VIISAGE TECHNOLOGY INC
Form 10-K
March 31, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2002

OR

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

For the Transition Period from_____to_____.

Commission File Number 000-21559

VIISAGE TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3320515**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
30 Porter Road, Littleton, MA	**01460**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code

(978)-952-2200

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to section 12(g) of the Act:

Common Stock $.001 par value

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.   x Yes   ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference into Part III of this Form 10-K or any amendment to this Form 10-K.   x

Indicate by a check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) ¨ Yes   x No

The aggregate market value of the voting stock held by nonaffiliates of the registrant as of March 26, 2003, was approximately $86 million.

As of March 26, 2003, the registrant had 20,259,647 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 13, 2003 are incorporated by reference in Part III of this 10-K.

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PART I

Item 1. Business

General Development of Business

We are the leading provider of advanced technology solutions for identity verification. We focus on identification solutions that improve personal convenience and security, deter fraud, and reduce identification program costs. We combine our systems integration and software design capabilities with our proprietary software and hardware products and other industry standard products to create complete customized solutions. These turnkey solutions integrate image and data capture, create relational databases, incorporate multiple biometrics and improve customers ability to move and manage information. Applications can include driver s licenses, voter registration, national identification cards, law enforcement, social services, access control and PC network and Internet access security. Our primary customers have been government agencies with particular penetration in Departments of Motor Vehicles. We have captured approximately 32% of the domestic driver s license market. Our products annually produce more than 28 million identification documents at more than 1,800 locations in 19 states. We have also provided services under subcontracts for projects in Jamaica, the Philippines and for the U.S. Immigration and Naturalization Service. Originally developed at MIT, face-recognition technology is widely recognized as the most convenient, non-intrusive and cost-effective biometric available. Our patented face-recognition technology is focused on three major product application areas.

*Face***EXPLORER**, our technology for image retrieval and analysis, is recognized for its leadership technology performance in real-time and large-database applications. *Face***EXPLORER** is deployed in the world s largest face-recognition application with a database of more than 11.2 million enrolled images and is growing by 15,000 new images per day.

*Face***PASS** for physical access control and keyless entry; and

*Face***FINDER** for surveillance and identification.

Financial Information about Industry Segments

We are engaged in the business of developing and implementing digital identification systems and solutions. For the years prior to 2002, we reported our financial results as a single business segment. However, in 2002 we completed three acquisitions through which we significantly enhanced our portfolio of facial recognition technologies and acquired additional facial recognition customers and distribution channels. Accordingly, for the year ended December 31, 2002, we began reporting our results in two separate segments: secure identification products and services segment, or SIPS, and facial recognition segment, or FRS. Our secure identification business accounted for approximately 84.7%, 90.4% and 97.9% of our revenues in 2002, 2001 and 2000, respectively. Facial recognition revenues were approximately 15.3%, 9.6% and 2.1% of total revenues in 2002, 2001 and 2000 respectively.

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We did not report business segments prior to 2002. We have not restated our results, outside of revenue, from 2001 or 2000 to provide segment information because it would be impracticable to do so and would not provide useful information. Due to the integration of three acquisitions in 2002, the net loss in the facial recognition segment includes an $824,000 restructuring charge. The table below sets forth a comparison of revenues, total assets and profit (loss) attributable to each of our business segments for the year ended December 31, 2002, as well as a restatement of revenues by segment for the years ended December 31, 2001 and 2000. Revenues are reported within the segments by customer contracts. Within the secure identification segment there is a component of the contract that utilizes our facial recognition technology. The following table identifies the value of facial recognition revenue that is included in the secure identification segment.

Unaudited

December 31, 2002	SIPS	FRS	Total
Credential revenue	$ 25,943	$	$ 25,943
Facial recognition revenue	1,427	4,932	6,359
Total segment revenue	$ 27,370	$ 4,932	$ 32,302
Profit (loss)	$ 1,088	$ (10,628)	$ (9,530)
Assets	$ 55,953	$ 5,236	$ 61,189

December 31, 2001	SIPS	FRS	Total
Credential revenue	$ 22,274	$	$ 22,274
Facial recognition revenue	483	3,523	4,006
Total segment revenue	$ 22,757	$ 3,523	$ 26,280

December 31, 2000	SIPS	FRS	Total
Credential revenue	$ 26,565	$	$ 26,565
Facial recognition revenue	407	567	974
Total segment revenue	$ 26,972	$ 567	$ 27,539

Industry Background

The need for proper identification affects most people every day. The desire for personal convenience, the significant and increasing costs of fraud and the growing concern over declining personal security have become driving forces behind the global need for effective identification solutions. Starting with only a fraudulent driver s license, an individual is able to create multiple identities, commit fraud, evade law enforcement and engage in other criminal activities that have significant financial and societal implications. Password security and identity card systems can also be compromised if someone obtains a password or identity card and uses this information to gain unauthorized access to facilities, networks or information.

In an effort to combat fraud and tampering, photographic identification cards encapsulated within laminated pouches were developed. However, photographic identification cards can be replicated using widely available advanced color copiers and printers, and laminated pouches have proven easy to delaminate. Advances in and the acceptance of digital technology have led to an increasing demand for digital identification systems to replace existing systems. Digital systems enable information and images to be captured and embedded within the fabric of the card through the use of dye-sublimation techniques, making digital cards more resistant to tampering than laminated pouches. Information can be stored in and later accessed from the card itself using bar codes, magnetic stripes and smart cards (cards which contain computer chips). Digital systems also facilitate the storage of information in computer databases, thereby reducing the need for manual record keeping, file cabinets, and cumbersome indexing systems. Finally, digital systems can be networked to enable up-to-date information to be shared and distributed across geographic and organizational boundaries. This ability to move and manage information helps to increase personal convenience and security for system users.

As an additional means of improving personal convenience and security and deterring fraud, identification systems have increasingly used biometrics (unique biological characteristics) to verify personal identities. Biometric identifiers include facial images, fingerprints, iris scans, retinal scans,

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voice data, hand geometry and others, with fingerprints enjoying wide usage in law enforcement. However, unlike other biometrics, a facial image can be easily verified visually and can be captured in an unobtrusive manner via a photograph, making it a practical means of identification.

Applications for digital identification systems and biometrics are increasing, as they become more sophisticated and easier to use. For example, the typical U.S. state has multiple licensing or other agencies, including its department of motor vehicles, which require the verification of personal identity. The public sector is also focusing on the value of sharing databases to avoid redundant data gathering efforts, distribute information in a timely manner, increase efficiency and deter fraud. We believe public and commercial sector applications for digital identification systems and biometrics will include national identifications, driver s licenses, law enforcement, voter registration, social services, access control, PC network and internet access security, ATMs, retail point-of-sale transaction processing, and administration of health care benefits.

The emergence of digital identification systems and biometrics present significant challenges for integrating these systems with customers existing software, hardware and computing environments. Consequently, customers are seeking complete, integrated solutions to overcome these issues.

Secure Identification Segment

Our secure identification business develops and implements digital identification systems and solutions. Our systems can produce identification cards that are virtually tamper proof, and utilize facial recognition and other biometrics with or without cards for the real-time identification (one-to-many) and verification (one-to-one) of individuals.

Depending on the customer s needs, we offer two types of identification systems. The first is an instant issue system that produces identification cards on location in minutes. The second is a central production system that receives the information electronically from the point of capture, and produces cards from a secure off-site processing location which are later mailed to recipients in several days. The facial images captured by the card systems can provide the content, or face bases, for identification and verification applications.

In a Viisage card system, the facial images and other information are captured in digital format at a PC-based *Image Capture Workstation,* which usually incorporates our proprietary *SensorMast* unit. Compact and self-contained, our workstations can easily be linked to a central image storage device, central card production unit and other remote devices using an existing network, custom designed data communications or the World Wide Web. This flexibility makes the *Image Capture Workstation* ideal for instant issue, central production, mobile use and multiple site systems. The *Viisage Quality Advisor* can be used to assess image quality at the point of capture. With an instant issue system, a commercially available dye-sublimation printer produces single-piece, tamper-resistant identification cards. Alternatively, with a central production system, a high speed-manufacturing unit produces the cards, and an integrated card delivery unit prepares the cards for mailing. When central production is selected, such systems incorporate our proprietary *Visual Inspection System* for quality control of all cards produced. Every system delivers top quality, tamper-resistant identification cards customized to meet the customer s information, delivery and security needs. A wide range of optional features are available, including bar codes, holographic overlays, ghost imaging, ultraviolet or micro preprinting, smart cards and a number of other features.

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Systems Integration and Software Design Capabilities

In addition to our systems integration capabilities, an important aspect of our services and ability to deliver turnkey solutions to our customers involves the design of customized software. Our secure identification proprietary software controls the system and integrates the system components, including the *SensorMast* and *Visual Inspection System* and a variety of third party components and technologies used by our customers. Our secure identification segment has designed software to support all current industry standard operating systems (e.g., Windows NT, Windows 2000, Unix and OS/2), network protocols (e.g., Novell Netware, TCP/IP and SNA), database products (e.g., Sybase or Oracle) and client/server architectures. Our software design and systems integration capabilities enable us to accommodate most computing environments and customers with special requirements.

Proprietary Products

Our proprietary products and related software are described below:

The *SensorMast* is a fully integrated, secure tower unit that incorporates computer-controlled image capture equipment. This equipment includes commercially available digital cameras, adjustable lighting, frame grabbers, step motors, fingerprint and signature capture devices and barcode readers. An integrated version of the *SensorMast* also includes the computer in the *SensorMast*.

The *Visual Inspection System* automatically evaluates cards produced by our central production systems to determine whether the image and data on a person s identification card correspond to the information about that person in the system database. If the information does not match, the *Visual Inspection System* rejects the printed card and identifies the defect for immediate corrective action. This system, which incorporates robotics, high-speed cameras and sophisticated software, automates an activity that is otherwise performed manually and is a potential source of cost savings for customers.

The *Viisage Quality Advisor* can be used by customers to ensure proper image quality. This software product instantly and precisely assesses image quality against desired standards. Images that fail to meet such standards are immediately rejected.

The *ImageCAM* is a secure video camera for the creation of high-quality picture identification cards. It consists of a 24-bit CCD color video camera assembly, a telescoping mounting rod, and a tabletop mounting base. Captured images are transmitted to a host computer via an S-Video. All image capture is accomplished automatically or through the keyboard for ease-of-use.

Customer Service and Support

Following the installation of its digital identification systems, our systems integration segment offers extensive customer training and help desk telephone support as well as ongoing maintenance services. Our systems integration segment s service and support teams, which vary in size depending on the customer and contract, are able to draw extensively upon the expertise of our software and hardware engineers. For some contracts, our systems integration segment has contracted with third party service organizations for maintenance support.

Facial Recognition Segment

In developing facial recognition technologies, we have focused on the face image as the key biometric because the human face is a unique and prominent feature that can be easily captured by a digital camera and verified visually in most cases by an individual with little special training. We are concentrating on four principal areas: physical keyless entry and access control; real-time large database applications; point-of-sale applications; and surveillance applications. We have several on-going facial recognition identification projects, including projects with the Massachusetts Department of Transitional Assistance, the Illinois Secretary of State, Illinois State Police, the Centers for Medicare and Medicaid Services, Global Cash Access/Infonox and a number of other installations, including more than 110 surveillance applications in casinos.

We have advanced the facial recognition technology, initially developed by Professor Alex Pentland of the Massachusetts Institute of Technology, or MIT. We have further developed products for access control, surveillance, and real-time large database identification and verification of individuals. We license the underlying MIT technology through Facia Reco Associates Limited Partnership, or Facia Reco, an entity formed by Dr. Pentland. While Dr. Pentland s software forms the basis of our facial recognition technologies, we believe that our proprietary software, developed over the last six years, is integral to making these technologies more robust and commercially viable.

Our patented facial recognition software offers organizations the ability to create unique identification solutions and enhances both existing identification solutions and offers opportunities for new applications. Using a sophisticated algorithm, the software translates the characteristics of a face into a unique number, or *eigenface*. The *eigenface* is used by the system for identification, a one-to-many search of a database, and verification, a one-to-one match to a specific stored image. Our facial recognition products are unique because they are scalable to databases of millions of faces.

We offer several facial recognition software systems that can be utilized in virtually any solution requiring identification or verification of an individual. Our identification software instantly calculates an individual s *eigenface* identifier and can search an existing database of millions of records in less than 10 seconds for images similar to the image being searched.

Proprietary Products

Below is a list of our facial recognition segment s proprietary products and related software:

> ***Face*FINDER** is a modern surveillance identification solution. Our patented real-time video technology scans crowds of people and matches individuals to selected faces previously stored in an image database. *FaceFINDER* assists customers, such as casinos, domestic and international airports, military bases and government buildings identify suspects either from long distance or from large crowds. We provide these security conscious customers with the tools to identify potential threats before trouble occurs.

*Face*EXPLORER is a large image database research tool that provides the ability to reduce fraud and crime by identifying duplicate images in large databases, such as licensed drivers, benefit recipients, missing children and visa holders. Additionally, law enforcement officials can use *Face*EXPLORER to match images and computer composites against image databases to identify suspects and known criminals. Enterprise customers can use *Face*EXPLORER to verify identities and reduce fraud by effectively retrieving, managing and analyzing their image databases. We have deployed *Face*EXPLORER in the world s largest facial recognition system for the Illinois Secretary of State and State Police. This system provides both duplicate identity fraud reduction and identity investigation capabilities. When fully deployed, the system will contain up to 20 million images with the ability to retrieve images within seconds.

*Face*PASS keyless entry system is used for convenient and authorized physical access to office buildings, factories, dormitories, etc. Physical access control currently has a ubiquitous set of escort devices, such as magnetic cards, PIN numbers and electronic keys to access office buildings, dormitories and homes. The security problem with all these devices is their propensity to be lost or accessed by unauthorized individuals. *Face*PASS replaces PINs and intrusive biometrics with an affordable, reliable and sanitary solution.

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BiometriCam is a compact camera with built-in facial recognition software that plugs directly into an Ethernet connection. Software is automatically downloaded from a server to the camera, enabling the camera to operate unattended. The camera remains constantly alert, checking for faces that might be on a database. The camera can also be integrated into other devices for application development. We acquired the rights to this product on March 18, 2002, when we acquired the capital stock of Biometrica Systems, Inc.

Sales and Marketing

We market our products directly through our internal sales force, and we continue to develop strategic partnerships and distribution channels with vendors, systems integrators and service organizations, particularly in international markets, in order to gain access to such organizations existing relationships, marketing resources and credibility in new markets. Our engineering department supports the direct sales staff by providing pre- and post-sale technical support. This support includes traveling with sales representatives to help explain the systems, defining solutions for customers, designing systems for public procurement activity, supporting the implementation process and providing post-implementation support. We also use our program management group to identify opportunities with existing customers and coordinate related selling efforts.

Our secure identification segment s systems and solutions are generally provided to public sector customers through a formal bidding process. Our sales and marketing personnel regularly conduct visits and attend industry trade shows to identify bid opportunities and particular customer preferences and to establish and cultivate relationships in advance of any bid. Once a request for proposal is issued, a comprehensive proposal is developed and usually followed by an on-site customer demonstration. The process from the issuance of an RFP to the ultimate award can take up to six months. Following the bid award a six-to-twelve month implementation and installation process usually ensues. We believe that long sales cycles in our public sector markets are endemic to the market and will continue. Further, customers may seek to modify the system either during or after the implementation of the system. While our long sales and implementation cycle requires the commitment of marketing resources and investments of working capital, we believe that it also serves as a barrier to entry for smaller companies and as an early indicator of potential competitors for particular projects. For existing customers, a considerably shorter sales and implementation cycle may be involved.

Our facial recognition applications consist primarily of software content. Our marketing efforts and business development activities are focused on establishing OEM and other distribution arrangements with vendors, systems integrators and service organizations serving our principal market areas.

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Product Development

We have developed proprietary software that supports all current industry standard operating systems and networking environments, and proprietary image capture and inspection products for our card-based identification systems. We believe these products will support our card-based identification system offerings for the foreseeable future. Development costs that benefited specific projects were recorded as cost of revenues and costs that did not benefit specific projects were recorded as research and development expenses. Software development costs we have capitalized subsequent to achieving technological feasibility have not been material. Our current development activities are focused on our facial recognition products and the further commercialization of our facial recognition technology. We also benefit from research and development activities conducted by the manufacturers of the components integrated into our systems such as cameras, database software, computers, etc.

For the years ended December 31, 2002, 2001 and 2000, research and development expense was $4,457,000, $2,054,000 and $688,000, respectively. Such amounts do not include amounts for specific projects that are reported as cost of revenues, and are material expenditures, or the benefits from the other research and development activities referred to above.

Manufacturing and Sources of Supply

Contract manufacturers make proprietary subsystems and assemblies, to our specifications. Other non-proprietary system components, such as certain software, cameras, personal computers, printers and related components are purchased from third-party vendors. We purchase some of the major contracted assemblies from single vendors to help ensure high quality, prompt delivery and low cost. We do, however, qualify second sources for most components, contracted assemblies and purchased subsystems, or at least identify alternative sources of supply. We believe that the open architecture of our systems facilitates substitution of components or software when this becomes necessary or desirable. We may from time to time experience delays due to a lack of the availability of component parts and assemblies.

Patents, Trademarks and Licenses

Secure Identification Segment

Our secure identification segment uses patented technology and trade secrets owned or controlled by Facia Reco. This technology relates to de-duplicating or querying databases utilizing information contained in personal identification cards. Our license extends until the expiration of the final patent included in the license. Our license includes Facia Reco s rights to use patented facial recognition technology of MIT. Facia Reco s rights in MIT s technology became non-exclusive in June 2001. MIT has applied to extend its patent rights to jurisdictions in Europe and in Singapore. The U.S. Patent and Trademark Office has allowed further broadened claims for the MIT patent. Our license agreement with Facia Reco provides for a royalty payment on a per machine copy basis incorporating the licensed technology.

Facial Recognition Segment

We have a number of U.S. patent applications in process for facial recognition technologies.

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Trademarks

We have registered our Viisage Technology trademark, as well as trademarks for Sensormast, Hunter, Face Off, Face in The Crowd and Po with the U.S. Patent and Trademark Office.

Copyrights

We have filed a copyright application for our SensorMast software and have made a copyright filing for our Visual Inspection System and related proprietary software.

Acquired Technology

On January 10, 2002, we acquired the assets of Lau Security Systems, a division of Lau Technologies, including all of its intellectual property, contracts and distribution channels. The intellectual property acquired from Lau included, among other things:

twenty-four U.S. or foreign patent grants or applications for inventions relating to facial recognition technologies or the production of identification cards;

the patent acquired by Lau from Daozeng Lu and Simon Lu for verifying the identity of an individual using identification parameters carried on an escort memory; and

numerous invention disclosures that are being considered for patent application.

In the transaction we also acquired an exclusive license in Lau s rights to use the patented facial recognition technology it licensed from MIT for use in the federal access control field. As a result of this transaction, Lau terminated our obligations to license intellectual property to Lau.

On March 18, 2002, we acquired the capital stock of Biometrica Systems, Inc, or Biometrica, for approximately $2.5 million in cash. Biometrica is a former licensee and distributor of our facial recognition technologies in the casino market. Biometrica s assets included, among other things, intellectual property relating to the BiometriCam, a compact camera with built-in facial recognition software.

On June 3, 2002, we acquired all of the intellectual property and related assets of the Miros division of eTrue.com, a major face recognition firm with customer installations across the globe, for approximately $275,000 in cash. In the acquisition, we acquired the patented TrueFace® software.

We can not assure you that our efforts to prevent the misappropriation of the intellectual property used in our business will be successful. Further, we can not assure you that any of the additional U.S. or foreign patents applied for by Lau or the foreign patents applied for by MIT will be issued or that, if issued, they will provide protection against competitive technologies or will be held valid and enforceable if challenged. Finally, we can not assure you that competitors would not be able to design around any such proprietary right or obtain rights that we would need to license or design around in order to practice under these patent and copyrights.

We believe that our patents are important to both our secure identification and our facial recognition segment. Our U.S. patents typically have a duration of 17 to 20 years.

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Seasonality

Our operations are not seasonal since contracts are awarded and performed throughout the year. However, we believe our public sector business could be subject to cyclical procurement delays that may be related to state election cycles.

Working Capital Requirements

In our secure identification business we are generally required to fund the development and implementation of large digital identification system projects for public sector customers. Historically, we have utilized bank borrowings and project lease financing to meet these needs. There are no special requirements or customer terms that are expected to have a material adverse effect on our working capital. As discussed more fully in Management s Discussion and Analysis of Financial Condition and Results of Operations , we may raise capital, as needed, to fund working capital needs or growth activities.

Customers and End Users

The following lists and categorizes our customers and end users for our secure identification products as of December 31, 2002:

State Departments of Motor Vehicles, Other State and Local Agencies

Arizona Department of Transportation

Arkansas Department of Human Services

Arkansas Office of Driver Services

Connecticut Department of Social Services

Connecticut Department of Motor Vehicles

Florida Department of Highway Safety and Motor Vehicles*

Illinois Secretary of State

Kentucky Transportation Cabinet

Maryland Department of Transportation and Motor Vehicle Administration*

Massachusetts Department of Transitional Assistance

Mississippi Department of Information Technology Services

New Mexico Department of Taxation and Revenue

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New York Department of Social Services*

North Carolina Department of Transportation

Ohio Bureau of Motor Vehicles

Ohio Department of Public Safety

Pennsylvania Department of Transportation

South Carolina Department of Public Safety*

State of Rhode Island, Department of Administration, Division of Motor Vehicles

State of Delaware Department of Public Safety

State of Georgia Department of Motor Vehicle Safety

Wisconsin Department of Corrections

Wisconsin Department of Transportation

Federal Agencies Foreign Contracts

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U.S. Immigration and Naturalization Services *

Commission on Elections of the Republic of the Philippines *

Electoral Commission of Jamaica *

Electoral Commission of Uganda

The following lists and categorizes our customers and end users for our facial recognition products as of December 31, 2002:

State Departments of Motor Vehicles, Other State and Local Agencies

Pinellas County Sheriff   s Office

City of New Bedford Massachusetts Department of Police

Illinois State Police

Middlesex County Sheriff   s Office

Kentucky State Police of the Commonwealth of Kentucky

University of Maryland Office of Research Administration

Federal Agencies Foreign Contracts

Federal Bureau of Investigation

U.S. Department of State

U.S. Technology Support Office, Technical Support Working Group

Airports

St. Petersburg   Clearwater International Airport

Commercial Customers and Distribution Partners

Booz-Allen & Hamilton, Inc.

Control Monitor Systems

Curtiss-Wright Corporation

Global Cash Access/Infonox

HummingBird Defense Systems, Inc.

Insurance Corp of British Columbia

Logicon

Rapor

Vision Interactive

Over 110 Casinos in North America

* By subcontract

In addition, most new contracts in our secure identification segment now include a facial recognition component.

For 2002, two customers, Connecticut Department of Information Technology and Mississippi Department of ITS each accounted for over 10% of our total revenues and an aggregate of 22% of our revenues for the year. For 2001, four customers, Illinois Secretary of State, Unisys Corporation (Florida Department of Safety and Motor Vehicles), Kentucky Transportation Cabinet and

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Pennsylvania Department of Transportation each accounted for over 10% of our total revenues and an aggregate of 49% of our revenues for the year. For 2000, four customers, Ohio Bureau of Motor Vehicles, Unisys Corporation (Florida Department of Safety and Motor Vehicles), Pennsylvania Department of Transportation, and Maryland Department of Transportation each accounted for over 10% of our total revenues and an aggregate of 58% of our revenues for the year. The loss of any such customers could have a material adverse impact on our business, operating results and financial condition.

Virtually all of our direct revenue has been derived within the United States and account for approximately 100.0%, 95.4%, and 100.0% of total revenues for the years 2002, 2001 and 2000 respectively. In 2001 approximately 4.6% of our total revenue was derived from foreign sales, all material foreign sales in 2001 took place in the country of Uganda.

Backlog

We measure backlog based on signed contracts, subcontracts and customer commitments for which revenue has not yet been recognized. Backlog does not include amounts for phase-outs or other extension opportunities included in such contracts. Accordingly, backlog is only somewhat indicative of future revenue because contracts may be changed positively or negatively. Backlog could be cancelled at any time for lack of performance, without penalty. However, cancellations not caused by the our lack of performance will be subject to recovery of all actual committed costs and profit on work performed through the date of cancellation. Any failure by us to meet an agreed-upon schedule could lead to the cancellation of the related order. The timing of award and performance on contracts as well as variations in size, complexity and requirements of the customer and modifications to contract awards may result in substantial fluctuations in backlog from period to period. Further, backlog typically represents a limited portion of our annual plan. Therefore, we believe that backlog cannot be considered a meaningful indicator of future financial performance.

At December 31, 2002, our backlog was approximately $78 million, compared to approximately $68 million at December 31, 2001. Of the $78 million in backlog as of December 31, 2002, we expect to recognize revenue of approximately $29 million in 2003.

Government Contacts

Both of our segments involve government contracts. Government contracts are generally subject to termination for convenience or lack of appropriation at the determination of the subject agency. While termination is a significant financial risk, we have never experienced a government contract termination.

Competition

The market for our products and services is extremely competitive and management expects this competitive environment to intensify as the market for our products continues to grow.

Secure Identification Segment

We face competition in the secure identification systems market from companies, including Digimarc, formerly Polaroid Corporation, and Unisys Corporation, which, in some cases, have

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greater financial and marketing resources than us. In some cases, we may be competing with an entity that has a pre-existing relationship with a potential customer, which could put us at a significant competitive disadvantage. As the secure identification market expands, additional competitors may seek to enter the market.

We believe that competition in the secure identification systems market is based primarily upon the following factors:

service,

support,

technical excellence,

price credibility,

flexibility in accommodating customer technical and business needs, and

responsiveness.

The relative importance of each of these and other factors depends upon the specific customer and situation involved. Substantially all of our sales to new customers have been the result of competitive bidding for contracts pursuant to public sector procurement rules. We believe that our competitive strength is our systems integration and software design capabilities, system performance and architecture technologies, operating flexibility, price, and robust service and project management.

Facial Recognition Segment

In the field of facial recognition technology, we compete with several facial recognition providers, none of whom have any market dominance, as well as providers of other biometric solutions, such as fingerprint recognition, which has a long history of use, particularly in law enforcement applications. We expect that as the market for biometric solutions develops new companies and companies with significant resources and capabilities may enter the market and competition will intensify.

Environmental Protection Regulations

We believe that our compliance with federal, state and local environmental regulations will not have a material adverse effect on our financial position or results of operations.

Employees

As of December 31, 2002, we had 106 full time and 9 supplemental employees. We significantly supplement our employee resources with independent contractors. None of our employees are represented by a labor union, and we consider our relationship with our employees and contractors to be very good.

<u>Officers</u>

Our executive officers are elected by our Board of Directors annually and serve until their successors have been duly elected and qualified.

Bernard Bailey, 49, joined Viisage in August 2002 as Chief Executive Officer. From January 2001 through August 2002, Mr. Bailey served as the Chief Operating Officer of Art Technology Group.

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Between April 1984 and January 2001, Mr. Bailey served in various capacities at IBM Corporation, including several executive positions. A graduate of the US Naval Academy, Mr. Bailey served for eight years as an officer in the US Navy.

Iftikhar A. Ahmad, 51, was elected as an officer in March 1999 with the title of Vice President of Engineering and Program Management of the Company. From November 1996 until March 1999, Mr. Ahmad served as a Director in the Company s Software Engineering Department. From January 1995 to November 1996, he was a senior consultant in Lau s Systems Engineering Department, and prior to that, he held various senior engineering positions at Digital Equipment Corporation.

Bill Aulet, 45, joined Viisage Technology in February 2003 as Chief Financial Officer. Between August 1996 and February 2003 he served as the President of SensAble Technologies. Mr. Aulet was one of the founders of Cambridge Decision Dynamics, where he served as President from April of 1995 to August of 1996. Prior to Cambridge Decision Dynamics he spent twelve years at IBM Corporation, where he held various management positions. He is a Senior Lecturer at MIT s Sloan School of Management.

Robert Schmitt, 59, joined Viisage in March 2002 as Senior Vice President and General Manager of the Facial Recognition business unit. He was president and founder of Biometrica Systems from January 1998 to March 2002. Prior to his employment at Viisage and Biometrica, he held various positions at Digital Equipment Corp., including Vice President of Marketing, Vice President of Marketing for the Far East, and Vice President of field technical support. He spent ten years at IBM prior to Digital.

James Ebzery, 43, joined Viisage Technology in November 2002 as Senior Vice President of Sales and Marketing. Mr. Ebzery served as Vice President of Operations for Internet Capital Group from April 2000 to February 2002. Prior to joining ICG, he held senior sales and marketing positions at IBM Corporation from December 1983 to April 2000. He also served as the Worldwide Solutions Executive for the IBM Supply Chain Software Business.

Jack Dillon, 66, joined Viisage in February 2003 as Senior Vice President of Government Solutions. Since 1988, he has served as a Vice President with Unisys Defense Systems, which became part of Loral Corporation, later purchased by Lockheed Martin. During this time, Mr. Dillon was Vice President of Business Development, Vice President of Software and Technical Services and Vice President of Command and Control and Security Systems. Most recently, he served as Vice President of Central and Eastern Europe for Lockheed Martin, focusing on command and control and security systems.

Financial Information about Foreign and Domestic Operations and Export Sales

The Company s foreign operations and export sales are currently not material.

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Company s Internet Website

We maintain a website with the address www.viisage.com. We are not including the information contained in our website, or incorporating it by reference into, this Annual Report on Form 10-K. We make available, free of charge through our website, our Annual Reports on Form10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and any amendments to these reports as soon as reasonably practicable after they are filed with the Securities and Exchange Commission.

Item 2. Properties

We currently use approximately 37,700 square feet of space in facilities located in Littleton, Massachusetts. The area is subleased to us from Lau Technologies and Inforonics through January 31, 2004 and October 31, 2004 respectively. We believe that our facilities are in good condition and are suitable and adequate for our present operations and that suitable space is available if such lease is not extended.

Item 3. Legal Proceedings

We do not believe that there are any legal matters that would have a material adverse effect on our business, financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders in the fourth quarter of 2002.

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Our common stock is traded on the Nasdaq National Market under the symbol VISG. On March 26, 2003, the closing price of our common stock was $4.25 per share and there were approximately 220 holders of record of our common stock. The quarterly high and low closing prices, as reported by NASDAQ, of our common stock in 2002 and 2001 were as follows:

	2002	2001

Quarter	High	Low	High	Low
First Quarter	$ 9.50	$ 5.63	$ 3.25	$ 0.84
Second Quarter	$ 7.05	$ 3.66	$ 2.70	$ 1.56
Third Quarter	$ 4.92	$ 2.82	$ 8.36	$ 1.75
Fourth Quarter	$ 5.72	$ 3.35	$ 15.97	$ 6.15

Dividend Policy

We presently intend to retain our cash for use in the operation and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, we are prohibited from paying dividends pursuant to our lending arrangements.

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Item 6. Selected Financial Data

The financial data set forth below should be read in conjunction with   Management s Discussion and Analysis of Financial Condition and Results of Operations   and our audited financial statements and the related notes included elsewhere in this Form 10-K.

Years Ended December 31,	2002	2001	2000	1999	1998(1)
	(in thousands, except per share amounts)				
Statement of Operations Data:					
Revenues	$ 32,302	$ 26,280	$ 27,539	$ 19,297	$ 16,259
Cost of revenues	25,239	19,602	21,136	15,131	15,957
Gross margin	7,063	6,678	6,403	4,166	302
Operating expenses:					
Sales and marketing	5,368	809	787	739	2,195
Research and development	4,457	2,054	688	253	358
General and administrative	5,069	2,500	2,489	1,939	2,247
Acquisition expenses		1,639			
Restructuring charges	824				
Total operating expenses	15,718	7,002	3,964	2,931	4,800
Operating income (loss)	(8,655)	(324)	2,439	1,235	(4,498)
Interest expense, net	875	1,210	1,637	2,230	1,667
Income (loss) before income taxes and cumulative effect of change in accounting principle	(9,530)	(1,534)	802	(995)	(6,165)
Provision for income taxes					
Income (loss) before cumulative effect of change in accounting principle	(9,530)	(1,534)	802	(995)	(6,165)
Cumulative effect of change in accounting principle					(1,038)
Net income (loss)	(9,530)	(1,534)	802	(995)	(7,203)
Preferred stock dividends		(5)	(327)	(1,003)	
Income (loss) applicable to common shareholders before cumulative effect	(9,530)	(1,539)	475	(1,998)	(7,203)
Cumulative effect of implementing EITF 00-27			(277)		
Net income (loss) applicable to common shareholders	$ (9,530)	$ (1,539)	$ 198	$ (1,998)	$ (7,203)
Basic income (loss) per share before cumulative effect	$ (0.48)	$ (0.09)	$ 0.05	$ (0.23)	$ (0.75)
Basic net income (loss) per share applicable to common shareholders (2)	$ (0.48)	$ (0.09)	$ 0.02	$ (0.23)	$ (0.88)
Weighted average basic common shares Outstanding	20,046	16,265	10,460	8,610	8,175

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Diluted income (loss) per share before cumulative effect	$	(0.48)	$	(0.09)	$	0.03	$	(0.23)	$	(0.75)
Diluted net income (loss) per share applicable to common shareholders (2)	$	(0.48)	$	(0.09)	$	0.01	$	(0.23)	$	(0.88)
Weighted average diluted common shares outstanding		20,046		16,265		14,504		8,610		8,175

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December 31,	2002	2001	2000	1999	1998(1)
Balance Sheet Data:					
Working Capital	$ 22,244	$			