L-1 IDENTITY SOLUTIONS, INC.
Form 10-Q
May 10, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended March 31, 2011.

OR

o **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 001-33002

L-1 IDENTITY SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**02-0807887**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
177 Broad Street, 12th Floor, Stamford, CT	**06901**
(Address of principal executive offices)	(Zip Code)

(203) 504-1100

Registrant s telephone number, including area code

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. þ Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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. þ Yes o 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 þ	Accelerated Filer o	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

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

Class	**Outstanding at May 5, 2011**
Common stock, $.001 par value	90,431,643

L-1 IDENTITY SOLUTIONS, INC.
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2011
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PART 1 FINANCIAL INFORMATION
ITEM 1 UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
L-1 IDENTITY SOLUTIONS, INC.
Condensed Consolidated Balance Sheets
(in thousands)
(Unaudited)

	March 31, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 4,407	$ 3,085
Accounts receivable, net	102,737	103,091
Inventory, net	44,797	32,672
Deferred tax asset, net	1,369	40,881
Other current assets	7,465	6,536
Assets held for sale		271,290
Total current assets	160,775	457,555
Property and equipment, net	127,862	126,184
Goodwill	701,218	700,331
Intangible assets, net	60,479	61,266
Deferred tax assets, net	40,515	33,235
Other assets, net	7,205	14,285
Total assets	$ 1,098,054	$ 1,392,856
Liabilities and Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 98,456	$ 90,567
Current portion of deferred revenue	16,622	18,559
Current maturities of long-term debt	3,040	271,401
Other current liabilities	7,967	7,503
Liabilities related to assets held for sale		42,124
Total current liabilities	126,085	430,154
Deferred revenue, net of current portion	6,263	5,472
Long-term debt, net of current maturities	225,734	212,062
Other long-term liabilities	4,612	4,837
Total liabilities	362,694	652,525
Equity:		
Common stock, $0.001 par value; 125,000,000 shares authorized; 94,266,499 and 94,012,584 shares issued at March 31, 2011 and December 31, 2010, respectively	94	94
Additional paid-in capital	1,464,423	1,459,814

Accumulated deficit	(654,756)	(643,935)
Pre-paid forward contract		(69,808)
Treasury stock, 3,875,090 and 384,690 shares of common stock, at cost at March 31, 2011 and December 31, 2010, respectively	(76,124)	(6,316)
Accumulated other comprehensive income	1,723	482
Noncontrolling interest		
Total equity	735,360	740,331
Total liabilities and equity	$ 1,098,054	$ 1,392,856

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

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L-1 IDENTITY SOLUTIONS, INC.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three Months Ended, March 31, 2011	March 31, 2010
Revenues	$ 97,197	$ 94,627
Cost of revenues:		
Cost of revenues	78,476	69,082
Amortization of acquired intangible assets	1,222	1,239
Total cost of revenues	79,698	70,321
Gross profit	17,499	24,306
Operating expenses:		
Sales and marketing	9,021	9,570
Research and development	6,045	5,384
General and administrative	13,644	13,561
Strategic alternative transactions costs and other	1,091	170
Total operating expenses	29,801	28,685
Operating loss	(12,302)	(4,379)
Financing costs:		
Contractual interest	(2,181)	(2,186)
Other financing costs	(2,117)	(1,811)
Loss on extinguishment of debt	(1,451)	
Other expense, net	(92)	(197)
Loss before income taxes and discontinued operations	(18,143)	(8,573)
Benefit for income taxes	5,117	2,422
Net loss from continuing operations, net of income taxes	(13,026)	(6,151)
Net income (loss) from discontinued operations:		
Loss from operations	(6,387)	(2,081)
Gain on sale of Intel Business	42,701	
Net income (loss) from discontinued operations before income taxes	36,314	(2,081)
Benefit (provision) for income taxes (Including $21.7 million provision and $0.7 million benefit for deferred income taxes in 2011 and 2010, respectively.)	(34,109)	729
Net income (loss) from discontinued operations, net of income taxes	2,205	(1,352)

Net loss	(10,821)	(7,503)
Net loss attributable to noncontrolling interest		(20)
Net loss attributable to L-1 s shareholders	$ (10,821)	$ (7,523)
Basic net income (loss) per share:		
Continued operations	$ (0.15)	$ (0.07)
Discontinued operations	$ 0.02	$ (0.02)
Attributable to L-1 s shareholders	$ (0.12)	$ (0.09)
Diluted net income (loss) per share:		
Continued operations	$ (0.15)	$ (0.07)
Discontinued operations	$ 0.02	$ (0.02)
Attributable to L-1 s shareholders	$ (0.12)	$ (0.09)
Weighted average common shares outstanding:		
Basic	88,906	86,851
Diluted	88,906	86,851

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L-1 IDENTITY SOLUTIONS, INC.
Condensed Consolidated Statements of Changes in Equity
(In thousands)
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Pre-paid Forward Contract To Purchase Common Stock	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Non-Controlling Interest	Total
Balance, January 1, 2010	$ 92	$ 1,432,898	$ (627,449)	$ (69,808)	$ (6,173)	$ 622	$ 279	$ 730,461
Exercise of employee stock options		2,140						2,140
Common stock issued for directors fees		900						900
Common stock issued under employee stock purchase plan		2,542						2,542
Deferred tax charge of stock options exercised		(2,044)						(2,044)
Retirement plan contribution settled in common stock	2	10,034						10,036
Stock-based compensation expense		13,344						13,344
Foreign currency translation (loss)						(476)		(476)
Unrealized gain on financial instruments, net of tax						324		324
Net income (loss)			(16,486)				21	(16,465)
Other					(143)	12	(300)	(431)
Balance, December 31, 2010	$ 94	$ 1,459,814	$ (643,935)	$ (69,808)	$ (6,316)	$ 482	$	$ 740,331

Exercise of employee stock options		1,690						1,690
Settlement of pre-paid forward contract				69,808	(69,808)			
Retirement plan contributions settled in common stock		127						127
Stock-based compensation expense		2,792						2,792
Foreign currency translation gain						983		983
Unrealized gain on financial instruments, net of tax						258		258
Net loss			(10,821)					(10,821)
Other								
Balance, March 31, 2011	$ 94	$ 1,464,423	$ (654,756)	$	$ (76,124)	$ 1,723	$	$ 735,360

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L-1 IDENTITY SOLUTIONS, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2011	March 31, 2010
Cash Flow from Operating Activities:		
Net loss	$ (10,821)	$ (7,503)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	11,169	9,901
Stock-based compensation costs	1,832	7,049
Provision (benefit) for non-cash income taxes	28,764	(3,151)
Loss on extinguishment of debt	7,799	
Amortization of deferred financing costs and debt discount	2,629	3,237
Gain on disposal of Intel Business	(42,701)	
Other non-cash items	9	(18)
Change in operating assets and liabilities, net of effects of dispositions:		
Accounts receivable	3,986	(849)
Inventory	(12,173)	(2,073)
Other assets	(1,417)	8
Accounts payable, accrued expenses and other liabilities	(7,769)	(3,863)
Deferred revenue	(789)	(2,383)
Net cash provided by (used in) operating activities	(19,482)	355
Cash Flow from Investing Activities:		
Acquisitions	(66)	(3,036)
Proceeds from disposal of Intel Business	289,528	
Capital expenditures	(10,164)	(11,661)
Additions to intangible assets	(2,059)	(1,690)
(Increase)/decrease in restricted cash	100	(9)
Net cash provided by (used in) investing activities	277,339	(16,396)
Cash Flow from Financing Activities:		
Borrowings under revolving credit agreement	30,000	23,000
Principal payments on term loan	(259,941)	(4,351)
Debt and equity issuance costs		(103)
Principal payments on borrowings under revolving credit agreement and other debt	(28,301)	(7,310)
Proceeds from issuance of common stock to employees		638
Proceeds from exercise of stock options by employees	1,690	142
Net cash provided by (used in) financing activities	(256,552)	12,016
Effect of exchange rate changes on cash and cash equivalents	17	50

Net increase (decrease) in cash and cash equivalents		1,322		(3,975)
Cash and cash equivalents, beginning of year		3,085		6,624
Cash and cash equivalents, end of period	$	4,407	$	2,649
Supplemental Cash Flow Information:				
Cash paid for interest	$	8,677	$	5,996
Cash paid for income taxes	$	680	$	66

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

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L-1 IDENTITY SOLUTIONS, INC.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. DESCRIPTION OF BUSINESS

Recent Transactions

In January 2010, L-1 announced that one of its strategic goals and objectives for 2010 was to explore strategic alternatives to enhance shareholder value. Subsequently, on September 19, 2010, the Company entered into an agreement (the Merger Agreement) with Safran SA (Safran) and Laser Acquisition Sub Inc. (Merger Sub), a wholly owned subsidiary of Safran, pursuant to which, subject to the terms and conditions set forth in the Merger Agreement, the Company is to be acquired by Safran in a merger transaction providing for shareholders to receive $12.00 per share in cash, for an aggregate enterprise value of approximately $1.6 billion, inclusive of outstanding debt. Completion of the merger remains subject to certain conditions, including, among others, (i) termination or expiration of the Committee on Foreign Investment in the United States (CFIUS) review period pursuant to the Exon-Florio Provision of the Defense Production Act of 1950; (ii) no Company Material Adverse Effect (as defined in the Merger Agreement) having occurred since the date of the Merger Agreement; (iii) subject to certain materiality exceptions, the accuracy of the representations and warranties made by the Company and Safran and compliance by the Company and Safran with their respective obligations under the Merger Agreement; (iv) no law or government order prohibiting the merger; and (v) other customary conditions.

As previously disclosed, CFIUS has been engaged in a review of the merger transaction with Safran and L-1 and Safran withdrew and re-filed a joint voluntary notice to CFIUS on February 11, 2011 in order to provide additional time to continue the negotiation of a mitigation agreement with the CFIUS agencies. The re-filing commenced a new 30-day review period that expired on March 15, 2011. CFIUS then determined to proceed with a 45-day investigation of the merger transaction, which was due to expire on April 29, 2011. Prior to expiration of the investigation period, L-1 and Safran voluntarily withdrew and re-filed the joint CFIUS notification in order to provide additional time for the efforts to negotiate a definitive mitigation agreement. On May 4, 2011, CFIUS informed L-1 that it had accepted the re-filed joint notification, which commenced a new 30-day review period scheduled to expire on June 2, 2011. There can be no assurance that a definitive mitigation agreement will be executed; however, L-1 expects the parties to work diligently in an effort to finalize the agreement as quickly as possible. The condensed consolidated financial statements do not reflect any adjustments to the reported assets and liabilities which may be required as a result of the consummation of the Safran merger.

In February 2011, the Company completed its previously announced sale of the Intel Business to BAE Systems Information Solutions, Inc. (BAE) (a subsidiary of BAE Systems, Inc., the U.S. affiliate of BAE Systems plc). Pursuant to the terms of the Purchase Agreement, dated as of September 19, 2010 (the BAE Purchase Agreement), by and between the Company and BAE, the Company sold the Intel Business to BAE for a purchase price of $295.8 million in cash (inclusive of acquired cash) and approximately $7.2 million in assumed obligations, the net proceeds of which were used to repay $289.3 million of outstanding debt under the Company s credit agreement. The accompanying condensed consolidated financial statements reflect the impact of the sale of the Intel Business the operating results of which have been reflected as discontinued operations for all periods presented. Unless otherwise noted, revenues and expenses in these notes to consolidated financial statements exclude amounts attributable to discontinued operations. The assets and liabilities of the discontinued operations were included in assets held for sale and liabilities related to assets held for sale at December 31, 2010.

Overview

L-1 Identity Solutions, Inc. and its subsidiaries (L-1 or the Company) provide solutions and services that protect and secure personal identities and assets and allow international governments, federal and state agencies, law enforcement and commercial businesses to guard the public against terrorism, crime and identity theft.

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The Company operates in two reportable segments: Solutions and Services. The Solutions segment includes Secure Credentialing and Biometrics/Enterprise Access. Secure Credentialing solutions span the entire secure credentialing lifecycle, from testing through issuance and inspection. This includes driver s licenses, national IDs, ePassports and other forms of government-issued proof of identity credentials. Biometric solutions capture, manage and move biometric data for positive, rapid ID and tracking of persons of interest. Biometrics solutions also encompass access control readers that enable businesses and governments to secure facilities and restricted areas by preventing unauthorized entry. The Services segment includes Enrollment Services which performs fingerprint-based background checks necessary for federal and state licensed employment in the banking, finance, insurance, healthcare, legal, real estate, education and other industries. Customers, depending on their needs, may order solutions that include hardware, equipment, consumables, software products or services or combine hardware products, consumables, equipment, software products and services to create multiple element arrangements.

Parent Company Summary Financial Data

The Company has no operations other than those carried through its investment in L-1 Operating and the financing operations related to the issuance of the Convertible Notes. A summary balance sheet of the Company (Parent Company only) is set forth below (in thousands):

	March 31, 2011	December 31, 2010
Assets:		
Deferred financing costs	$ 1,182	$ 1,439
Investment in L-1 Operating	907,861	909,465
	$ 909,043	$ 910,904
Liabilities and equity:		
Accrued interest	$ 2,466	$ 825
Deferred tax liability	3,107	3,107
Convertible debt	168,110	166,641
	173,683	170,573
Equity	735,360	740,331
	$ 909,043	$ 910,904

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that in the opinion of management are necessary for a fair presentation of the financial statements for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC) for interim financial statements, and in accordance with SEC rules, omit or condense certain information and footnote disclosures. Results for the interim periods are not necessarily indicative of results to be expected for any other interim period or for the full year. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K filed on March 1, 2011. The condensed consolidated financial statements include the accounts of L-1 and its wholly-owned subsidiaries, after elimination of material inter-company transactions and balances.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant assumptions and estimates relate to the allocation of the purchase price of the acquired businesses, assessing the impairment of goodwill, other intangible assets and property and equipment, revenue recognition, estimating the useful life of long-lived assets, inventory valuation, provision for bad debts, income taxes, litigation and valuation of and accounting for financial instruments, including convertible notes, foreign currency contracts, warrants and stock options. Actual results could differ materially from those estimates.

Revenue Recognition

The Company derives its revenue from sales of solutions that include hardware, components, consumables and software components and related maintenance, technical support, training and installation services integral to sales of hardware and software. The Company also derives revenues from sales of fingerprinting enrollment services. A customer, depending on its needs, may order solutions that include hardware, equipment, consumables, software products or services or combine these products and services to create a multiple element arrangement. The Company s revenue recognition policies are described in the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K filed on March 1, 2011. There have been no material changes to such policies, except as described below.

Effective January 1, 2011, the Company adopted the following accounting standards:

Multiple Element Arrangements , which modifies accounting for multiple element arrangements by requiring that the separation of the arrangements be based on estimated selling prices based on entity specific assumptions rather than fair value, eliminating the residual method of allocation and requiring additional disclosures related to such arrangements. The standard was effective prospectively for arrangements entered into or materially modified on or after January 1, 2011.

Certain Revenue Arrangements That Include Software Elements , which amends software revenue recognition guidance to eliminate from its scope tangible products containing software components that function together to deliver the tangible product s essential functionality and to provide guidance on how to allocate arrangement consideration to deliverables arrangements that contain both tangible products and software. The standard was effective prospectively for revenue arrangements entered into or materially modified on or after January 1, 2011.

Revenue Recognition Milestone Method , which amends the milestone method of revenue recognition for research and development transactions. The standard is effective prospectively for milestones achieved beginning on or after January 1, 2011.

During the three months ended March 31, 2011, the Company did not enter into or materially modify arrangements that are within the scope of these standards. Substantially all the revenues recognized for the three months ended March 31, 2011 were accounted in accordance with the revenue recognition policies described in our Annual Report on Form 10-K for the year ended December 31, 2010.

It is likely that in the future we will enter into arrangements or