VIISAGE TECHNOLOGY INC
Form 10-K
March 30, 2004
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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, 2003

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 incorporation or organization)	(I.R.S. Employer 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. ¨

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 June 29, 2003, was approximately $70 million.

As of March 25, 2004, the registrant had 35,623,844 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 20, 2004 are incorporated by reference in Part III of this Annual Report on Form 10-K.

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PART I

Item 1. ***Business***

Overview

Viisage Technology, Inc. was formed as a division of Lau Technologies in 1992. In 1996, we were incorporated as a Delaware company, just prior to the completion of our initial public offering of common stock. Our principal executive offices are located at 30 Porter Road in Littleton, MA 01460, Tel. 978.952.2200. Effective April 5, 2004, our principal executive offices will be located at 296 Concord Road, Suite 302, Billerica, MA 01821 Tel. 978.932.2200. When we refer to we , our and Viisage in this Annual Report on Form 10-K, we mean the current Delaware corporation (Viisage Technology, Inc.) as well as all of our consolidated subsidiaries.

We deliver advanced technology identity solutions for governments, law enforcement agencies and businesses concerned with enhancing security, reducing identity theft, providing access control, and protecting personal privacy. We focus on identity solutions for civil identification, criminal identification and border management applications that improve personal convenience and security, deter fraud, and reduce identification program costs. By combining secure document and face recognition biometric technologies that quickly, reliably, and accurately identify individuals in both one-to-one and one-to-many situations, we create innovative identity solutions. Our goal is to help our customers solve three critical aspects of verifying and managing identities:

assurance that an identification document is authentic,

confidence that the person holding the identification document is uniquely tied to and authorized to use the document, and

verification of the privileges the document grants.

We combine our proprietary biometric and secure credential software and hardware products with complementary industry standard products to create identity solutions that integrate into our customers environments. These turnkey solutions integrate secure document technologies, image and data capture, relational databases, and multiple biometrics, improving our customers ability to process and manage identity information. Applications include passports, driver s licenses, voter registration, national identification credentials, law enforcement, social services, access control, surveillance and PC network and Internet access security. Our primary customers are government agencies, with particular penetration in U.S. government agencies such as the Department of State, and state departments of motor vehicles, social services, and law enforcement. We are the sole source provider of high security technology and services to the U.S. Department of State for the production of U.S. passports and have captured approximately 32% of the domestic driver s license market. Our solutions annually produce more than 30 million secure credentials at more than 2,000 locations, including at each of the 16 U.S. Department of State passport-issuing agencies. We also have provided services under subcontracts for projects in the United Arab Emirates, Jamaica, the Philippines and the U.S. Immigration and Naturalization Service.

Our business involves two related segments: secure credentials (formerly called secure identification or SIPS) and biometrics (formerly called facial recognition). See Note 12 of Notes to Consolidated Financial Statements below.

For the year ended December 31, 2003 approximately $36.6 million, or 97.8% of our direct revenue was derived within the United States. The remaining $818,000, or 2.2% of revenue was derived in Canada and the United Arab Emirates.

Industry Background

We recognize the pivotal role of identity in international security, national security, and personal privacy. The need for proper identification affects most businesses and people each day. The problem of identity theft continues to impact governments, individuals, businesses and economies at growing rates, and is expected to cost

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an aggregate of $2 trillion in financial losses to those groups by the end of 2005 (source: Aberdeen Group). Further, the desire for personal convenience and the concern over personal security have become driving forces behind the global need for identity solutions that address the multiple aspects in which we use identification. Identification is used nearly as often online as it is in the offline or physical world. Prior to the technology boom, would-be identity thieves needed only to obtain their victim s drivers license, which is widely considered standard identification, to gain access to multiple identities, commit fraud, and evade law enforcement. Today with increased activity online, digital identity theft has become an additional vehicle for criminal activity and a global concern, thereby making digital identity a point of both convenience and vulnerability.

The drivers license remains the standard identification document throughout North America. It has extended beyond its original use of solely providing evidence of the holder s driving privilege, when a photograph was optional in many states, to its common use as an identity document for financial and information transactions. The thrust has therefore moved from simply issuing a document that entitles the user to driving privileges to building a process in which agencies issuing drivers licenses implement measures to ensure:

- one identity per individual,
- one identity document tied to that individual, and
- one record that follows an individual throughout a lifetime.

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

As independent biometric solutions gain broader adoption and achieve similar successes to those of physical credentials, the demand increases for integration of multiple biometric technologies to further increase the security of important credentials such as drivers licenses, passports, national Ids and visas. For example, the U.S. Department of Homeland Security s U.S. VISIT program uses biometrics such as face recognition and fingerprints to confirm and track the identities of visitors entering the United States with a visa. This is a real life example of how multiple biometric technologies will co-exist to provide law enforcement and government personnel with additional tools to increase security at domestic borders. Face recognition technology is one of the biometrics of choice recommended for many of these multi-biometric solutions. Both the International Civil Aviation Organization (ICAO), which recommends the use of face recognition in passports worldwide, and the National Institute for Standards and Testing (NIST), which recommends using face recognition in the U.S. border crossing initiatives, are advocating deployments of face recognition technology based on the dramatic improvements in face recognition that have occurred in recent years.

Identity Solutions

Increasingly we are finding that our customers and prospects demand integrated secure credential and biometric solutions. As a result, we are spearheading the convergence of these two market segments. We refer to the market being created by this convergence as the identity solutions market. As our re-positioning supports a customer in approach where we focus on solving our customer problems, we believe that our message is resonating with customers, partners and investors alike. This strategy delineates the difference between solving customer problems and pushing technologies. By focusing on solving customer problems, our solutions are grounded in applications that demonstrate a measurable return on investment for our customers.

Our target markets include the federal government, local government and law enforcement. Our technologies may be applied to address the challenges for these markets in the areas of border control, civil identification and criminal identification. The federal government along with local governments and law enforcement agencies are among the early adopters of these advanced technology identity solutions. As identity solutions continue to demonstrate effectiveness, we anticipate increased adoption by public and private

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enterprises of these solutions for various identity applications. Further, through the February 2004 acquisition of Trans Digital Technologies Corporation, or TDT, we have gained an additional competitive advantage in border management applications, as the acquisition instantly established Viisage as the sole-source provider of high security technology and services to the U.S. Department of State for the production of U.S. passports. With this advantageous positioning in the federal market and border management applications, we believe that we are poised to play a significant role in the worldwide identity solutions market.

Just as we benefited during the transition from film-based credentials to digital credentials, today we are seizing the opportunity to lead the secure credentials and biometric industries into the next generation of identity solutions. We are combining multiple secure document, biometric and database technologies to create identity solutions that detect and prevent identity breaches by addressing the many forms in which identity may be accessed and used.

Secure Credential Solutions

Our secure credentials business develops and implements secure credentials systems and solutions. These solutions can produce identification credentials that are virtually tamper proof, and utilize face recognition and other biometrics for the real-time identification (one-to-many) and verification (one-to-one) of individuals.

Within the secure credentials market, our products and solutions integrate into our customer s varied credential provisioning processes, including:

- identity proofing using credential authentication of secondary forms of identification also known as breeder documents,
- scanning and storing identity-supporting credentials (birth certificates, passports, visas, etc.), and
- conducting biometrics verification using face recognition or fingerprints.

We then provide means and methods to create highly secure and durable credentials that not only have security features embedded in the various layers that construct the identity credential, but also tie the credential to the place of issuance, the person/agency that issued it, the material that was used to make the credential, etc. Using both the ability to create a secure credential and associate a single individual with that credential, we can provide on-line and real-time checking and verification capabilities to assure our customers that the identity documents produced by that individual are authentic and the individual is the authorized user of those documents.

Depending on the customer s needs, we offer two types of identification systems. The first is an instant issuance or over the counter system that enables our customers to produce identification credentials on location in minutes. The second is a central production system that receives the information electronically from the point of capture, and enables our customers to produce credentials from a secure off-site processing location. These credentials are later mailed to recipients. The face images captured by the credential systems can provide the content, or face bases, for identification and verification applications. One of the primary features of these databases of face images is the ability to conduct database mining based on an image alone. This capability represents two of our critical differentiators. The first is the ability to quickly and reliably manage and mine some of the largest face images databases in the world. The second is our ability to take advantage of numerous face image databases that exist today as part of legacy infrastructure, including those found in passport and drivers license issuing agencies.

In a Viisage credential 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 credential 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 system further helps the issuing agency assess image quality at the point of capture. With an instant issue system, a commercially available dye-sublimation printer

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produces single-piece, tamper-resistant identification credentials. Alternatively, with a central production system, a high speed-manufacturing unit produces the credentials, and an integrated credential delivery unit prepares the credentials for mailing. When central production is selected, such systems incorporate our proprietary *Visual Inspection System* for quality control of all credentials produced. Every system delivers top quality, tamper-resistant identification credentials customized to meet the customer s information, delivery and security needs. A wide range of optional features is available, including bar codes, holographic overlays, ghost imaging, ultraviolet or micro preprinting, smart credentials and a number of other features.

Biometrics Solutions

We have developed a platform upon which we are able to integrate multiple biometrics such as face recognition, fingerprint, and signature. The platform is designed to be independent of specific biometric technologies, thereby enabling customers to select the biometrics that best fit their multi biometric identity solution needs. By designing a platform that handles multi-biometric solutions and is vendor neutral, we are able to provide customers with advanced identity solutions with increased accuracy as a result of the multiple biometrics employed.

We are finding that face recognition is the biometric of choice for many customers and prospects for several reasons, including its:

- complementary match to many customer legacy databases, such as passports and licenses,
- uniqueness as a prominent feature that can be easily captured by a digital camera
- ability to be verified visually in most cases by an individual with little special training, and
- non-intrusive nature.

Our face recognition technology is fast and scaleable, most notably in large-scale image database mining. This technology is advantageous for many businesses that have large repositories of images. For these businesses, prior to the implementation of our face recognition technology, matching identities using their image databases was slow if not impossible. Using our solution capabilities, the images are easily face recognition enabled, and quickly and accurately matched, even in databases containing tens of thousands of images.

We are concentrating on implementing biometrics as integral proofing elements to support the civil identification, criminal identification and border management application requirements of today. Each identity solution category requires its own variation of proofing, or verifying, an identity. These range from local database applications such as facility access control or surveillance, to large distributed database applications involving fraud and identity theft or border management. We have several on-going face recognition identification projects, including projects with the Pinellas County, Florida Sheriff s Office, the Illinois Secretary of State, the Illinois State Police, the U.S. Department of Defense, Deutsche Bank in Germany, Berlin Airport in Germany, Dubai International Airport, Hanover Zoo in Germany, more than 100 surveillance applications in casinos and a number of other installations.

Our patented face recognition software offers customers the ability to create unique identification solutions, enhances existing identification solutions and provides opportunities for new applications. We offer several face recognition products that can be utilized in a wide variety of solutions requiring identification or verification of an individual.

Proprietary Products

Our proprietary products and related software are described below:

The *Image Capture Work Station* is a multifunctional software solution that offers modules for capturing images, laying templates, checking image quality, previewing printing, managing devices such as cameras, connecting to mainframes, and handling point of sale.

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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 credentials produced by our central production systems to determine whether the image and data on a person s identification credential correspond to the information about that person in the system database. If the information does not match, the *Visual Inspection System* rejects the printed credential 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.

As a result of our February 2004 acquisition of TDT, Viisage now works in conjunction with Toppan Printing Co., Ltd. to bring MP300 cutting edge printing technology to our customers and markets. Toppan provides thermal transfer pigment ink to enhance both printing quality and counterfeiting protection. The MP300 can be networked to multiple printers through a computerized workstation. Printer networking allows efficient use of equipment and personnel when adapting to variations in document production.

The FaceTOOLS® Software Developer s Kit (SDK) is designed for application developers who want to incorporate state-of-the-art face recognition technology into their applications. Using FaceTOOLS, developers can create virtually any kind of face recognition application. The updated version (V3.0), released in Q1 of 2004, is based on flexible template matching, a new and powerful technological foundation, incorporating a unique combination of multiple approaches to face recognition.

FaceEXPLORER® is a large image database research and mining 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 FaceEXPLORER to match images and computer composites against image databases to identify suspects and known criminals. Enterprise customers can use FaceEXPLORER to verify identities, improve customer service and reduce fraud by effectively retrieving, managing and analyzing their image databases. We have deployed FaceEXPLORER in one of the world s largest face 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.

FacePASS® is a ready-to-use verification solution designed to meet the most demanding access control system requirements. By verifying the claimed identity of a user, FacePASS® enables the customer to allow the right people in and keep the wrong people out. A variety of access control configurations are available to handle a customer s specific physical environment.

FaceFINDER® 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.

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 implementation of standard products and the design of customized solutions. Our secure credentials 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 credentials segment has designed software to support all current industry standard operating systems (e.g., Windows NT, Windows 2000, Windows XP, and Unix), network protocols (e.g., Novell Netware, TCP/IP and SNA), database products (e.g., Sybase, SQL Server or Oracle) and client/server or webserver architectures. Our software design and systems integration capabilities enable us to accommodate most computing environments and customers with special requirements.

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Customer Service and Support

We provide extensive customer training and help desk telephone support as well as ongoing maintenance services to our customers. In delivering these services, our service and support teams leverage the expertise of our software and hardware engineers or external technology consultants to ensure post installation customer satisfaction. Our turnkey solutions include program management, installation, training, complete service and support. In addition to our help desk, we maintain in state field service technicians for the duration of our contracts. We also maintain a spare parts inventory, and provide storage management, distribution and repair of the products we supply.

Sales and Marketing

We market our products and identity solutions through both a direct sales force and strategic partnerships and alliances. Our direct sales force is responsible for marketing and selling the entire identity solutions portfolio of offerings. We have an international sales force responsible for the North American Market, Europe, the Middle East and Asia Pacific. We have established a dedicated U.S. federal sales team in Washington, D.C. responsible for marketing and selling to U.S. government agencies such as the Department of Homeland Security, the Department of State (providers of the U.S. Passport), the Department of Defense, and others. We continue to develop strategic partnerships and distribution channels to broaden our coverage and increase the size of our market around the world. We have established original equipment manufacture, or OEM, distribution agreements with partners to leverage our face recognition technology. We work with systems integrators, solution providers, and service organizations to deliver identity solutions in combination with their core capabilities to expand our access to such organizations existing relationships, marketing resources and credibility in new markets. We utilize in-country agents to expand our international access to opportunities. Our sales and partner strategy is designed to enable us to deliver identity solutions to customers throughout the world that are focused on solving identity problems through civil identification, criminal identification and border management applications.

With the recent acquisition of ZN Vision Technologies AG, or ZN, we have increased our direct sales and marketing coverage in the European marketplace. Dedicated sales and services teams operate from our Bochum, Germany location. The acquisition of TDT has strengthened our coverage and access to the U.S. federal marketplace.

We have a direct services organization that supports our 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 have a program management group that is dedicated to identifying additional opportunities with existing customers and coordinating related selling efforts.

Product Development

We have developed proprietary software products that support all current industry standard operating systems and networking environments, and proprietary image capture and inspection products for identity solutions. We believe these products will support our identity solutions for the foreseeable future. Our current development activities are focused on expanding our capability in supporting solution sets for the civil identification, criminal identification and border management applications. Specific to our biometrics capabilities, we are adding a second face recognition engine to our face recognition technology. We believe that the combination of two face recognition engines with biometric matching flexibility when handling multiple biometric templates will provide a unique offering within the biometric industry. 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, 2003, 2002 and 2001, research and development expense was $3.7 million, $4.5 million and $2.0 million, respectively. These amounts are not inclusive of specific projects that are reported in cost of revenues.

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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. Most of our purchasing is done from more than one source. However, to enable better prices and quality control, these purchases are managed on a contract-by-contract basis, which assures consistency in long-term contracts. We purchase some sub-assemblies from single vendors to help ensure high quality, prompt delivery and low cost. We qualify additional 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. Although we may experience delays due to a lack of the availability of component parts and assemblies on contracts we mitigate these delays by maintaining a spares pool and/or substituting obsolete parts.

Patents, Trademarks and Licenses

Patents

Both our secure credentials segment and our biometrics segment use patented technology and trade secrets developed or acquired by Viisage. We have significantly expanded our portfolio of face recognition patents and trade secrets through the acquisition of ZN. In addition, we have a number of U.S. and foreign patent applications in process for face recognition technologies, including 12 foreign patent applications previously filed by ZN.

Trademarks

We have registered our Viisage Technology trademark, as well as trademarks for FaceEXPLORER , FaceFINDER , FacePASS , FaceTOOLS Sensormast with the U.S. Patent and Trademark Office. Applications are pending in the United States and Europe for the Viisage trademark and in Europe for FaceEXPLORER , FaceFINDER and FacePASS .

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.

We cannot assure you that our efforts to prevent the misappropriation of the intellectual property used in our business will be successful. Further, we cannot assure you that any patents will be issued for our U.S. or foreign applications or that, if issued, they will provide protection against competitive technologies or will be held valid and enforceable if challenged. Finally, we cannot 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 credentials and our biometrics segments. Our U.S. patents typically have a duration of 17 to 20 years.

Seasonality

Performance on our contracts is generally ratable throughout the contract terms and, therefore, our business is not seasonal. We do experience fluctuations on secure credentials contracts due to changes in the volume of state drivers license issuances. Our business is also somewhat dependent on federal, state and local funding of projects as well as state regulatory requirements resulting in the modification of individual states credentials, issuance of new state drivers license contracts or contract extensions.

Working Capital Requirements

Our secure credentials contracts require significant capital to fund development and implementation. In 2003, we utilized bank borrowings and other lease financing vehicles to supplement our working capital to fund

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these capital requirements. In addition, in 2003, we raised approximately $12.2 million in net proceeds through the private sale of shares of our common stock to certain institutional investors. These funds also were used for working capital. There are no special requirements or customer terms in our bank borrowings or other lease financing vehicles 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 additional 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 credentials solutions:

State Departments of Motor Vehicles, Other State and Local Agencies

Alaska Department of Motor Vehicles

Arkansas Department of Human Services

Arkansas Office of Driver 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 York Department of Social Services*

North Carolina Department of Transportation

Ohio Bureau of Motor Vehicles

Ohio Department of Public Safety

Oklahoma Department of Public Safety

Pennsylvania Department of Transportation

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 Transportation

Federal Agencies Foreign Contracts

U.S. Immigration and Naturalization Services *

Commission on Elections of the Republic of the Philippines *

Electoral Commission of Jamaica *

Electoral Commission of Uganda

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The following lists and categorizes our customers and end users for our biometrics solutions:

State Departments of Motor Vehicles, Other State and Local Agencies

City of New Bedford Massachusetts Department of Police

Connecticut Department of Motor Vehicles

Illinois Secretary of State Office

Illinois State Police

Kentucky State Police of the Commonwealth of Kentucky

Mississippi Department of Information Technology Services

Middlesex County Sheriff s Office

Oklahoma Department of Public Safety

Pinellas County Sheriff s Office

State of Delaware Department of Public Safety

State of Rhode Island Division of Motor Vehicles

University of Maryland Office of Research Administration

Federal Agencies

U.S. Department of State

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

Foreign Contracts

Canadian Bank Note Company

United Arab Emirates Ministry of Interior*

Airports

St. Petersburg Clearwater International Airport

Dubai International Airport

Berlin International Airports

Commercial Customers and Distribution Partners

Canadian Bank Note

Novar

European, Russian and Lithuanian Banks

Over 100 Casinos worldwide

* By subcontract

For the year ended December 31, 2003, two customers, Pensylvania Department of Transportation and Illinois Secretary of State, each accounted for over 10% of our revenue and an aggregate of 26% of our revenue.

In addition, most new contracts for secure credential solutions now include a biometric technology component.

Backlog

Our backlog consists of signed contracts, subcontracts and customer commitments for which revenue has not yet been recognized and excludes phase-out or other extension opportunities included in such contracts.

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Backlog is only somewhat indicative of future revenue because contracts may be changed positively or negatively. Contracts included in our backlog could be cancelled at any time due to lack of performance without penalty. Contracts terminated by our customers for convenience would generally result in our recovery of all actual committed costs and profit, if any, on work performed through the date of cancellation.

At December 31, 2003, our backlog was $112 million, compared to $78 million at December 31, 2002. Of the $112 million in backlog as of December 31, 2003, we expect to recognize revenue of approximately $35 million in 2004. Approximately $32 million of this increase in backlog was related to our adoption of EITF 00-21 on a cumulative basis as of January 1, 2003. EITF 00-21 limits the amount of revenue that we may allocate to the customization, design and installation of systems to the amount that is not contingent upon the production of secure credentials. Revenue on our secure documentation contracts under EITF 00-21 is earned based on, and is contingent upon, the production of credentials from the system. Due to the contingent performance of credential production in these contracts, we defer revenue recognition for the system design and installation phase of our contracts, including customized software and equipment, until credentials are produced. As a result, revenue and margins that were recognized as earned and unbilled under our previous revenue recognition policy for secure documentation contracts were deferred under EITF 00-21 and therefore are included in our backlog at December 31, 2003.

Government Contracts

A majority of our contracts are with U.S. federal or state governmental agencies. 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.

In July 2003, following the institution of a law suit by one of our competitors, a Georgia court issued a preliminary injunction which effectively prevents us from completing installation work on a drivers license system for the Georgia Department of Motor Vehicle Safety. The merits of the lawsuit are the subject of ongoing court proceedings. However, if the lawsuit is successful and we lose the contract, we could lose up to $19.7 million in revenue that we expected to recognize over the next five and one-half years. In addition, although we expect that the Department of Motor Vehicle Safety would be required to reimburse us for our costs incurred under the contract, if we are unable to obtain reimbursement of those costs, we could be required to recognize a loss of up to approximately $5 million for costs incurred to date on the Georgia contract.

Competition

The market for our products and services in our individual component areas is extremely competitive and management expects this competitive environment to intensify as the market for our products continues to grow. However, we believe that our unique solutions, which address a broad spectrum of identity needs, will differentiate us from our competition. We are not aware of any company that competes with us directly on the basis of combining secure credentials and biometrics to create identity solutions that address customer needs in civil identification, criminal identification and border management applications.

Secure Credentials Segment

We face competition in the secure credentials systems market from companies, including Digimarc ID Systems, LLC, which, in some cases, have 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.

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We believe that competition in the secure credentials 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.

Biometrics Segment

In the field of face recognition technology, we compete with several face recognition providers, none of which 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, 2003, we had 119 full time and 7 supplemental employees. Supplemental employees are generally technology contractors utilized in the delivery of secure credentials systems on an as needed basis. None of our employees are covered by collective bargaining

agreements. We believe that our relations with our employees are good.

Officers

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

Bernard C. Bailey, 50, 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. 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, 52, was appointed Senior Vice President and General Manager of our Secure Credentials business segment in October of 2002. Between March 1999 and October 2002 he served as Viisage s Vice President of Engineering and Program Management. From November 1996 until March 1999, Mr. Ahmad served as a Director in our 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.

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William K. Aulet, 46, 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.

James P. Ebzery, 44, 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.

John J. Dillon, 67, joined Viisage in February 2003 as Senior Vice President of Government Solutions. From January 1997 to February 2003, he served as Vice President of Central and Eastern Europe for Lockheed Martin, focusing on command and control and security systems. Prior to 1997, Mr. Dillon held a number of senior positions with Lockheed Martin, including Vice President of Business Development, Vice President of Software and Technical Services and Vice President of Command and Control and Security Systems. Mr. Dillon also previously served as a Vice President with Unisys Defense Systems, which became part of Loral Corporation, later purchased by Lockheed Martin.

There are no family relationships among any of our executive officers and directors.

Code of Ethics

We have adopted a *Code of Business Ethics and Standards of Conduct* that applies to our directors, executive officers (including our principal executive, financial and accounting officers) and to all of our other employees. A copy of the *Code of Business Ethics and Standards of Conduct* will be provided to any person, without charge, upon receipt of a written request addressed to our Chief Financial Officer at our principal executive offices or an e-mail request addressed to investor@viisage.com.

Financial Information about Foreign and Domestic Operations and Export Sales

For the years ended December 31, 2003 and 2001 export sales were approximately $800,000 and $1.2 million, respectively. We did not have any revenue related to export sales for the year ended December 31, 2002. We do not consider export sales to be material for the years ended December 31, 2003, 2002 and 2001. Foreign operations and export sales may be significant in the future due to our acquisition of ZN in 2004.

Company s Internet Website

We maintain a corporate 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 Form 10-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. This space is leased to us by DEK Portfolio Limited Partnership through October 31, 2004, although we can terminate our lease as to approximately 11,300 square feet of such space on 15 days notice. Effective, April 5, 2004, we are vacating this space and moving our corporate headquarters to a Class A office building in Billerica, Massachusetts. In Billerica, we will use approximately 32,000 square feet of space pursuant to a sublease from eiStream, Inc. The term of the new sublease will run through December 31, 2008. We will not be required to pay

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rent at the new facility until December 5, 2004. We expect to use this property for corporate, administrative, research and development, customer support and other general business needs. While we believe that this new facility will be adequate to meet our immediate needs, it may become necessary to secure additional space in the future to accommodate any future growth. We believe that such additional space will be available as needed in the future on commercially reasonable terms. With the exception of our principal executive office lease, we have no material operating leases.

Item 3. ***Legal Proceedings***

On July 31, 2003 the superior court for Fulton County, Georgia issued a preliminary injunction prohibiting Georgia s Department of Motor Vehicle Safety from continuing to work with us to install a new drivers license system for the State of Georgia. This injunction is the result of a lawsuit filed in March 2003 by one of our competitors, Digimarc ID Systems, LLC. The suit claims that the Department of Motor Vehicle Safety did not comply with its own bid process when selecting a vendor for the digital drivers license program. The merits of Digimarc s claims against the Department of Motor Vehicle Safety are to be addressed in further court proceedings. The Department of Motor Vehicle Safety has confirmed that our contract with them remains in place. However, if the lawsuit is successful and we lose the contract, we could lose up to $19.7 million in revenue that we expected to recognize over the next five and one-half years. In addition, although we expect that the Department of Motor Vehicle Safety would be required to reimburse us for our costs incurred under the contract, if we are unable to obtain reimbursement of those costs, we could be required to recognize a loss of up to approximately $5 million for costs incurred to date on the Georgia contract.

We are not aware of any other legal matters that could 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 2003.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Market for Our Common Stock

Our common stock is traded on the Nasdaq National Market under the symbol VISG. On March 25, 2004, the closing price of our common stock was $7.00 per share and there were approximately 250 holders of record of our common stock. The quarterly high and low sales prices, as reported by Nasdaq, of our common stock in 2003 and 2002 were as follows:

	2003		2002	
Quarter	**High**	**Low**	**High**	**Low**
First Quarter	$ 5.40	$ 3.01	$ 10.14	$ 5.02
Second Quarter	$ 5.78	$ 3.76	$ 7.64	$ 3.63
Third Quarter	$ 5.40	$ 3.85	$ 5.10	$ 2.50
Fourth Quarter	$ 4.61	$ 3.34	$ 5.84	$ 3.27

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.

Recent Sales of Unregistered Securities

Information concerning an unregistered sale of our common stock during 2003 was included in Part I, Item 2 of our Quarterly Report on Form 10-Q for the three months ended September 28, 2003 under the caption Other Events .

Repurchases of Common Stock

We did not repurchase any shares of our common stock during the fourth quarter of 2003.

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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 report. The historical results of operations are not necessarily indicative of future results.

Years Ended December 31,