan ID.

Each of the businesses within Identive conducts its own sales and marketing activities in the markets in which it competes, utilizing its own sales and marketing organization, and in most cases selling primarily through indirect sales channels that may include dealers, systems integrators, value added resellers, resellers or Internet sales. Within our ID Management segment, the majority of sales in our Hirsch business are made through a dealer/systems integrator distribution channel. Businesses in our ID Products segment primarily sell to original equipment manufacturers (OEMs) that typically either bundle our products with their own solutions, or repackage our products for resale to their customers. Our OEM customers typically sell our ID Products solutions to government contractors, systems integrators, large enterprises and computer manufacturers, as well as to banks and other financial institutions. Additionally, we sell our digital media readers primarily to major brand computer and photo processing equipment manufacturers.

Our corporate headquarters are co-located with our Hirsch business headquarters in Santa Ana, California and our European and operational headquarters are in Ismaning, Germany. We maintain facilities in Chennai, India for research and development and in Australia, Brazil, Canada, Europe, Hong Kong, Japan, the Netherlands, Switzerland and the U.S. for individual business 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 Significant Acquisitions

On April 14, 2010, we acquired RockWest Technology Group, a privately held provider of identification and security solutions based in Denver, Colorado (RockWest), pursuant to the Share Purchase Agreement dated March 30, 2010 and amended on April 9, 2010, under which we issued an aggregate of 2.6 million shares of our common stock. RockWest s operating results have been included in our consolidated results since April 14, 2010. RockWest was integrated into the Company s Multicard business in September 2010 and adopted the name Multicard U.S.

On January 4, 2010, we acquired Bluehill ID, pursuant to the Business Combination Agreement dated as of September 20, 2009, as amended, under which we made an offer to the Bluehill ID shareholders to acquire all of the Bluehill ID shares and issued 0.52 new shares of Identive common stock for every one share of Bluehill ID tendered. A total of 29,422,714, or approximately 92% of Bluehill ID shares outstanding were tendered in the offer and exchanged for a total of 15,299,797 new shares of Identive common stock. Immediately following the close of the transaction, approximately 38% of the Company s outstanding shares were held by the former Bluehill ID shareholders. Bluehill ID s operating results have been included in our consolidated results since January 4, 2010.

On April 30, 2009, we acquired Hirsch Electronics Corporation, a privately-held California corporation that designs, engineers, manufactures and markets software, hardware and services in the security management system/physical access control market. The acquisition of Hirsch Electronics Corporation was accomplished through a two-step merger, in accordance with the Agreement and Plan of Merger entered into on December 10, 2008, pursuant to which Hirsch Electronics Corporation became Hirsch Electronics LLC, a Delaware limited liability company and a wholly-owned subsidiary of the Company (Hirsch). In exchange for all of the outstanding capital stock of Hirsch, we paid approximately $14.2 million in cash, issued approximately 9.4 million shares of our common stock, and issued warrants to purchase approximately 4.7 million shares of our common stock. The merger was approved by our stockholders at a special meeting held on April 16, 2009. Immediately following the close of the transaction, approximately 37% of the shares of Identive common stock outstanding were held by the former Hirsch shareholders. Hirsch s operating results have been included in our consolidated results since April 30, 2009.

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Recent Trends and Strategies for Growth

Identive is focused on building the world's leading company in access control, identity management and RFID technologies. Our growth strategy is focused both around technology-driven organic growth and disciplined acquisitive activity, acting as a consolidator in a rapidly growing, yet highly fragmented industry. With each acquisition we seek to expand our business, reinforce our market position in targeted areas and fully leverage our strengths and opportunities to enter new markets.

We believe our April 2009 acquisition of Hirsch supported our growth strategy, as it significantly increased our revenues, increased our scale and has helped further diversify our customer base and position our company to better address the growing market demand for solutions that address both IT security and physical access, a trend referred to in the security industry as convergence. Following the acquisition, Lawrence W. Midland, a former Hirsch director and current President of Hirsch, joined our Board of Directors and became an Executive Vice President of the Company.

As a result of our January 2010 acquisition of Bluehill ID, we are able to provide identification and authentication solutions for applications ranging from security to asset tracking to transaction processing for mobile and fixed installations. The acquisition of Bluehill ID further increased our revenue base and our scale to enable us to participate in additional parts of the secure identification market. Following the acquisition, Ayman S. Ashour, Chief Executive Officer of Bluehill ID, joined the Board of Directors of the Company and now serves as our Chairman and Chief Executive Officer. Daniel S. Wenzel, a former director of Bluehill ID, also joined our Board. Three other executives from Bluehill ID also joined the management team of the Company following the transaction, including Melvin Denton-Thompson, who serves as our Chief Financial Officer; John S. Rogers, who serves as Executive Vice President Transition Management and Acquisition Integration; and Joseph Tassone, who serves as Executive Vice President Technology and Product Management. The new management from Bluehill ID has extensive expertise in identifying acquisition candidates, executing mergers and acquisitions and successfully integrating acquired businesses.

Our goal is to build a lasting business of scale and technology to both enable and capitalize on the growth of the security and RFID industries. As part of our acquisition strategy, we employ a buy, build and grow approach worldwide that is designed to rapidly establish Identive as a leading company in the identification and identity management markets. In particular, we pursue majority investments and acquisitions that drive consolidation in the rapidly growing, yet highly fragmented markets for identification-based technologies. At the corporate level, we provide strategic guidance, operational support and market expertise to facilitate sharing of technology and resources across the group and help our individual business units expand and compete more effectively in the global marketplace.

As part of our organic growth strategy, we are focused on the ongoing development of our core RFID technology base and of a broad range of new contactless infrastructure products to enable fast growing contactless applications and services for markets such as electronic transactions (including payment and ticketing) and various electronic security programs within the government and enterprise sectors. Our RFID inlays and inlay-based tags, stickers and other products, and our contactless readers, modules and tokens are intended to address markets such as national/citizen ID, electronic passports, physical and logical (computer) security, ticketing for transit and events, cashless payments and mobile transactions, among others. Additionally, we are developing and implementing programs to market our existing product offerings into new distribution channels and new geographic regions. The worldwide economic downturn has slowed our progress in penetrating new markets; however, we continue to invest in the products, programs and resources to develop new customers so that we will be able to leverage a strong position in the market as the economic situation improves.

Trends in our Business

Sales Trends

While the global economic situation continues to influence budget allocations, capital purchases and the spending decisions of our customers, we believe that the broad cautionary environment we experienced through 2009 has become more stable during 2010. While growth in some markets appears to remain constricted due to ongoing economic uncertainty, in general we believe that normal demand patterns are beginning to resume, driven by technological advancements and the need for more and better security systems.

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Our sales increased 103% in the first nine months of 2010 compared with the same period of 2009, primarily as a result of the inclusion of revenue from the acquired Hirsch, Bluehill ID and Multicard U.S. (formerly RockWest) businesses, strong U.S. government sales from Hirsch in the 2010 second and third quarters, and the first delivery of several large citizen ID program orders for our SCM readers in the third quarter of 2010.

Sales in the Americas. Sales in the Americas accounted for 55% of our revenue in the third quarter and 59% of revenue in the first nine months of 2010. In our Hirsch business, sales of integrated physical access control systems and other solutions have been strong in each of the last several quarters, as U.S. federal agencies have continued to improve their security systems as mandated under programs such as Homeland Security Presidential Directive-12 (HSPD-12). We believe that this higher level of activity will continue until various agencies reach compliance with applicable directives and standards, a process that is still in the early stages. In the second and third quarters of 2010, the higher level of activity related to U.S. government security programs resulted in a 31% increase in Hirsch sales compared with the same period of 2009.

In our SCM Microsystems Americas business, sales of smart card reader products for PC and network access by military and other federal employees were down slightly in the third quarter and first nine months of 2010 compared with the previous year as a result of a shortage of semiconductor components for some products. SCM won its first volume reader order for government security programs in Brazil, facilitated by the local presence and expertise provided by our ACiG business. ACiG also worked in partnership with our TagStar business to secure orders for limited use tickets for a major mass transit system in the U.S. Sales from our Multicard U.S. business grew approximately 25% in the third quarter compared with the previous quarter, which was their first as part of Identive, as a result of continued demand for identity management solutions from the local and state government and education markets.

Sales in Europe. Sales in Europe accounted for 36% of our revenue in the third quarter and 32% of revenue in the first nine months of 2010. In our SCM business, the shipment of 165,000 IT security kits to fulfill the first of four large orders related to the German government s implementation of a new electronic citizen ID card contributed $2.5 million of revenue in the quarter. Shipments for the additional three orders are expected to begin during the fourth quarter of 2010 and to continue over the next twelve months. The largest of these orders is through our German Multicard business, which was selected by Germany s Federal Ministry of the Interior to act as project manager for the distribution of 317,000 German electronic ID readers, along with application software and related services. The first shipments of SCM readers for the German Multicard order to customers are expected to begin in the fourth quarter of 2010. During the third quarter, Multicard Netherlands was selected by Rabobank to provide personalization and fulfillment services for the Dutch bank s latest application of its cashless e-payment solution and shipped the first RFID labels to enable Rabobank s 45,000 employees to make cashless payments using their mobile phones. Overall, sales in our European Multicard businesses were somewhat impacted by customer project delays. The RFID labels used for the Rabobank application were supplied by our TagStar business, which achieved record sales in the third quarter of 2010. Higher sales levels were driven by new applications, including the RFID labels for cashless payments noted above, limited use tickets for transit programs in the U.S. and Europe, secure tracking of pharmaceutical consumables and electronic authentication and tracking for the rental car market in Europe. Higher sales levels were supported by the increased capacity that TagStar had installed earlier in the year and were slightly offset by a continued shortage of some semiconductor components.

Sales in Asia/Pacific. Sales in the Asia/Pacific region accounted for 9% of our revenue in both the third quarter and the first nine months of 2010. In the Asia/Pacific region, sales of smart card reader chips continued to be strong in the third quarter of 2010 and our SCM business continued to benefit from its investments in forming distribution partner relationships and building sales resources in Asia. During the quarter, SCM added new customers in China and Japan and shipped additional readers to China Unicom, one of China s top three mobile phone service providers, to be used in retail stores to configure and personalize phone SIM cards for subscribers. Overall sales for SCM in Asia in both the third quarter and first nine months of 2010 were relatively steady compared with the same periods of last year despite semiconductor shortages in the second and third quarters of 2010. Multicard sales in Australia were lower in the third quarter due to variation in the timing of orders.

Looking forward, we believe demand will continue to increase across our markets for products, systems and solutions that address emerging applications such as ePayment schemes and national ID programs. The trends towards the convergence of logical 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 banks 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.

In our business overall, we may experience significant variations in demand for our products quarter to quarter. This is particularly true for our smart card readers and other products targeting citizen /national ID applications, a significant portion of which are currently sold for smart card-based ID programs run by various U.S., European and Asian governments. 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 governmental budget cycles, with lowest sales in the first quarter and highest sales in the fourth quarter of each year. During the first nine months of 2010, semiconductor shortages have at times constricted our ability to fulfill demand from our customers in our SCM and TagStar businesses, and if semiconductor supply does not increase, sales at SCM, TagStar or other Identive businesses could continue to be affected in future periods. Additionally, our dependence on a small number of customers in our ID Products segment may result in any given period in additional variability in our revenues.

Operating Expense Trends

Our base operating expenses (research and development, sales and marketing and general and administration) increased 52% in the first nine months of 2010 compared with the same period of the prior year, reflecting the addition of expenses for the acquired Hirsch, Bluehill ID and Multicard U.S. (RockWest) businesses, offset by cost reduction programs initiated in the first quarter of 2010. Immediately following the acquisition of Bluehill ID in early January 2010, we implemented a cost reduction program across all our business units with the goal of significantly lowering expenses and establishing a corporate culture of profit-driven growth. Cost reduction actions included consolidation of the Identive and Bluehill ID development centers in India into one facility, closure of Bluehill ID s office in Mainz, Germany, a reduction in force of approximately 15% of the Company s global workforce, and reductions in executive salaries and director fees. The impact of these cost reductions was partially realized in the first quarter and more fully realized in the second and third quarters of 2010. Additionally, during the second quarter of 2010 we began consolidating administrative services and programs including payroll, banking and health benefits across all our employees in the U.S., which we expect will yield incremental savings going forward. During the 2010 third quarter, we implemented additional cost reduction measures in our European Multicard businesses, which were completed during the quarter. We expect our cost reduction measures will result in savings of approximately $6.0 million per year, of which approximately $4.5 million will be realized in 2010. We continue to work to further reduce our ongoing expenses.

Over the past several quarters, we have invested in new products and additional sales resources to enhance our ability to address additional areas of the secure identification market. In our Hirsch business, we continue to make significant investments to develop Hirsch s next generation product offering of controllers. This development work was substantially completed at the end of 2009 and the remaining internal development costs to finalize these products will continue to decrease throughout 2010. In our SCM business, we have focused our research and development activities on the development of new contactless readers, tokens and modules and on extending our contactless platforms, and this work is ongoing. In our TagStar business, over the past year we have made significant investments in a new production system for our RFID inlays, which are used in a variety of applications including event ticketing, mobile payments and library tracking systems. During the first quarter of 2010 this expansion was completed and as a result TagStar s production capacity was more than doubled. We have also made advances in our inlay designs and technology and have a number of new patent applications in process. In our Multicard Netherlands business we continue to make investments to enhance our electronic payment software systems.

During 2009 and 2010, costs associated with our acquisitions of Hirsch, Bluehill ID and Multicard U.S. (RockWest) have comprised a significant component of our general and administrative expenses. Mergers and acquisitions are a central component of our growth strategy; however, we believe that we will be able to execute large acquisitions at significantly lower cost going forward as a result of our larger scale and greater experience with the processes involved.

Critical Accounting Policies and Estimates

Our 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 make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to product returns, customer incentives, bad debts, inventories, asset impairment, deferred tax assets, accrued warranty reserves, restructuring costs, contingencies and litigation. 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. Actual results may differ from these estimates under different assumptions or conditions.

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Management believes the following critical accounting policies, among others, contain our more significant judgments and estimates used in the preparation of our consolidated financial statements.

We derive revenue from sales of products and services, primarily from sales of hardware products, and to a lesser extent, from the license of proprietary software products and sales of service contracts. We recognize revenue from the sale of hardware products pursuant to ASC Topic 605, *Revenue Recognition* (ASC 605). Accordingly, revenue from product sales is recognized upon product shipment, provided that risk and title have transferred, a purchase order has been received, the sales price is fixed and determinable and collection of the resulting receivable is probable. There are no formal customer acceptance terms or further obligations related to the sale of hardware products, outside of our standard product warranty. Provisions for estimated warranty repairs and returns and allowances are provided for at the time of sale. Certain sales of our hardware products are bundled with our software products. In such arrangements, both the software and hardware products are delivered simultaneously. We account for software sales in accordance with ASC Topic 985-605, *Software Revenue Recognition* (ASC 985-605) whereby the revenue from the sale of software products is recognized at the time the software is delivered to the customer, provided all the revenue recognition criteria noted above have been met. All proprietary application software sold by Identive is not essential to the functionality of the security hardware. Therefore, in multiple-element arrangements containing hardware and software, the hardware elements are excluded from ASC 985-605 and are accounted for in accordance with ASC 605-25, *Multiple Element Arrangements*. Revenue from such bundled arrangements is generally recognized upon delivery of the hardware products, assuming all other basic revenue recognition criteria are met, as both the hardware and software products are considered delivered elements and no undelivered elements exist.

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

We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. We regularly review inventory quantities on hand and record an estimated provision for excess inventory, technical obsolescence and inability to sell based primarily on our historical sales and expectations for future use. Actual demand and market conditions may be different from those projected by our management. This could have a material effect on our operating results and financial position. If we were to make different judgments or utilize different estimates, the amount and timing of our write-down of inventories could be materially different. Once we have written down inventory below cost, we do not subsequently write it up.

In accordance with ASC Topic 740, *Income Taxes* (ASC 740), we are required to make certain judgments and estimates in determining income tax expense for financial statement purposes. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period. The calculation of our tax liabilities requires dealing with uncertainties in the application of complex tax regulations. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It is inherently difficult and subjective to estimate such amounts. We reevaluate such uncertain tax positions on a quarterly basis based on factors such as, but not limited to, changes in tax laws, issues settled under audit and changes in facts or circumstances. Such changes in recognition or measurement might result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

The carrying value of our net deferred tax assets reflects that we have been unable to generate sufficient taxable income in certain tax jurisdictions. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before we are able to realize their benefit, or that future deductibility is uncertain. Management evaluates the realizability of the deferred tax assets quarterly. The deferred tax assets are still available for us to use in the future to offset taxable income, which would result in the recognition of a tax benefit and a reduction in our effective tax rate. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of the realizability of deferred tax assets inaccurate, which could have a material impact on our financial position or results of operations.

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Goodwill is not subject to amortization but is subject to annual assessment, at a minimum, for impairment in accordance with ASC Topic 350 *Intangibles Goodwill and Other* (ASC 350). We evaluate goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit s carrying value, including goodwill, to the fair value of the reporting unit. If the carrying value of the reporting unit exceeds the fair value, goodwill is considered impaired and a second step is performed to measure the amount of the impairment loss, if any. Under this second step, the implied goodwill value is determined, in the same manner as the amount of goodwill recognized in a business combination, to assess level of goodwill impairment, if any.

We determine the fair value of the reporting units using the income, or discounted cash flows, approach (DCF model) and verify the reasonableness of such fair value calculations of the reporting units using the market approach, which utilizes comparable companies data. The completion of the DCF model requires that we make a number of significant assumptions to produce an estimate of future cash flows. These assumptions include projections of future revenue, costs and working capital changes. In addition, we make assumptions about the estimated cost of capital and other relevant variables, as required, in estimating the fair value of our reporting units. The projections that we use in our DCF model are updated annually and will change over time based on the historical performance and changing business conditions for each of our reporting units. The determination of whether goodwill is impaired involves a significant level of judgment in these assumptions, and changes in our business strategy, government regulations, or economic or market conditions could significantly impact these judgments. We will continue to monitor market conditions and other factors to determine if interim impairment tests are necessary in future periods.

The reporting units are identified in accordance with ASC 350-20-35-33 through 35-46. Our reporting units are the Hirsch and Multicard businesses in the ID Management reporting segment, and the SCM, Tagstar, ACiG and Syscan businesses in the ID Products reporting segment. The goodwill acquired as a result of the acquisitions of Hirsch of $21.9 million was allocated to the Hirsch reporting unit. During the third quarter of 2010, we completed the assignment of goodwill to various reporting units. Of the total goodwill of $26.2 million measured during the year, we assigned $16.9 million of goodwill to Multicard, $1.4 million to SCM, $3.7 million to Tagstar, $2.8 million to ACiG and $1.4 million to the Syscan reporting unit, as required by ASC 350. We performed our annual impairment test for the Hirsch reporting unit on December 1, 2009 (which was the only reporting unit to have recorded goodwill) and the fair value of the Hirsch reporting unit according to our Step 1 test exceeded the carrying value by approximately 10% and determined that there was no impairment of goodwill at that time. As of December 1, 2009, there were no potential events and/or changes in circumstances that were expected to occur which could have a negative effect on the key assumptions used in the Step 1 analysis. Additionally, as discussed in Note 6 to the financial statements included in this Form 10-Q, there were no impairment indicators during the three and nine months ending September 30, 2010.

We evaluate our long-lived assets and certain identifiable intangibles for impairment in accordance with ASC Topic 360, *Property, Plant and Equipment* (ASC 360) whenever events or changes in circumstances indicate that the carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by an asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Intangible assets with definite lives are being amortized using the straight-line method over the estimated useful lives of the related assets. For intangible assets, where we have determined that these have an indefinite useful life, no amortization is recognized until its useful life is determined to be no longer indefinite. We evaluate indefinite useful life intangible assets for impairment at a minimum on an annual basis and whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

We recognize stock-based compensation expense for all share-based payment awards in accordance with ASC Topic 718, *Compensation Stock Compensation* (ASC 718). Stock-based compensation expense for expected-to-vest awards is valued under the single-option approach and amortized on a straight-line basis, net of estimated forfeitures. We utilize the Black-Scholes-Merton option-pricing model in order to determine the fair value of stock-based awards. The Black-Scholes-Merton model requires various highly subjective assumptions including volatility, expected option life, and risk-free interest rate. The assumptions used in calculating the fair value of share-based payment awards represent management s best estimates. These estimates involve inherent uncertainties and the application of management s judgment. If factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those expected-to-vest shares. If our actual forfeiture rate is materially different from our estimate, our recorded stock-based compensation expense could be different.

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Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) No. 2009-14, *Software (Topic 985) Certain Arrangements That Contain Software Elements a consensus of the FASB Emerging Issues Task Force* (EITF) (ASU 2009-14), which amends the scope of software revenue guidance in ASC Subtopic 985-605, *Software-Revenue Recognition,* to exclude tangible products containing software and non-software components that function together to deliver the product s essential functionality.

In October 2009, FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements a consensus of the FASB EITF* (ASU 2009-13), which eliminates the residual method of allocation and requires the relative selling price method when allocating deliverables of a multiple-deliverable revenue arrangement. ASU 2009-13 specifies the best estimate of a selling price is consistent with that used to determine the price to sell the deliverable on a standalone basis.

ASU 2009-14 and ASU 2009-13 are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, and must be adopted in the same period using the same transition method. If adoption is elected in a period other than the beginning of a fiscal year, the amendments in these standards must be applied retrospectively to the beginning of the fiscal year. Full retrospective application of these amendments to prior fiscal years is optional. We are currently assessing the timing of adoption and effects that ASU 2009-14 and ASU 2009-13 will have on our consolidated results of operations and financial condition.

Results of Operations

The comparability of our operating results in the three and nine months ended September 30, 2010 with the three and nine months ended September 30, 2009 is impacted by our acquisition of Hirsch on April 30, 2009, our acquisition of Bluehill ID on January 4, 2010 and our acquisition of RockWest on April 14, 2010. Results of the Hirsch business have been included since May of 2009; results of the Bluehill ID business have been included in our results of operations since the beginning of 2010; and results of the RockWest business have been included since the middle of April 2010. During the third quarter of 2010, RockWest s name was changed to Multicard U.S. and the business s results are now included within results of the Multicard group.

Revenue

Summary information by business segment for the three and nine months ended September 30, 2010 and 2009 is shown below:

(In thousands)	Three months ended September 30, 2010	Three months ended September 30, 2009	% change period to period	Nine months ended September 30, 2010	Nine months ended September 30, 2009	% change period to period
ID Management:						
Revenue	$ 12,231	$ 6,759	81%	$ 33,572	$ 11,332	196%
Gross profit	6,174	3,856		17,451	6,803	
Gross profit %	50%	57%		52%	60%	
ID Products:						
Revenue	$ 11,065	$ 6,575	68%	$ 26,248	$ 18,118	45%
Gross profit	3,949	2,821		9,253	7,844	
Gross profit %	36%	43%		35%	43%	
Total:						
Revenue	$ 23,296	$ 13,334	75%	$ 59,820	$ 29,450	103%
Gross profit	10,123	6,677		26,704	14,647	
Gross profit %	43%	50%		45%	50%	

Total revenue for the third quarter of 2010 was $23.3 million, up 75% compared with $13.3 million for the third quarter of 2009. For the first nine months of 2010, revenue was $59.8 million, up 103% compared with $29.5 million for the first nine months of 2009. The increase in both the third quarter and the first nine months of 2010 primarily was the result of incremental revenue from acquisitions as well as growth in our Hirsch and SCM Microsystems businesses during the periods. Incremental revenue from the acquired Bluehill ID and Multicard U.S. (formerly

RockWest) businesses was approximately $8.0 million in the third quarter and $19.3 million in the first nine months of 2010, and incremental revenue from the acquired Hirsch business was approximately $8.7 million in the first nine months of 2010.

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ID Management Segment Revenue. Business units in our ID Management segment provide solutions and services that enable the secure management of credentials in diverse markets. Our ID Management business units include Hirsch and Multicard, which specialize in the design and manufacturing of highly secured and 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 ID Management segment are made to customers in the government, commercial and enterprise markets and encompass vertical market segments including healthcare, finance, industrial, retail and critical infrastructure.

Revenue in our ID Management segment was $12.2 million in the third quarter of 2010, up 81% from $6.8 million for the third quarter of 2009, as a result of the inclusion of incremental revenue from the acquired Bluehill ID (Multicard group) and Multicard U.S. (formerly RockWest) businesses, as well as higher sales in our Hirsch business year over year. For the first nine months of 2010, revenue in our ID Management segment was $34 million, up 196% from $11.3 million in the first nine months of 2009, as a result of the inclusion of incremental revenue from the acquired Hirsch, Bluehill ID and Multicard U.S. businesses, as well as growth in our Hirsch business. For the third quarter and first nine months of 2010, the acquired businesses added approximately $4.7 million and $20.2 million, respectively, in incremental revenue. Within the Hirsch business, higher levels of activity related to security programs in the U.S. government sector resulted in a 8% increase in sales in the third quarter of 2010 compared with the same quarter of 2009.

Sales from our Multicard business remained stable overall in the third quarter, although project delays somewhat impacted the European Multicard businesses. During the third quarter, Multicard Netherlands shipped the first RFID labels related to an order from Rabobank to support the Dutch bank s program allowing its 45,000 employees to make cashless payments using their mobile phones. Sales from our Multicard U.S. business grew approximately 25% in the third quarter compared with the previous quarter and Multicard U.S. was selected to provide equipment and systems for state and county programs to identify and coordinate first responders, patients and assets in case of emergency or pandemic events.

ID Products Segment Revenue. Business units in our ID Products segment focus on the design and manufacture of both standard and highly specialized products and components that help identify people, animals and objects in a multitude of applications and markets. Products and components in our ID Products segment include semiconductors, cards, tags, inlays, readers and terminals that are used by original equipment manufacturers and system integrators to deliver identity based systems and solutions. Business units in our ID Products business include SCM Microsystems, TagStar Systems, ACiG Technology and Syscan ID.

Sales in our ID Products segment were $11.1 million in the third quarter of 2010, up 68% from sales of $6.6 million in the third quarter of 2009. For the first nine months of 2010, ID Products sales were $26.2 million, up 45% from $18.1 million for the first nine months of 2009. The increase in both periods primarily was due to the inclusion of incremental revenues from the acquired Bluehill ID businesses, which include TagStar Systems, ACiG Technology, Arygon and Syscan ID, which contributed approximately $3.3 million in the 2010 third quarter and $7.8 million in the first nine months of 2010. Also driving the year over year increases were higher sales levels in our SCM business, which grew 22% in the third quarter of 2010 and 4% in the first nine months of 2010 compared with the same periods of the prior year as a result of approximately $2.5 million of revenue related to shipments of readers for the German electronic ID program. These shipments were related to SCM s European business, which grew 45% in the 2010 third quarter compared with the same period of 2009. SCM s U.S. sales decreased approximately 9% in the third quarter of 2010 compared with the previous year as a result of a shortage of semiconductors which prevented the shipment of some readers. SCM s U.S. sales were up 4% in the first nine months of 2010 compared with the previous year. SCM sales in Asia relatively unchanged in the third quarter and first nine months of 2010 compared with the prior year. Record sales in our TagStar business also contributed to higher revenues in the ID Products segment in the third quarter.

Gross Profit

Gross profit for the third quarter of 2010 was $10.1 million, or 43% of revenue, compared to $6.7 million, or 50% of revenue in the third quarter of 2009. For the first nine months of 2010, gross profit was $26.7 million, or 45% of revenue, compared to $14.6 million, or 50% of revenue for the first nine months of 2009.

By segment, gross profit margin for our ID Management segment was 50% in the third quarter of 2010, compared to 57% in the third quarter of 2009. For the first nine months of 2010, ID Management gross profit margin was 52%, compared to 60% for the first nine months of 2009. ID Management gross profit margin in the 2010 periods was affected by unfavorable product mix in our European Multicard business, while gross profit margins in our U.S. Multicard and Hirsch businesses generally were stable.

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Gross profit margin for our ID Products segment was 36% for the third quarter of 2010, compared to 43% in the third quarter of 2009. For the first nine months of 2010, ID Products gross profit margin was 35%, compared to 43% for the first nine months of 2009. Gross profit margin in the third quarter of 2010 was impacted by an unfavorable product mix in our SCM business and low margins in our TagStar and ACiG businesses. These factors and the effect of earlier inefficiencies associated with the start up of a new RFID inlay product manufacturing line in our TagStar business in the first quarter of 2010 impacted gross profit margin in the first nine months of 2010.

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, product configuration and mix, the availability of new products, product enhancements, software and services, inventory write-downs and the cost and availability of components.

Research and Development

(In thousands)	Three months ended September 30,		% change period to period	Nine months ended September 30,		% change period to period
	2010	2009		2010	2009	
Expenses	$ 1,035	$ 1,252	(17)%	$ 3,513	$ 3,175	11%
Percentage of total revenues	4%	9%		6%	11%	

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 development of products for new and emerging market opportunities. Research and development expenses for 2009 exclude the results of the Bluehill ID business, and for the nine-month period include only five months of expenses for the Hirsch business. Research and development expenses in the first nine months of 2010 include an additional four months of expenses for the Hirsch business and nine months of expenses for the Bluehill ID businesses that were not included in 2009.

Research and development expenses in the third quarter of 2010 were $1.0 million, or 4% of revenue, compared to $1.3 million, or 9% of revenue in the third quarter of 2009, a decrease of 17%. For the first nine months of 2010, research and development expenses were $3.5 million, representing 6% of revenue, up 11% from $3.2 million, or 11% of revenue for the first nine months of 2009. Additional research and development expenses related to the acquired businesses totaled approximately $0.3 million and $1.5 million in the third quarter and first nine months of 2010, respectively. Excluding the impact of these additional expenses, research and development expenses were 40% lower in the 2010 third quarter and 36% lower in the first nine months of 2010 as compared to same periods of 2009. Lower research and development expenses in the third quarter and first nine months of 2010 compared to the same periods of 2009 were due to cost reductions implemented in the first quarter of 2010, as well as lower development expenses in our Hirsch business for the development of Hirsch s next generation of controllers. Cost reduction measures included consolidation of the Company s two development facilities in India into one development center and headcount reductions associated with this consolidation, as well as other cost reductions across the Company.

We expect our research and development expenses to vary based on future project demands and the markets we target.

Selling and Marketing

(In thousands)	Three months ended September 30,		% change period to period	Nine months ended September 30,		% change period to period
	2010	2009		2010	2009	
Expenses	$ 4,823	$ 3,795	27%	$ 14,877	$ 8,763	70%
Percentage of total revenues	21%	28%		25%	30%	

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 portion of our sales and marketing activities on new and emerging market opportunities. Sales and marketing expenses for 2009 exclude the results of the Bluehill ID and Multicard U.S. (RockWest) businesses, and for the nine-month period include only five months of expenses for the Hirsch business.

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Selling and marketing expenses were $4.8 million in the third quarter of 2010, or 21% of revenue, up 27% from $3.8 million in the third quarter of 2009, which represented 28% of revenue. For the first nine months of 2010, sales and marketing expenses were $14.9 million, representing 25% of revenue, up 70% from $8.8 million, or 30% of revenue for the first nine months of 2009. Sales and marketing expenses in the first nine months of 2010 include an additional four months of expenses for the Hirsch business, nine months of expenses for the Bluehill ID businesses and six months of expenses for the Multicard U.S. (RockWest) business that were not included in 2009. Higher sales and marketing expenses in 2010 were due to the inclusion of approximately $1.3 million and $6.6 million of additional expenses related to the acquired businesses in the third quarter and first nine months of 2010, respectively. Excluding the impact of these additional expenses, sales and marketing expenses decreased 6% in the third quarter and the first nine months of 2010 as compared to same periods in 2009 due to cost reductions implemented earlier in the year.

General and Administrative

(In thousands)	Three months ended September 30, 2010	Three months ended September 30, 2009	% change period to period	Nine months ended September 30, 2010	Nine months ended September 30, 2009	% change period to period
Expenses	$ 5,341	$ 4,384	22%	$ 16,201	$ 10,706	51%
Percentage of total revenues	23%	33%		27%	36%	

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. General and administrative expenses for 2009 exclude the results of the Bluehill ID and Multicard U.S. (RockWest) businesses, and for the nine-month period include only five months of expenses for the Hirsch business.

General and administrative expenses in the third quarter and first nine months of 2010 included transaction costs of $0.3 million and $1.3 million, respectively, related to the acquisitions of Multicard U.S. (RockWest) and Bluehill ID, as well as other acquisition activity. In the first nine months of 2009, there were $2.7 million of transaction costs related to our merger with Hirsch and our acquisition of Bluehill ID, of which $0.8 million was recognized in the third quarter of 2009. Additionally, we recognized severance costs of $0.5 million in the 2009 third quarter.

In the third quarter of 2010, general and administrative expenses were $5.3 million, or 23% of revenue, compared to $4.4 million, or 33% of revenue in the third quarter of 2009, an increase of 22%. For the first nine months of 2010, general and administrative expenses were $16.2 million, representing 27% of revenue, up 51% from $10.7 million, or 36% of revenue for the first nine months of 2009. General and administrative expenses in the first nine months of 2010 include an additional four months of expenses for the Hirsch business, nine months of expenses for the Bluehill ID businesses and six months of expenses for the Multicard U.S. (RockWest) business that were not included in 2009. Higher general and administrative expenses in 2010 were the result of the inclusion of approximately $1.8 million and $7.3 million of additional expenses related to the acquired businesses in the third quarter and first nine months of 2010, respectively. Excluding the impact of these additional expenses, general and administrative expenses were 19% lower in the third quarter and 17% lower in the first nine months of 2010 as compared to the same periods of 2009 due to cost reduction measures implemented earlier in the year, which included salary reductions for executive officers, fee reductions for directors, headcount reductions and synergies achieved by consolidating certain administrative services and programs for U.S. employees.

Restructuring

We recorded zero and $0.3 million in restructuring costs in the third quarter and first nine months of 2010 related to the closure and consolidation of facilities as well as headcount reductions associated with consolidation under the cost reduction program initiated in the first quarter of 2010.

Gain on Sale of Assets

During the third quarter of 2009, we recorded a $1.2 million gain on the sale of our office building in India. During the first quarter of 2009, we recorded $0.2 million gain on the sale of certain non-core patents that were unrelated to our current business. No gain has been recorded in 2010.

Loss on Equity Investments

Net loss on equity investments of $0.2 million and $0.8 million for the third quarter and first nine months of 2009 relate to our share of the net losses of our equity method investment in TranZfinity and amortization of the differences between the Company s cost and underlying equity in net assets of TranZfinity, subsequent to the date of investment. Our investment in TranZfinity was determined to be impaired and written off in the fourth quarter of 2009. No loss on equity has been recorded in 2010.

Interest Expense, Net

Interest expense, net of $0.2 million and $0.7 million in the three and nine months ended September 30, 2010, respectively, and $0.2 million and $0.3 million in the three and nine months ended September 30, 2009, respectively, mainly consists of interest accretion expense for a liability to related party in the Hirsch business (which was pro-rated in the second quarter of 2009), offset by interest earned on invested cash during the respective periods. In addition, the third quarter and first nine months of 2010 also include interest paid on mortgage loan and line of credit facilities with the financial institutions.

Foreign Currency Gains (Losses), Net

We recorded foreign currency gains of $0.4 million in the third quarter of 2010, compared with foreign currency gains of $0.1 million in the third quarter of 2009. For the first nine months of 2010, we recorded foreign currency losses of $0.2 million, compared with foreign currency gains of $0.3 million in the first nine months of 2009. Changes in currency valuation in all periods presented were the result of exchange rate movements between the U.S. dollar and mainly the Euro and their impact on the valuation of intercompany transaction balances. Accordingly, they are predominantly non-cash items.

Income Taxes

For the three and nine months ended September 30, 2010, we recorded a net provision for income taxes of $39,000 and a net benefit for income taxes of $0.9 million, respectively. The income taxes recorded in the nine months period primarily resulted from accounting treatment following the acquisition of RockWest, under which deferred tax liabilities of $0.6 million were netted against the Company s existing deferred tax assets, and a $0.6 million release of the Company s valuation allowance was recorded in the second quarter of 2010.

For the three and nine months ended September 30, 2009, we recorded a net provision for income taxes of $0.4 million and a net benefit for income taxes of $1.3 million, respectively. The tax provision recorded in the third quarter of 2009 primarily resulted from the capital gains tax on the sale of our office building in India. The tax benefit recorded in the first nine months of 2009 primarily resulted from accounting treatment following the acquisition of Hirsch, under which deferred tax liabilities of $1.7 million were netted against the Company s existing deferred tax assets, and a $1.7 million release of the Company s valuation allowance was recorded.

Liquidity and Capital Resources

As of the nine months ended September 30, 2010, our working capital, which we have defined as current assets less current liabilities, was $2.4 million, compared to $4.1 million as of December 31, 2009, a decrease of approximately $1.7 million. The reduction in working capital for the first nine months of 2010 reflects a $13.2 million increase in accounts payable, accrued expenses and income taxes payable, the addition of a $0.5 million mortgage loan and line of credit payable to the bank, offset by a $10.7 million increase in accounts receivable, inventories, income taxes receivable and other current assets, as well as a $1.3 million increase in cash and cash equivalents.

Cash and cash equivalents were $6.2 million as of September 30, 2010, an increase of approximately $1.3 million compared to $4.8 million as of December 31, 2009 as a result of cash and cash equivalents acquired from the Bluehill ID and RockWest acquisitions, partially offset by cash used for acquisition, transition and integration activities.

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The following summarizes our cash flows for the nine months ended September 30, 2010 (in thousands):

	Nine Months Ended September 30, 2010	
Cash used in operating activities from continuing operations	$	(4,753)
Cash used in operating activities from discontinued operations		(778)
Cash provided by investing activities		5,258
Cash provided by financing activities		1,844
Effect of exchange rate changes on cash and cash equivalents		(236)
Increase in cash and cash equivalents		1,335
Cash and cash equivalents at beginning of period		4,836
Cash and cash equivalents at end of period	$	6,171

Significant commitments that will require the use of cash in future periods include obligations under operating leases, inventory purchase commitments and other contractual agreements. Gross committed lease obligations were approximately $5.6 million and purchase and other contractual obligations were approximately $12.6 million at September 30, 2010. Total commitments due within one year were approximately $13.4 million and commitments due thereafter were approximately $4.9 million at September 30, 2010.

We currently expect that 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 should be sufficient to meet our operating and capital requirements through at least the end of 2010. We may, however, seek additional debt or equity financing. The sale of additional debt or equity securities may cause dilution to existing stockholders. If sufficient funds are not available or are not available on acceptable terms, our ability to take advantage of unexpected business opportunities or to respond to competitive pressures could be limited or severely constrained.

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 September 30, 2010. 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, 2009.

Item 4T. Controls and Procedures

(a) 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 fiscal quarter ended September 30, 2010, the Company 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.

In light of the amendments required to the Company's Form 8-K/A filed on March 16, 2010 to comply with Rule 8-04 of Regulation S-X, as filed on August 6, 2010, our principal executive officer and principal financial officer implemented additional measures ensure the effectiveness of our disclosure controls and procedures. Notwithstanding the foregoing, based on this evaluation, our principal executive officer and principal financial officer concluded that, as of September 30, 2010, our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in

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reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls over Financial Reporting

In the first quarter of 2010, we implemented a new enterprise resource planning (ERP) system. In connection with our continued monitoring and maintenance of our controls procedures as part of the implementation of section 404 of the Sarbanes-Oxley Act of 2002, we continue to review, revise and improve the effectiveness of our internal controls. There were no changes to our internal control over financial reporting, as defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934, as amended, during the three months ended September 30, 2010 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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 adverse 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 the following risk factors described below 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.

Risks of Market Dynamics

Disruption in the global financial markets may adversely impact the availability and cost of credit.

We may seek or need to raise additional funds. Our ability to obtain financing for general corporate and commercial purposes or acquisitions depends on our operating and financial performance, and is also subject to prevailing economic conditions and to financial, business and other factors beyond our control. The global credit markets and the financial services industry have been experiencing a period of unprecedented uncertainty and weakness as a result of the bankruptcy, failure or sale of various financial institutions. Governments in the U.S. and elsewhere have intervened in the banking industry at unprecedented levels. As a result of such disruption, our ability to raise capital may be severely restricted and the cost of raising capital through such markets or privately may increase significantly at a time when we would like, or need, to do so. Any of these events could have an impact on our flexibility to fund our business operations, make capital expenditures, pursue additional expansion or acquisition opportunities, or make another discretionary use of cash and could adversely impact our financial results. In any case, there can be no assurance that such funds, if available at all, can be obtained on terms reasonable to us.

We are exposed to credit risk on our accounts receivables. This risk is heightened in times of economic weakness.

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 disruption in the global financial markets may adversely impact customers and customer spending patterns.

Continuing disruption in the global financial markets as a result of ongoing global economic weakness or uncertainty may cause consumers, businesses and governments to defer purchases in response to tighter credit, decreased cash availability and low consumer confidence. Accordingly, demand for our products could fail to grow or could decrease and differ materially from our current expectations. In addition, some of our customers may require substantial financing in order to fund their operations and make purchases from us. 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.

Disruption in the global financial 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, 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.

The markets for our products are competitive and characterized by rapidly changing technology. Additionally, the demand for higher security environments including rapid certified 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 productize 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 identity management solutions and secure identification products. 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 SCM Microsystems business, we sell our 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 Hirsch business, many of our dealer channel partners act as system integrators, providing 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 approach 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.

Strategic Risks

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

The markets for our 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 are still evolving. 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. For example, a significant portion of our revenues results from the sale of access control panels that include certain design elements that are more than a decade old. These controllers are typically used in a network architecture that may become outdated or obsolete. If a product is deemed to be obsolete or unmarketable, then we might have to reduce revenue expectations or write down inventories for that product. We may also lose market share.

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. We must be able to demonstrate that our products have features or functions that are clearly differentiated from existing or anticipated competitive offerings, or we may be unsuccessful in selling these products. Our failure to develop, manufacture, launch and sell next-generation security products and solutions could significantly affect our financial performance. 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.

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Sales of our products depend on the development of emerging applications in our target markets and on diversifying and expanding our customer base in new markets and geographic regions, and with new products.

We sell our products primarily to address emerging applications that have not yet reached a stage of mass adoption or deployment. For example, we sell our smart card readers for use in various smart card-based security programs in Europe, such as electronic driver s licenses, national IDs and e-passports, which are applications that are not yet widely implemented. In our Multicard business, our solutions are used in various identity management programs in Europe, such as transit, payments, ticketing, national and regional IDs and stadiums, which are applications that are not yet widely implemented.

We are also focused on expanding sales of professional services, identity management and RFID products and solutions. The market for some of these solutions is at an early stage of development. Additionally, we have a strategy of expanding sales of existing product lines into new geographic markets and diversifying and expanding our customer base, for example expanding sales of our smart card readers to address authentication programs in the government and enterprise sectors in Asia and increasing sales of our Multicard RFID solutions to address programs utilizing mobile phones.

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 security and RFID programs demonstrate success. If demand for products and solutions to enable identity management applications 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:

- general economic conditions, for example economic uncertainty;
- 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; and
- 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.

We may not be able to realize the benefits we expect from recent strategic transactions.

A significant 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. 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.

For example, on October 1, 2008, we entered into a Stock Purchase Agreement with TranZfinity, Inc., a privately held entity, pursuant to which we purchased 33.7% of the outstanding shares of TranZfinity common stock for an aggregate purchase price of $2.5 million. During the fourth quarter of 2009, we determined that the value of our investment in TranZfinity was impaired and we recorded a charge for the impairment to write-off 100% of our investment and our proportionate losses realized by TranZfinity of $2.2 million.

On January 4, 2010, we acquired Bluehill ID and on April 14, 2010 we acquired RockWest. Integrating the Bluehill ID and RockWest 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 integrating the diverse

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business practices and operations of the acquired companies. The integration process may divert the attention of our executive officers and management from day-to-day operations and disrupt our businesses 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, and may cause our stock price to decline.

Any acquisitions that we undertake in the future could be difficult to integrate, disrupt our business, dilute stockholder value, and harm our operating results.

Any future acquisition could expose us to 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 on reasonable terms or at all;
- accounting charges we might incur in connection with such acquisitions;
- 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 the 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.

We may not recognize anticipated benefits from the strategic disposition or divestiture of our businesses from time to time.

Our business strategy also contemplates 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, all or one or more portions 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

We have incurred and will incur significant expenses as a result of our acquisition strategy, which reduces the amount of capital available to fund our business.

We have incurred, and will continue to incur, significant expenses related to our acquisition strategy, including our acquisition of Hirsch in April 2009, our business combination with Bluehill ID in January 2010, our acquisition of RockWest in April 2010 and possible future acquisitions. These expenses include investment banking fees, legal fees, accounting fees, printing and mailing of stockholder materials, integration and other costs, as well as past and possible future outlays of cash. There may also be unanticipated costs related to our acquisition on an ongoing basis. As a result, the capital available to fund our activities

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has been and is expected to be further reduced. If we are unsuccessful in securing sufficient sales from established markets or in generating sufficient new revenues from emerging markets, then we would likely continue to require cash to fund our operations. The remaining cash available to us might not be adequate in subsequent years.

We currently expect that our current capital resources and available borrowings should be sufficient to meet our operating and capital requirements at least through the end of 2010. We may, however, seek additional debt or equity financing prior to that time. 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.

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

A significant portion of our assets is goodwill and other intangible assets, which are reviewed 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 carrying value of these assets exceeds the current fair value, the asset is considered impaired and is reduced to fair value, resulting in a non-cash charge to earnings during the period in which any impairment is determined. Events and conditions that could result in impairment include 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. We cannot accurately predict the amount and timing of any impairment of assets.

We have incurred operating losses and may not achieve profitability.

We have a history of losses. In the future, we may not be able to achieve expected results, including any guidance or outlook we may provide from time to time; we may continue to incur losses and we may be unable to achieve or maintain profitability.

Our quarterly and annual operating results fluctuate.

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 these factors are beyond our control. Our revenues, gross profit and operating results may fluctuate significantly from quarter to quarter due to, among other things:

- 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 budgetary cycles, seasonal demand, product plans or program roll-out schedules;
- cancellations or delays of customer orders or the loss of a significant customer;
- our ability to obtain an adequate supply of components on a timely basis;
- poor quality in the supply of our components;
- delays in the manufacture of our products;
- the absence of significant backlog in our business;

our inventory levels;

our customer and indirect sales channel inventory levels and product returns;

competition;

new product announcements or introductions;

our ability to develop, introduce and market 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;

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; and
- costs related to events such as dispositions, organizational restructuring, headcount reductions, 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.

It is difficult to estimate operating results prior to the end of a quarter.

In our ID Management business, 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 business, the largest component of revenue in any given quarter is sales of smart card reader technology. Historically, many of our smart card reader customers have tended to make a significant portion of their purchases towards the end of the quarter, in part because they believe they are able to negotiate lower prices and more favorable terms. As a result, smart card reader revenue in any quarter depends on contracts entered into or orders booked and shipped in that quarter. This makes it difficult to predict revenues both in our smart card reader business, and for the company overall. 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 may choose to take back unsold inventory from our customers.

If demand is less than anticipated, our distribution customers may ask that we accept returned products that they do not believe they can sell. We do not have a policy relating to product returns for the majority of our products. However, we may determine that it is in our best interest to accept returns in order to maintain good relations with our customers. If we were to accept product returns, we may be required to take additional inventory reserves to reflect the decreased market value of slow-selling returned inventory, even if the products are in good working order.

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. During this sales cycle, we may expend 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.

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

Sales to a relatively small number of customers historically have accounted for a significant percentage of our revenues. We believe that the addition of customers and markets from our Hirsch, Bluehill ID and RockWest acquisitions has improved the diversity of our customer base and reduced our reliance on a small number of customers in our business overall. However, in our ID Products business, we expect that a small number of customers will continue to account for a significant percentage of sales in any given period, for the foreseeable future. The loss of a customer or reduction of orders from a significant customer, including those due to product performance issues, changes in customer buying patterns, or market, economic or competitive conditions in our market segments, could significantly lower our revenues in any period and would increase our dependence on a smaller group of our remaining customers. Variations in the timing or patterns of customer orders could also increase our dependence on other customers in any particular period. Dependence on a small number of customers and variations in order levels period to period could result in decreased revenues, decreased margins, and/or inventory or receivables write-offs and otherwise harm our business and operating results.

Our business could be adversely affected by significant changes in the contracting or fiscal policies of governments and governmental entities.

We derive a substantial portion of our revenues from indirect sales to federal, state and local governments and government agencies, as well as from subcontracts under federal government prime contracts. Large government programs are a primary target for our ID Management business, as higher security systems employing smart card, 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.

Among the factors that could adversely affect our government-related business are:

- changes in fiscal policies or decreases in available government funding or grants;
- changes in government programs or applicable requirements;
- delays in developing technology standards;
- the adoption of new laws or regulations or changes to existing laws or regulations pertaining to security;
- changes in political or social attitudes with respect to security or electronic identification issues;
- potential delays or changes in the government appropriations process; and
- delays in the payment of its invoices by government payment offices.

These and other factors could cause governments and governmental agencies to reduce their purchases or to defer or cancel new identity management programs that might have utilized our products, any of which could have an adverse effect on our business, financial condition and results of operations. Many of our government end customers are subject to stringent budgetary constraints. The award of additional orders from government agencies could be adversely affected by existing or future spending reduction efforts or budget cutbacks at these agencies.

For example, over the past several quarters, purchases of our SCM Microsystems external smart card readers for use by U.S. government agencies have been significantly lower than in previous periods, due to ongoing project and budget delays, which were in part related to the change in presidential administration, and a movement by the U.S. government towards purchasing computer equipment with embedded reader capabilities. We continue to believe that we remain a leading supplier of smart card reader technology to the U.S. government market and that we are not losing share to competitors. However, lower overall market demand and the replacement of external smart card reader sales with sales of lower-priced interface chips for embedded readers is a trend that we do not believe will reverse.

We anticipate that an increasingly significant portion of our future revenues will come from government programs outside the U.S., such as national identity, e-government, e-health and others applications. We currently supply smart card readers, RFID stickers and identity 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. For example, while the German government had stated that it planned to distribute new electronic health cards to its citizens beginning in early 2009 and to put in place a corresponding network and card reader infrastructure during 2009, there have been significant delays in this program and as a result our anticipated sales of eHealth terminals for this program have not materialized. The delay of government projects in any country for any reason could negatively impact our sales.

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. The portion of our business conducted in foreign currencies has increased since the Bluehill ID business combination as the Bluehill ID businesses conduct more than 95% of their business outside the U.S. 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.

We derive a substantial portion of revenue through the sale of Hirsch solutions for U.S. government programs that involve competitive bidding and may be subject to significant delay, which may produce volatility in our revenues and earnings.

In our Hirsch business a substantial portion of revenues are related to orders received from government agencies through our indirect channel partners, and to a lesser extent, from direct sales governed by pricing as published in the General Services Administration (GSA) schedules. 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.

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.

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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 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 statement 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;

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.

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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. For example, limited availability of certain semiconductor chips used in our TagStar and SCM Microsystems products had a negative impact in our sales during the first nine months of 2010. 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.

Security 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 security 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, our systems may be vulnerable to physical or electronic 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 break-ins, we may experience such attempts in the future. Our systems may also 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 will 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. Changes in the actual and estimated costs and time to complete fixed-price, time-certain projects may result in revenue adjustments for contracts where revenue is recognized under the percentage of completion method. Finally, if we miscalculate the amount of resources or time we need to complete a project for which we have agreed to capped or fixed fees, our financial results could be adversely affected.

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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 SCM Microsystems smart card readers, Hirsch s access control panels and TagStar s inlays may contain defects for many reasons, including defective design or manufacture, defective material or software interoperability 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 lose or experience a delay in market acceptance of the affected product or products and we might be unable to retain existing customers or attract new customers. In addition, these defects could interrupt or delay sales. 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 twelve to twenty-four 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 twelve 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.

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

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 effort to address the evolving needs of our customers and markets. To support our development and sales efforts, we maintain company offices and business operations in several locations around the world, including Australia, Brazil, Canada, Germany, Hong Kong, India, Japan, the Netherlands, Switzerland and the U.S. We also must 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 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. 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 41% of our revenue for the first nine months of 2010 and 2009 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.

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, dual-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 creates additional liability and exposure for directors and 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.

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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, particularly in the U.S.;
- 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;
- 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.

Identive common stock has historically traded at a very low volume. The market price of Identive common stock could decline as a result of the large number of shares that have been issued to the former Hirsch and Bluehill ID shareholders and that are currently eligible for sale

or securities that have been issued to the former Hirsch shareholders that will become exercisable for shares of Identive common stock in the future.

The new shares of Identive common stock issued as consideration in connection with the acquisition of Hirsch became freely saleable on January 30, 2010 and the warrants to purchase shares of Identive common stock will be exercisable for a two year period beginning on April 30, 2012. The new shares of Identive common stock issued to former Bluehill ID shareholders in the business combination with Bluehill ID are unrestricted and can be freely traded. The new shares of Identive common stock issued to RockWest are subject to a 24-month lock-up period which ends April 13, 2012. Consequently, a substantial number of additional shares of Identive common stock have recently become available for resale in the public market. Stockholders of Identive and former shareholders of Hirsch or Bluehill ID may not wish to continue to invest in the operations of the company or may wish to dispose of some or all of their interests in Identive. Sales of substantial numbers of shares of both the newly issued and the existing Identive common stock in the public market could adversely affect the market price of our stock.

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.

In connection with the acquisition of Hirsch on April 30, 2009, after giving effect to the acquisition, we issued approximately 9.4 million shares of Identive common stock, and warrants to purchase approximately 4.7 million shares of Identive common stock, as consideration for the outstanding shares of Hirsch common stock. In connection with our business combination with Bluehill ID on January 4, 2010, we issued approximately 15.3 million shares of Identive common stock as consideration for the outstanding shares in Bluehill ID that were tendered in the transaction. In connection with the acquisition of RockWest on April 14, 2010, we issued approximately 2.6 million shares of Identive common stock as consideration for the outstanding shares of RockWest stock. 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 110,000,000 shares of common stock. As of November 8, 2010, 44,002,764 shares of common stock were outstanding, including 618,400 shares held in treasury.

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In 2007, our Board of Directors and our stockholders approved our 2007 stock option plan, under which, as amended in October 2009, options to purchase 3.5 million shares of our common stock may be granted. As of September 30, 2010, an aggregate of approximately 4.8 million shares of common stock was reserved for future issuance under all our stock option plans, of which 1.8 million shares were subject to outstanding options. In connection with our acquisition of Bluehill ID, we assumed the Bluehill Plans under which up to 2.1 million shares may be issued. In addition, in 2010 our Board of Directors and our stockholders approved the 2010 Bonus and Incentive Plan under which 3.0 million shares of common stock were reserved for equity-based awards under the plan, of which 80,885 shares were issued and outstanding as of September 30, 2010. 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. Additionally, as of September 30, 2010, warrants to purchase approximately 4.9 million shares of Identive common stock were outstanding.

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.

The large percentage ownership of Identive common stock by former shareholders of Hirsch and Bluehill ID gives those shareholders significant influence over the outcome of corporate actions requiring stockholder approval.

Immediately following our respective acquisitions of Hirsch and Bluehill ID, the former Hirsch shareholders beneficially owned approximately 37% and the former Bluehill ID shareholders beneficially owned approximately 38% of Identive s common stock. Accordingly, the former Hirsch and Bluehill ID shareholders hold significant influence over the outcome of any corporate transaction or other matter submitted to the Identive stockholders for approval, including the election of directors, any merger, consolidation or sale of all or substantially all of Identive s assets or any other significant corporate transaction, such that such former shareholders of Hirsch or Bluehill ID could delay or prevent a change of control of Identive, even if such a change of control would benefit our other stockholders. The interests of the former Hirsch and Bluehill ID shareholders may differ from the interests of other stockholders.

Several of our directors directly or indirectly hold significant amounts of our common stock, and each of them could have significant influence over the outcome of corporate actions requiring board and stockholder approval, respectively.

As of October 31, 2010, Mountain Partners AG, together with its affiliates and certain related parties, including BH Capital Management (collectively Mountain Partners), had the right to vote approximately 14% of the outstanding shares of our common stock. Daniel Wenzel, a director of our Company, is a co-founder and current affiliate of Mountain Partners. As of October 31, 2010, Lincoln Vale owned and had the right to vote approximately 7% of the outstanding shares of our common stock. Dr. Hans Liebler, one of our directors, is a partner of Lincoln Vale and also may be deemed to beneficially own, either directly or indirectly through limited partnerships, the Identive shares beneficially owned by Lincoln Vale. As of October 31, 2010, Ayman S. Ashour, our Chief Executive Officer and Chairman, and Lawrence Midland, a director and an Executive Vice President of Identive, held approximately 3% and 3%, respectively, of our common stock.

Accordingly, these directors and significant stockholders could each 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.

Our listing on both the NASDAQ Stock Market and the Frankfurt Stock Exchange exposes our stock price to additional risks of fluctuation.

Our common stock is listed both on the NASDAQ Stock Market and the Frankfurt Stock Exchange (FSE) and we typically experience the majority of our trading on the FSE. Because of this, factors that would not otherwise affect a stock traded solely on the NASDAQ Stock Market may cause our stock price to fluctuate. For example, European investors may react differently and more positively or negatively than investors in the U.S. to events such as acquisitions, dispositions, one-time charges, any change in the status of our stock listing in Germany and higher or lower than expected revenue or earnings announcements. A significant positive or negative reaction by investors in Europe to such events could cause our stock price to increase or decrease

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significantly. The European economy and market conditions in general, or downturns on the Ayman S. Ashour, our Chief Executive Officer and Chairman, and specifically, regardless of the NASDAQ Stock Market conditions, also could negatively impact our stock price.

Provisions in our agreements, charter documents, Delaware law and our rights plan 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.

We have adopted a stockholder rights plan. The triggering and exercise of the rights would cause substantial dilution to a person or group that attempts to acquire us on terms or in a manner not approved by our Board of Directors, except pursuant to an offer conditioned upon redemption of the rights. While the rights are not intended to prevent a takeover of our company, they may have the effect of rendering more difficult or discouraging an acquisition of us that was deemed to be undesirable by our Board of Directors.

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);
- 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.

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 its operating costs, profit margins and its 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,

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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 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.

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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.

Changes to financial accounting standards may affect our results of operations and cause us to change our business practices.

We prepare our financial statements to conform with U.S. GAAP. These accounting principles are subject to interpretation by the Financial Standards Accounting Board, the American Institute of Certified Public Accountants, the SEC and various other bodies formed to interpret and create appropriate accounting rules and policies. A change in those rules or policies could have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Any changes in accounting rules or policies in the future may result in significant accounting charges.

We face costs and risks associated with maintaining effective internal controls over financial reporting, and if we fail to achieve and maintain adequate internal controls over financial reporting, our business, results of operations and financial condition, 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. We have found a material weakness in our internal controls in the past and we cannot be certain in the future that we will be able to report that our controls are without material weakness or to complete our evaluation of those controls in a timely fashion.

If we fail to maintain an effective system of disclosure controls or internal control over financial reporting, we may not be able to rely on the integrity of our financial results, which could result in inaccurate or late reporting of our financial results and investigation by regulatory authorities. If we fail to achieve and maintain adequate internal controls the financial position of our business could be harmed; current and potential future shareholders could lose confidence in us and/or our reported financial results, which may cause a negative effect on the trading price of our common stock; and we could be exposed to litigation or regulatory proceedings, which may be costly or divert management attention.

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. Removed and Reserved

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits are listed on the Index to Exhibits 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.
November 9, 2010	By: /s/ AYMAN S. ASHOUR **Ayman S. Ashour** **Chairman of the Board and Chief Executive Officer** **(Principal Executive Officer and Director)**
November 9, 2010	By: /s/ MELVIN DENTON-THOMPSON **Melvin Denton-Thompson** **Chief Financial Officer and Secretary** **(Principal Financial and Accounting Officer)**

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EXHIBIT INDEX

Exhibit Number	DESCRIPTION OF DOCUMENT
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.