

IDENTIVE GROUP, INC.
Form 10-Q
November 10, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

September 30, 2011 For the quarterly period ended September 30, 2011

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: 0-29440

IDENTIVE GROUP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)
1900 Carnegie Avenue, Building B
Santa Ana, California 92705
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES INCLUDING ZIP CODE)
(949) 250-8888
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)
(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

77-0444317
(I.R.S. EMPLOYER
IDENTIFICATION NUMBER)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller Reporting Company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At November 7, 2011, 57,613,590 shares of common stock were outstanding, excluding 618,400 shares held in treasury.

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Table of Contents**PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****IDENTIVE GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS***(In thousands, except per share data)**(unaudited)*

| | Three Months Ended September 30, | | Nine Months Ended September 30 | |
|---|-------------------------------------|----------------------|-----------------------------------|----------------------|
| | 2011 | Restated 2010 (A) | 2011 | Restated 2010 (A) |
| Net revenue | \$ 26,752 | \$ 20,511 | \$ 74,784 | \$ 57,035 |
| Cost of revenue | 14,922 | 11,563 | 43,360 | 31,506 |
| Gross profit | 11,830 | 8,948 | 31,424 | 25,529 |
| Operating expenses: | | | | |
| Research and development | 2,286 | 1,035 | 4,823 | 3,513 |
| Selling and marketing | 6,198 | 4,823 | 17,432 | 14,877 |
| General and administrative | 6,372 | 5,341 | 17,212 | 16,201 |
| Restructuring and other charges | | | | 337 |
| Total operating expenses | 14,856 | 11,199 | 39,467 | 34,928 |
| Loss from operations | (3,026) | (2,251) | (8,043) | (9,399) |
| Other income | 25 | | 255 | |
| Interest expense, net | (242) | (208) | (805) | (654) |
| Foreign currency gains (losses), net | (622) | 388 | (398) | (174) |
| Loss from continuing operations before income taxes and noncontrolling interest | (3,865) | (2,071) | (8,991) | (10,227) |
| (Provision) benefit for income taxes | (54) | (39) | 1,550 | 866 |
| Loss from continuing operations | (3,919) | (2,110) | (7,441) | (9,361) |
| (Loss) income from discontinued operations, net of income taxes | | (24) | | 69 |
| Consolidated net loss | (3,919) | (2,134) | (7,441) | (9,292) |
| Less: Net loss attributable to noncontrolling interest | 233 | 109 | 336 | 526 |
| Net loss attributable to Identive Group, Inc. | \$ (3,686) | \$ (2,025) | \$ (7,105) | \$ (8,766) |
| Basic and diluted net loss per share attributable to Identive Group, Inc.: | | | | |
| Loss from continuing operations | \$ (0.06) | \$ (0.05) | \$ (0.14) | \$ (0.21) |
| Income from discontinued operations | \$ | \$ | \$ | \$ |
| Net loss | \$ (0.06) | \$ (0.05) | \$ (0.14) | \$ (0.21) |

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| | | | | |
|--|--------|--------|--------|--------|
| Weighted average shares used to compute basic and diluted loss per share | 57,579 | 43,279 | 52,478 | 41,901 |
|--|--------|--------|--------|--------|

- (A) As stated in Note 20 to the Consolidated Financial Statements in its 2010 Annual Report on Form 10-K, the Company had determined that an error occurred in the recognition of revenue related to the sale of readers for the German national ID program as reported in the third quarter of 2010. Upon review of Accounting Standards Codification 605, *Revenue Recognition*, the Company had concluded that not all criteria for recognizing the sale were in fact met until the fourth quarter of 2010. As a result, revenue and cost of revenue of approximately \$2.8 million and \$1.6 million, respectively reported in the Company's Form 10-Q for the three and nine months ended September 30, 2010 were overstated, resulting in an impact of \$1.2 million on gross profit, operating loss and net loss in such periods. The loss per share was understated by \$(0.03). The amounts presented for the three and nine months ended September 30, 2010 in the table above have been restated to correct the impact of such error.

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value data)

(unaudited)

| | September 30, 2011 | December 31, 2010 (A) |
|--|-----------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,720 | \$ 10,799 |
| Accounts receivable, net of allowances of \$445 and \$484 as of September 30, 2011 and December 31, 2010, respectively | 14,765 | 15,231 |
| Inventories, net | 10,067 | 10,584 |
| Income taxes receivable | 166 | 126 |
| Other current assets | 3,160 | 2,088 |
| Total current assets | 45,878 | 38,828 |
| Property and equipment, net | 5,406 | 5,373 |
| Goodwill | 58,996 | 47,126 |
| Intangible assets, net | 37,477 | 33,865 |
| Other assets | 476 | 793 |
| Total assets | \$ 148,233 | \$ 125,985 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 10,425 | \$ 12,833 |
| Mortgage loan payable to bank and bank line of credit | 57 | 630 |
| Debt note | 829 | 1,040 |
| Liability to related party | 1,066 | 1,058 |
| Accrued compensation and related benefits | 4,104 | 3,694 |
| Deferred revenue | 2,907 | 1,244 |
| Other accrued expenses and liabilities | 6,913 | 8,980 |
| Income taxes payable | 181 | 44 |
| Total current liabilities | 26,482 | 29,523 |
| Long-term earn-out liability | 5,397 | |
| Long-term liability to related party | 7,390 | 7,615 |
| Long-term mortgage loan payable to bank | 811 | 840 |
| Deferred tax liability | 6,234 | 6,795 |
| Long-term debt note | 632 | 950 |
| Long-term income taxes payable | 690 | 458 |
| Total liabilities | 47,636 | 46,181 |
| Commitments and contingencies (see Notes 11 and 12) | | |
| Equity: | | |
| Identive Group, Inc. stockholders' equity: | | |
| Common stock, \$0.001 par value: 130,000 shares authorized; 58,232 and 48,276 shares issued and outstanding as of September 30, 2011 and December 31, 2010, respectively | 58 | 48 |

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| | | |
|---|------------|------------|
| Additional paid-in capital | 331,255 | 306,203 |
| Treasury stock, 618 shares as of September 30, 2011 and December 31, 2010 | (2,777) | (2,777) |
| Accumulated deficit | (233,001) | (225,896) |
| Other accumulated comprehensive income | 3,076 | 323 |
| Total Identive Group, Inc. stockholders' equity | 98,611 | 77,901 |
| Noncontrolling interest | 1,986 | 1,903 |
| Total equity | 100,597 | 79,804 |
| Total liabilities and stockholders' equity | \$ 148,233 | \$ 125,985 |

(A) The condensed consolidated balance sheet has been derived from the audited consolidated financial statements at December 31, 2010 but does not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

See notes to condensed consolidated financial statements.

Table of Contents**IDENTIVE GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE LOSS****Year Ended December 31, 2010 and Nine Months Ended September 30, 2011****(unaudited)**

| <i>(In thousands)</i> | Identive Group, Inc. Stockholders | | | | | Other | | Total Equity | Comprehensive Loss |
|---|-----------------------------------|------------------------|----------------------------------|-------------------|------------------------|--|----------------------------|-----------------|-----------------------|
| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Treasury Stock | Accumulated Deficit | Accumulated Comprehensive Income | Noncontrolling Interest | | |
| Balances, December 31, 2009 | 25,753 | \$ 26 | \$ 253,910 | \$ (2,777) | \$ (216,378) | \$ 3,159 | \$ | \$ 37,940 | |
| Issuance of common stock in connection with acquisitions | 17,900 | 18 | 38,758 | | | | | 38,776 | |
| Fair value of stock options converted in connection with Bluehill ID acquisition | | | 3,007 | | | | | 3,007 | |
| Assumption of treasury stock in connection with Bluehill ID Acquisition | | | | (2,880) | | | | (2,880) | |
| Repurchase of treasury stock in connection with Bluehill ID acquisition | | | (402) | 2,880 | | | | 2,478 | |
| Issuance of common shares to acquire additional noncontrolling interest in a subsidiary | 88 | | 199 | | | | (199) | | |
| Issuance of common stock upon exercise of options | 7 | | 11 | | | | | 11 | |
| Issuance of common stock in connection with stock bonus and incentive plans | 99 | | 174 | | | | | 174 | |
| Issuance of common stock to affiliates for conversion of loan | 181 | | 291 | | | | | 291 | |
| Issuance of common stock in connection with private placement, net of issuance costs | 4,098 | 4 | 9,582 | | | | | 9,586 | |
| Issuance of common stock for settlement of pre-acquisition liabilities | 150 | | 343 | | | | | 343 | |
| Noncontrolling interest in connection with Bluehill ID acquisition | | | | | | | 3,057 | 3,057 | |
| Stock options compensation expense | | | 330 | | | | | 330 | |
| Comprehensive loss: | | | | | | | | | |
| Net loss | | | | | (9,518) | | (630) | (10,148) | \$ (10,148) |
| Foreign currency translation adjustment, net tax of nil | | | | | | (2,836) | (325) | (3,161) | (3,161) |
| Comprehensive loss | | | | | | | | | \$ (13,309) |
| Balances, December 31, 2010 | 48,276 | \$ 48 | \$ 306,203 | \$ (2,777) | \$ (225,896) | \$ 323 | \$ 1,903 | \$ 79,804 | |
| Issuance of common stock in connection with capital raise, net of issuance costs | 7,843 | 8 | 18,204 | | | | | 18,212 | |

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| | | | | | |
|---|--------|-------|------------|------------|--------------|
| Issuance of common stock in connection with idOnDemand acquisition | 996 | 1 | 3,023 | | 3,024 |
| Issuance of common stock in connection with earn-out agreements | 137 | | 316 | | 316 |
| Issuance of common shares to acquire additional noncontrolling interest in a subsidiary | 3 | | 8 | (8) | |
| Issuance of common stock in connection with stock bonus and incentive plans | 550 | 1 | 1,433 | | 1,434 |
| Issuance of common stock upon exercise of warrants | 406 | | 1,075 | | 1,075 |
| Issuance of common stock upon exercise of options | 21 | | 57 | | 57 |
| Stock options compensation expense | | | 242 | | 242 |
| ESPP compensation expense | | | 84 | | 84 |
| Stock options grants in connection with stock bonus and incentive plans | | | 610 | | 610 |
| Noncontrolling interest in connection with idOnDemand acquisition | | | | 468 | 468 |
| Comprehensive loss: | | | | | |
| Net loss | | | | (7,105) | (7,441) |
| Foreign currency translation adjustment | | | | 2,753 | 2,712 |
| Comprehensive loss | | | | | (4,729) |
| Balances, September 30, 2011 | 58,232 | \$ 58 | \$ 331,255 | \$ (2,777) | \$ (233,001) |
| | | | | \$ 3,076 | \$ 1,986 |
| | | | | | \$ 100,597 |

See notes to condensed consolidated financial statements.

Table of Contents**IDENTIVE GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)**(unaudited)*

| | Nine Months Ended September 30, | |
|--|--|------------------------------|
| | 2011 | Restated 2010 (A) |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,441) | \$ (9,292) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Income from discontinued operations | | (69) |
| Deferred income taxes | (2,666) | (223) |
| Depreciation and amortization | 4,013 | 3,475 |
| Accretion of interest to related party liability | 563 | 581 |
| Interest on debt note, bank line of credit and mortgage loan | 176 | 56 |
| Remeasurement of contingent consideration | 254 | |
| Stock-based compensation expense | 831 | 1,018 |
| Gain on disposal of fixed assets | 55 | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,224 | (3,053) |
| Inventories | 1,337 | (919) |
| Other assets | (303) | (2,463) |
| Income taxes receivable | (40) | (272) |
| Accounts payable | (2,950) | 2,822 |
| Liability to related party | (780) | (829) |
| Accrued expenses | (685) | 1,946 |
| Deferred revenue | 514 | 2,785 |
| Income taxes payable | 369 | (316) |
| | | |
| Net cash used in operating activities from continuing operations | (5,529) | (4,753) |
| Net cash used in operating activities from discontinued operations | | (778) |
| | | |
| Net cash used in operating activities | (5,529) | (5,531) |
| Cash flows from investing activities: | | |
| Capital expenditures | (897) | (638) |
| Net cash (paid) acquired (for) from acquisitions | (5,154) | 4,881 |
| Maturities of short-term investments | | 1,015 |
| | | |
| Net cash (used in) provided by investing activities | (6,051) | 5,258 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock, net of issuance costs | 18,211 | 1,936 |
| Payments on debt note and mortgage loan | (857) | (40) |
| Payments on bank line of credit, net | (605) | (52) |
| Proceeds from issuance of common stock upon options exercised | 56 | |
| Proceeds from issuance of common stock upon warrants exercised | 1,076 | |
| | | |
| Net cash provided by financing activities | 17,881 | 1,844 |

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| | | |
|---|-----------|-----------|
| Effect of exchange rates on cash and cash equivalents | 620 | (236) |
| Net increase in cash and cash equivalents | 6,921 | 1,335 |
| Cash and cash equivalents at beginning of period | 10,799 | 4,836 |
| Cash and cash equivalents at end of period | \$ 17,720 | \$ 6,171 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Common stock issued in connection with business combinations | \$ 3,024 | \$ 38,776 |
| Conversion of stock options in connection with business combinations | \$ | \$ 3,007 |
| Common stock issued in connection with contingent consideration | \$ 316 | \$ |
| Common stock issued in connection with stock bonus and incentive plans | \$ 1,434 | \$ 135 |
| Stock option grants in connection with stock bonus and incentive plans | \$ 610 | \$ |
| Common stock issued to affiliates for conversion of loan | \$ | \$ 291 |
| Fair value of contingent consideration in connection with business combinations | \$ 5,060 | \$ 298 |
| Cash paid for interest expense | \$ 739 | \$ 637 |

- (A) As stated earlier, the Company had determined an error in the recognition of revenue related to the sale of readers for the German national ID program as reported in the third quarter of 2010 as not all criteria for recognizing the sale were in fact met until the fourth quarter of 2010. As a result, revenue, cost of revenue, gross profit, operating loss and net loss reported in the Company's Form 10-Q for the quarter ended September 30, 2010 was overstated, however there was no impact to the total net cash used in operating activities. The amounts presented in the table above have been restated to correct the impact of such error.

See notes to condensed consolidated financial statements.

Table of Contents**IDENTIVE GROUP, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2011****1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of Identive Group, Inc. (Identive or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of Company s unaudited condensed consolidated financial statements have been included. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or any future period. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The preparation of unaudited condensed consolidated financial statements necessarily requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

On April 14, 2010, the Company acquired RockWest Technology Group (RockWest), a privately held provider of identification and security solutions based in Denver, Colorado. Following the acquisition, RockWest s name was changed to Multicard U.S. The results for the acquired RockWest business are included in the Company s consolidated statements of operations since April 14, 2010. On November 19, 2010, the Company acquired FCI Smartag Pte., Ltd. (Smartag), a Singapore-based manufacturer of high frequency and ultra high frequency radio frequency identification inlays and inlay-based solutions including labels and tags used for asset tracking, cards and stickers used for e-payment and ticketing transactions, and near field communication labels used to enable secure payments with mobile devices. The results for the acquired Smartag business are included in the Company s consolidated statements of operations since November 19, 2010. On May 2, 2011, the Company acquired idOnDemand, Inc. (idOnDemand), a privately-held provider of identity management services based in Pleasanton, California. The results for the acquired idOnDemand business are included in the Company s consolidated statements of operations since May 2, 2011. On July 18, 2011, Multicard AG, a subsidiary of the Company, acquired all of the outstanding shares of polyright SA (polyright), a provider of integrated ID solutions for the Swiss education and healthcare markets. The results for the acquired polyright business are included in the Company s consolidated statements of operations since July 18, 2011. As a result of the timing of these acquisitions, the Company s operating results for the periods presented are not directly comparable.

2. Summary of Significant Accounting Policies*Recently Adopted Accounting Pronouncements*

In December 2010, the FASB issued ASU No. 2010-29, *ASC Topic 805, Business Combinations: Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), which provides further comparative disclosure guidance and expands the pro forma disclosure requirements under ASC Topic 805, *Business Combinations* (ASC 805). This guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. ASU 2010-29 relates to disclosure requirements only and as such does not impact the Company's consolidated results of operations or financial condition. The Company adopted the provisions of ASU 2010-29 effective January 1, 2011.

In December 2010, the FASB issued ASU No. 2010-28, *ASC Topic 350, Intangibles-Goodwill and Other: When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (ASU 2010-28), which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Company adopted the provisions of ASU 2010-28 effective January 1, 2011. The Company currently does not have any reporting units with zero or negative carrying amounts.

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In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements* (ASU 2009-13). ASU 2009-13 changes the requirements for establishing separate units of accounting in a multiple element arrangement and eliminates the residual method of allocation and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price allocation method. The relative selling price method allocates any discount in the arrangement proportionately to each deliverable on the basis of the deliverable's estimated fair value. Concurrently with issuing ASU 2009-13, the FASB issued ASU No. 2009-14, *Software (Topic 985) Certain Arrangements That Contain Software Elements* (ASU 2009-14), which amends the scope of software revenue guidance in Accounting Standards Codification (ASC) Subtopic 985-605, *Software-Revenue Recognition* (ASC 985-605), to exclude tangible products containing software and non-software components that function together to deliver the product's essential functionality. ASU 2009-14 provides that tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software revenue guidance in ASC 985-605 and should follow the guidance in ASU 2009-13 for multiple-element arrangements. All non-essential and standalone software components will continue to be accounted for under the guidance of ASC 985-605.

ASU 2009-13 and ASU 2009-14 are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company prospectively adopted the provisions of ASU 2009-13 and ASU 2009-14 effective January 1, 2011. The Company has assessed the effects of ASU 2009-13 and ASU 2009-14 and has concluded that the adoption of these standards had no material impact on the condensed consolidated results of operations and financial position for the three and nine months ended September 30, 2011. This was because the Company's determination of separate units of accounting in a multiple element arrangement under the previous standard (ASC 605-25, *Multiple Elements Arrangements*) is not impacted by ASU 2009-13. In addition, as stated below, the Company's revenue is derived primarily from sales of hardware products, and to a lesser extent, from the license of software products and software components in revenue arrangements that are considered non-essential and standalone. As a result, ASU 2009-14 did not have any impact during the three and nine month periods ended September 30, 2011 and revenues from such software products will continue to be recognized under the guidance of ASC 985-605. ASU 2009-13 generally does not change the units of accounting for the Company's revenue arrangements. The Company cannot reasonably estimate the effect of adopting these standards on future financial periods as the impact will vary depending on the nature and volume of new or materially modified deals in any given period.

Recent Accounting Policy Changes

Revenue Recognition

The Company derives revenue from sales of products and services, primarily from sales of hardware products, and to a lesser extent, from the license of proprietary software products and sales of service contracts. The revenue is generated from sales to direct end-users and to distributors. Revenue arrangements may include one of these single elements, or may incorporate one or more elements in a single transaction or combination of related transactions. ASU 2009-13 affects accounting and reporting for all multiple-deliverable arrangements. The Company recognizes revenue from the sale of hardware products to direct end-users and distributors pursuant to ASC Topic 605, *Revenue Recognition* (ASC 605). Accordingly, revenue from product sales is recognized upon product shipment, provided that risk and title have transferred, a purchase order has been received, the sales price is fixed and determinable and collection of the resulting receivable is probable. There are no formal customer acceptance terms or further obligations related to the sale of hardware products, outside of the Company's standard product warranty. Provisions for estimated warranty repairs and returns and allowances are provided for at the time of sale.

Certain sales of the Company's hardware products are bundled with its software products. In such arrangements, both the software and hardware products are delivered simultaneously. The Company accounts for software sales in accordance with ASC 985-605, whereby the revenue from the sale of software products is recognized at the time the software is delivered to the customer, provided all the revenue recognition criteria noted above have been met. The proprietary application software sold by the Company is not essential to the functionality of the security hardware. Therefore, in multiple-element arrangements containing hardware and software, the hardware elements are excluded from ASC 985-605 and are accounted for in accordance with ASU 2009-13. Revenue from such bundled arrangements is generally recognized upon delivery of the hardware products, assuming all other basic revenue recognition criteria are met, as both the hardware and software products are delivered simultaneously and no undelivered elements exist. Certain sales of the Company's hardware products are bundled with its installation services and maintenance contracts. For transactions entered into subsequent to the adoption of ASU 2009-13 that include multiple elements, arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy as required by ASU 2009-13. In such bundled arrangements, the revenue from hardware products is generally recognized upon delivery, assuming all other basic revenue recognition criteria are met. The revenue from installation contracts is recognized upon completion of such services, which happens within a short period after the delivery of hardware products, and the revenue from maintenance contracts is deferred and amortized ratably over the period of the maintenance contracts.

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

ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable in revenue arrangements. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, or the Company's best estimated selling price (ESP) if neither VSOE nor TPE are available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. VSOE of fair value is based on the price charged when the element is sold separately. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. The best estimate of selling price is established considering multiple factors, including, but not limited to, pricing practices in different geographies and through different sales channels, gross margin objectives, internal costs, competitor pricing strategies and industry technology lifecycles. Some of the Company's products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality; as a result, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as the Company is unable to reliably determine what competitors products' selling prices are on a stand-alone basis, the Company is not typically able to determine TPE for such products. Therefore ESP is used for such products in the selling price hierarchy for allocating the total arrangement consideration. The Company evaluates each deliverable in an arrangement to determine whether they represent separate units of accounting in accordance with the provisions of ASU 2009-13. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. Allocation of the consideration is determined at arrangement inception on the basis of each unit's relative selling price.

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles-Goodwill and Other, ASC Topic 350, Testing for Impairment* (ASU 2011-08). ASU 2011-08 amends the guidance in ASC 350-20, *Intangibles-Goodwill and Other-Goodwill*. The intent of this ASU is to simplify how entities, both public and non-public, test goodwill for impairment by allowing an entity to use a qualitative approach to test goodwill for impairment. The amendments in the ASU permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC 350-20. This guidance is effective for annual and interim tests performed in fiscal years beginning on or after December 15, 2011. Early adoption is permitted. The Company will adopt the provisions of ASU 2011-08 effective December 1, 2011 at the time of its annual goodwill impairment test.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income, ASC Topic 220, Presentation of Comprehensive Income* (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective in the first quarter of fiscal 2012 and should be applied retrospectively. The Company is currently evaluating the impact of its pending adoption of ASU 2011-05 on its consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards, ASU Topic 820, Fair Value Measurement* (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. ASU 2011-04 is effective in the first quarter of fiscal 2012 and should be applied prospectively. The Company is currently evaluating the impact of its pending adoption of ASU 2011-04 on its consolidated financial statements.

Table of Contents**3. Acquisitions***Acquisition of polyright*

Multicard AG, a subsidiary of the Company, completed the acquisition and acquired all of the outstanding shares of polyright on July 18, 2011 (polyright acquisition date), for a combination of cash and payment of outstanding indebtedness in the aggregate amount of CHF 2.55 million (or approximately \$3.1 million). The sellers included Securitas AG, Kudelski SA and members of polyright management. The sellers may receive aggregate potential earn-out payments payable in shares of the Company s common stock over the 30-month period following the closing of the acquisition, subject to achievement of specific financial and sales performance targets over such period. The number of such shares, if any, issued under the earn-out will be based on the average share price during the month preceding the date of announcement of the Company s annual results, and will be subject to a two-year lockup. polyright is a provider of identity management platforms and open-ended rights and services management solutions for higher education, healthcare and industry.

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

| | |
|--|----------|
| Cash consideration | \$ 3,133 |
| Fair value of contingent consideration | 302 |
| Fair value of total consideration transferred | 3,435 |
| Fair value of net identifiable assets acquired | (716) |
| Goodwill | \$ 2,719 |

The fair value of the contingent consideration is based on achieving certain revenue and profit targets as defined under the acquisition agreement. These contingent payments were probability weighted and discounted to present value. An additional discount was applied to reflect the restriction on the resale or transfer of such shares. The key assumptions in calculating the fair value of contingent consideration are as follows: 21.7% discount rate and probability adjusted revenues between \$2.9 million and \$7.1 million. The fair value of the contingent consideration was classified as liability in accordance with ASC Topic 480, *Distinguishing Liabilities from Equity* (ASC 480). As of September 30, 2011, there were no significant changes in the range of outcomes for the contingent consideration recognized as of the acquisition date.

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

Assets acquired and liabilities assumed as of July 18, 2011 (in thousands):

| | |
|--|---------|
| Cash and cash equivalents | \$ 375 |
| Accounts receivable | 623 |
| Inventory | 589 |
| Property and equipment | 88 |
| Other current assets | 170 |
| Accounts payable | (316) |
| Accrued expenses and other liabilities | (810) |
| Deferred revenue | (1,155) |

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| | |
|--|--------|
| Intangible assets subject to amortization | |
| Customer relationships | 1,290 |
| Order backlog | 246 |
| Deferred tax liabilities in connection with acquired intangible assets | (384) |
| Fair value of polyright net identifiable assets acquired | \$ 716 |

Intangible assets of \$1.5 million consist primarily of customer relationships and order backlog. Customer relationships relate to polyright's ability to sell existing, in-process and future versions of its products to its existing customers. Order backlog represents future revenue to be derived from confirmed orders. The customer relationships were valued using the income approach based on DCF and using a discount rate of 24%. The discount rate used in the present value calculation was derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset's characteristics. The intangible assets of \$1.5 million are subject to amortization and the Company expects to amortize these intangible assets on a straight-line basis over their expected useful lives of approximately one to six years.

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Of the total purchase consideration, \$2.7 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the polyright acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company's Identity Management reportable segment in accordance with ASC 350. None of the goodwill recorded as part of the polyright acquisition will be deductible for United States federal income tax purposes.

The amounts of revenue and earnings of polyright included in the Company's condensed consolidated statement of operations from the polyright acquisition date to the period ending September 30, 2011 are as follows (in thousands):

| | |
|----------|----------|
| Revenues | \$ 1,403 |
| Net loss | \$ 295 |

Acquisition of idOnDemand

The Company completed the acquisition of idOnDemand on May 2, 2011 (the idOnDemand acquisition date), pursuant to a Stock Purchase Agreement dated April 29, 2011 between the Company and certain shareholders (the Selling Shareholders) of idOnDemand, under which the Company has acquired approximately 95.8% of the shares of idOnDemand in exchange for cash and shares of the Company's common stock. idOnDemand was a privately held corporation and is a provider of service-based identity credential provisioning and management. idOnDemand is headquartered in Pleasanton, California and maintains data centers in Santa Clara, California and Canberra, Australia. Initial consideration at closing consisted of approximately \$2.4 million in cash and 995,675 shares of the Company's common stock. Shares issued at closing to the Selling Shareholders are subject to a three-year lock-up period from the closing date of the acquisition. Of the total initial share consideration paid to the Selling Shareholders, 407,289 shares will be released from the lock-up on the six month anniversary of the closing date. Beginning on the second anniversary of the closing date, the remaining shares will be released from the lock-up in equal amounts on a monthly basis until the expiration of the lock-up period.

The shares of the Company's common stock issued at closing were issued in reliance upon available exemptions from the registration requirements of the Securities Act of 1933, as amended (the Securities Act), including Section 4(2) thereof and Regulation S thereunder, as well as comparable exemptions under applicable state and foreign securities laws. In addition, Selling Shareholders may receive potential earn-out payments over a period of three years and eight months from the idOnDemand acquisition date, payable in shares of the Company's common stock and subject to achievement of specific financial and sales performance targets. Any shares issued in connection with the earn-out will be subject to a 12-month lock-up from date of issuance.

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

Subsequent to the filing of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, the Company received new information, which existed at the time of acquisition, related to idOnDemand's customer base and product offerings which impacted our preliminary purchase price allocation and measurement of contingent consideration. As a result of this new information, the fair value of contingent consideration, the fair value of noncontrolling interest as well as the fair value of net identifiable assets acquired was decreased by \$5.3 million, \$0.2 million and \$0.3 million, respectively as of September 30, 2011, with corresponding adjustment to goodwill. The following table summarizes the remeasured fair value of total consideration for idOnDemand controlling and noncontrolling interest, the total fair value of net identifiable assets acquired at the idOnDemand acquisition date and the resulting goodwill recorded (in thousands):

| | |
|---|----------|
| Cash consideration | \$ 2,396 |
| Fair value of common stock | 3,024 |
| Fair value of contingent consideration | 4,758 |
| Fair value of total consideration transferred | 10,178 |
| Fair value of noncontrolling interest | 468 |

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| | |
|---|----------|
| Fair value of controlling and noncontrolling interest | 10,646 |
| Fair value of net identifiable assets acquired | (2,847) |
| Goodwill | \$ 7,799 |

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The fair value of the shares of the Company's common stock issued in connection with the acquisition was determined using the closing market price of the Company's common stock as of the idOnDemand acquisition date of \$3.64 per share and then discounted to reflect the restriction on the resale or transfer of shares under the Securities Act. The fair value of the contingent consideration was based on achieving certain revenue and profit targets as defined under the Stock Purchase Agreement. These contingent payments were probability weighted and also discounted to present value. The key assumptions in calculating the fair value of contingent consideration are as follows: 22.9% discount rate and probability adjusted revenues between \$1.6 million and \$14.5 million. The fair-value of the contingent consideration was classified as liability in accordance with ASC 480. As of September 30, 2011, there were no significant changes in the range of outcomes for the contingent consideration recognized as a result of the acquisition of idOnDemand, although the Company recognized \$0.4 million of expenses as a result of passage of time (reduced impact of discounting) in accordance with ASC 480 which has been included in general and administration expenses in the condensed consolidated statement of operations. The acquisition-date fair value of the noncontrolling interests is derived by determining the fair value of the acquired business as a whole and then subtracting the consideration transferred by the Company for its controlling interest in idOnDemand.

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

Assets acquired and liabilities assumed as of May 2, 2011 (in thousands):

| | |
|---|----------|
| Accounts receivable | \$ 65 |
| Inventory | 70 |
| Property and equipment | 96 |
| Other assets | 291 |
| Accounts payable | (123) |
| Accrued expenses and other liabilities | (116) |
| Deferred revenue | (148) |
| Intangible assets subject to amortization | |
| Developed technology | 2,700 |
| Patents | 790 |
| Customer relationships | 390 |
| Trade secrets | 300 |
| Order backlog | 17 |
| Trade name | 60 |
| Deferred tax liabilities in connection with acquired intangible assets and inventory fair value adjustment, net | (1,545) |
| Fair value of idOnDemand net identifiable assets acquired | \$ 2,847 |

Intangible assets of \$4.3 million consist primarily of developed technology, patents, customer relationships, trade secrets, and trade name. Developed technology, patents and trade secrets relates to idOnDemand's technology and knowhow which is currently generating revenue. Customer relationships relate to idOnDemand's ability to sell existing, in-process and future versions of its products to its existing customers. Trade names represent future value to be derived associated with the use of existing trade names. Order backlog represents future revenue to be derived from confirmed orders. Developed technology, patents and trade name were valued using the relief from royalty method based on discounted cash flow (DCF). A discount rate of 18% was used to value developed technology and trade name and 20% to value patents. The customer relationships and trade secrets were valued using the income approach based on DCF and using a discount rate of 20%. The discount rates used in the present value calculations were derived from a weighted average cost of capital (WACC) analysis, adjusted to reflect additional risks related to each asset's characteristics. The intangible assets of \$4.3 million are subject to amortization and the Company expects to amortize these intangible assets on a straight-line basis over their expected useful lives of approximately one to twelve years.

Of the total purchase consideration, \$7.8 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the idOnDemand acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company's Identity Management reportable segment in accordance with ASC 350. None of the goodwill recorded as part of the idOnDemand acquisition will be deductible for United States

federal income tax purposes.

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Deferred tax assets and liabilities resulting from the acquisition of idOnDemand have been netted, where applicable. Following the idOnDemand acquisition, idOnDemand has become part of the U.S. tax group of the Company's entities. Accordingly, the deferred tax liability of \$1.5 million which was recognized in the purchase price accounting has been netted with the Company's existing deferred tax assets. As a result, there was a \$1.5 million reversal of the Company's valuation allowance. In accordance with ASC 805, the reversal of the valuation allowance was recorded as a tax benefit in the 2011 second quarter financial statements.

The Company recognized \$0 and \$0.2 million of acquisition-related costs that were expensed in the three and nine months ended September 30, 2011, respectively. These costs are included as part of general and administration costs in the condensed consolidated statement of operations.

The amounts of revenue and earnings of idOnDemand included in the Company's condensed consolidated statement of operations from the idOnDemand acquisition date to the period ending September 30, 2011 are as follows (in thousands):

| | |
|----------|----------|
| Revenues | \$ 363 |
| Net loss | \$ 1,546 |

Acquisition of Smartag

The Company completed the acquisition of Smartag on November 19, 2010 (the Smartag acquisition date). The Company paid approximately \$3.2 million to acquire all the shares and intellectual property of Smartag, consisting of a one-time cash payment at the close of the transaction of \$1.0 million and a debt note for approximately \$2.2 million. The debt note carries an interest rate of 6% per year and is payable within 30 months from the closing date.

Certain closing balance sheet items in connection with the acquisition of Smartag were subject to post-closing adjustment which was finalized during the second quarter of 2011. As a result, the net assets acquired increased by \$0.1 million and the purchase consideration was increased by \$0.2 million which were accounted for as measurement period adjustments in the second quarter of 2011 with a corresponding adjustment to goodwill. The fair value of total consideration transferred was determined to be \$3.2 million. The Company recognized identifiable intangible assets of \$0.3 million related to the acquisition of Smartag, which are being amortized on a straight-line basis over their expected useful lives of approximately one to five years.

Acquisition of RockWest (now Multicard U.S.)

The Company completed the acquisition of RockWest on April 14, 2010 (the RockWest acquisition date). As a part of the purchase consideration for the acquisition, the Company issued an aggregate of 2.6 million restricted shares of its common stock to the sellers of RockWest. The shares issued to the Sellers are subject to a 24-month lock-up from the closing date of the acquisition. Additionally, the Sellers are eligible to receive limited earn-out payments (contingent consideration), based on achieving certain revenue and profit targets as defined under the Share Purchase Agreement, in the form of shares of common stock subject to a 12-month lock-up period.

The fair value of total consideration transferred, which included contingent consideration, was determined to be \$4.5 million as of the RockWest acquisition date. The fair value of the contingent consideration is classified as liability in accordance with ASC 480. As of September 30, 2011, the Company remeasured the contingent consideration to fair value in accordance with ASC 480 and recognized \$0.1 million and \$0.2 million as a credit to expense during the three and nine months ended September 30, 2011, respectively, which has been included in general and administration expenses in the condensed consolidated statement of operations.

The Company recognized identifiable intangible assets of \$2.2 million and goodwill of \$3.0 million related to the acquisition of RockWest. The Company is amortizing the intangible assets on a straight-line basis over their expected useful lives of approximately one to six years.

Deferred tax assets and liabilities resulting from the acquisition of RockWest have been netted, where applicable. Following the RockWest acquisition, RockWest has become part of the U.S. tax group of the Company's entities. Accordingly, the deferred tax liability of \$0.6 million which was recognized in the purchase price accounting has been netted with the Company's existing deferred tax assets. As a result, there was a \$0.6 million reversal of the Company's valuation allowance. In accordance with ASC 805, the release of the valuation allowance was recorded as a tax benefit in the 2010 second quarter financial statements.

Table of Contents*Pro forma financial information:*

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

Pro forma results of operations for the three and nine months ended September 30, 2011 and 2010 are as follows (in thousands, unaudited):

| | Three Months Ended | | Nine Months Ended | |
|----------|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Revenues | \$ 27,002 | \$ 24,405 | \$ 78,308 | \$ 69,433 |
| Net loss | (3,715) | (3,081) | (8,947) | (13,611) |

4. Fair Value Measurements

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

Level 1 Quoted prices for identical instruments in active markets;

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

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

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

Cash equivalents include money market fund deposits with maturities of three months or less at the date of acquisition. These financial instruments are classified in Level 1 of the fair value hierarchy.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities that are measured and recognized at fair value on a recurring basis have been classified under the appropriate level of the fair value hierarchy as of September 30, 2011 and December 31, 2010 were as follows (in thousands):

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| | September 30, 2011 | | | | December 31, 2010 | | | |
|----------------------------|--------------------|---------|----------|----------|-------------------|---------|---------|--------|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | | | | | |
| Money market fund deposits | \$ 521 | \$ | \$ | \$ 521 | \$ 36 | \$ | \$ | \$ 36 |
| Liabilities: | | | | | | | | |
| Contingent consideration | \$ | \$ | \$ 5,520 | \$ 5,520 | \$ | \$ | \$ 519 | \$ 519 |

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

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As discussed in Note 3 above, the Sellers of polyright, idOnDemand and RockWest are eligible to receive limited earn-out payments (contingent consideration) in the form of shares of common stock subject to certain lock-up periods. The fair value of the contingent consideration is based on achieving certain revenue and profit targets as defined under the applicable acquisition agreement and is payable in shares of the Company's common stock. These contingent payments are probability weighted and are discounted to reflect the restriction on the resale or transfer of such shares. The valuation of the contingent consideration is classified as a Level 3 measurement, because it is based on significant unobservable inputs and involved management judgment and assumptions about achieving revenue and profits targets and discount rates used. The fair value of the contingent consideration is classified as liability and is remeasured each reporting period in accordance with ASC 480. The contingent consideration above as of September 30, 2011 and December 31, 2010, respectively, includes the short-term portion of \$46,000 and \$0.5 million relating to the RockWest acquisition and \$0.1 million and zero relating to the polyright acquisition which is included in the other accrued expenses and liabilities in the condensed consolidated balance sheets. As of September 30, 2011, the Company remeasured the total contingent consideration to fair value and recognized \$0.4 million and \$0.3 million as an expense during the three and nine months ended September 30, 2011, which has been included in general and administration in the condensed consolidated statements of operations.

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

As of September 30, 2011 and December 31, 2010, there were no assets or liabilities that are measured and recognized at fair value on a non-recurring basis.

5. Stockholders' Equity of Identive Group, Inc.***Public Offering***

In May 2011 the Company issued 7,843,137 shares of common stock at a price of \$2.55 per share in an underwritten public offering for a net consideration of approximately \$18.2 million after recording approximately \$0.4 million in underwriting discounts and commissions and issuance costs related to the offering.

Private Placement

In November 2010, the Company issued 4,097,626 shares of common stock at a price of \$2.525 per share and warrants to purchase an additional 4,097,626 shares of its common stock at an exercise price of \$2.65 per share in a private placement to accredited and other qualified investors (the Investors or Warrant holders), for net consideration of approximately \$9.6 million after recording approximately \$0.8 million in issuance costs related to the private placement. The warrants are exercisable beginning on the date of issuance and ending on the fifth anniversary of the date of issuance. Any portion of warrants not exercised prior to the expiration date will become void and of no value and such warrants shall be terminated and no longer outstanding. The Company calculated the fair value of the warrants using the Black-Scholes option pricing model and determined the fair value to be \$6.3 million. The warrants are classified as equity in accordance with ASC Topic 505, *Equity* (ASC 505) as the settlement of the warrants will be in shares and are within the control of the Company.

During the nine months ended September 30, 2011, the Company issued 0.4 million shares of its common stock to the warrant holders upon exercise of the warrants as disclosed in the condensed consolidated statements of equity and comprehensive loss.

Acquisition Warrants

As part of the consideration paid by the Company in connection with the acquisition of Hirsch Electronics, the Company issued approximately 4.7 million warrants to purchase shares of the Company's common stock at an exercise price of \$3.00, in exchange for the outstanding capital stock of Hirsch. Also, as part of the Hirsch transaction, the Company issued 0.2 million warrants to purchase shares of the Company's common stock in exchange for outstanding Hirsch warrants at exercise prices in the range between \$2.42 and \$3.03, with a weighted average exercise price of \$2.79. All warrants issued in connection with the Hirsch transaction will become exercisable for a period of two years on April 30, 2012. The Company measured the fair value of the warrants using the Black-Scholes option pricing model and determined the fair value to be \$1.5 million. The warrants are classified as equity in accordance with ASC 505 as the settlement of the warrants will be in shares and are within the control of the Company.

Table of Contents***2011 Employee Stock Purchase Plan (ESPP)***

In June 2011, Identive's stockholders approved the 2011 Employee Stock Purchase Plan (the ESPP). Initially, 2.0 million shares of common stock are reserved for issuance over the term of the ESPP, which is ten years. In addition, on the first day of each fiscal year commencing with fiscal year 2012, the aggregate number of shares reserved for issuance under the ESPP is automatically increased by a number equal to the lowest of (i) 750,000 shares, (ii) two percent of all shares outstanding at the end of the previous year, or (iii) an amount determined by the Board. If any option granted under the ESPP expires or terminates for any reason without having been exercised in full, the unpurchased shares subject to that option will again be available for issuance under the ESPP. Under the ESPP, eligible employees may purchase shares of common stock at 85% of the lesser of fair market value of our common stock at the beginning of or end of the applicable offering period. Each offering period lasts for six months. The first six-month exercise period under the ESPP commenced on July 1, 2011 and no shares have been issued as of September 30, 2011. The Company recognized approximately \$84,000 in stock-compensation expense related to ESPP during the three and nine months ended September 30, 2011, of which approximately \$14,000 is included in cost of revenue, approximately \$19,000 in research and development, approximately \$27,000 in sales and marketing and approximately \$24,000 in general and administrative in the condensed consolidated statements of operations. As of September 30, 2011, there was \$0.6 million of total unrecognized compensation cost related to the ESPP that is expected to be recognized on a straight-line basis over the remaining vesting periods.

Stock-Based Compensation Plans

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

Stock Bonus and Incentive Plans

In connection with its acquisition of Bluehill ID AG in January 2010, the Company assumed the Bluehill Plans, pursuant to which options to purchase 2.1 million shares of the Company's common stock may be granted to executives, key employees and other service providers, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), based upon the achievement of certain performance targets or other terms and conditions as determined by the administrator of the plans. No grants have been made under these plans since the date of assumption.

In June 2010, Identive's stockholders approved the 2010 Plan under which cash and equity-based awards may be granted to executive officers, including the CEO and CFO, and other key employees (Participants) of the Company and its subsidiaries and members of the Company's Board, as designated from time to time by the Compensation Committee of the Board (the Committee). An aggregate of 3.0 million shares of the Company's common stock were reserved for issuance under the 2010 Plan as equity-based awards, including shares, nonqualified stock options, restricted stock or deferred stock awards. These awards provide the executives and employees with the opportunity to earn shares of common stock depending on the extent to which certain performance goals are met. For services rendered, the executives shall be paid an incentive bonus to be received in cash and shares of the Company with certain lock-up periods. In addition, the executives and employees are entitled to receive a grant of non-qualified stock options in an amount equal to 20% of the number of U.S. dollars in the participant's base salary. The Committee may make incentive awards based on such terms, conditions and criteria as it considers appropriate, including awards that are subject to the achievement of certain performance criteria. Stock awards are generally fully vested at the time of grant, but subject to a 24-month lock-up from the date of grant. Since the award of share-based payments described above represents an obligation to issue a variable number of Company's shares determined on the basis of a monetary value derived solely on variations in an operating performance measure (and not on the basis of variations in the fair value of the entity's equity shares), the award is considered a share-based liability in accordance with ASC 480 and is remeasured to fair value each reporting period. While the Company will maintain its current 2010 Plan for making performance-based awards to Participants, all future equity awards granted under the 2010 Plan will be issued pursuant to the 2011 Plan. As of September 30, 2011, a total of 0.7 million shares have been issued pursuant to the 2010 Plan, of which 0.1 million were issued during the fiscal year ended December 31, 2010 as disclosed in the consolidated statements of equity and comprehensive loss.

On June 6, 2011, Identive's stockholders approved the 2011 Plan, which is administered by the Compensation Committee of the Company's Board of Directors. The plan is to provide stock options, stock units, restricted shares, and stock appreciation rights to be granted to officers, directors, employees, consultants, and other persons who provide services to the Company or any related entity. The 2011 Plan serves as a successor plan to the Company's 2007 Plan. The Company reserved 4.0 million shares of common stock plus any remaining common stock available for delivery under the 2007 Plan and the 2010 Plan as of June 6, 2011. In aggregate, as of June 6, 2011, 8.5 million shares were available for future grants under the 2011 Plan, including shares rolled over from 2007 Plan and 2010 Plan.

Table of Contents*Stock-Based Compensation Expense (Share Bonus and Incentive Plans)*

The following table illustrates the stock-based compensation expense resulting from stock bonus and incentive plans included in the condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------|-------------------------------------|---------------|------------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenue | \$ 1 | \$ 25 | \$ 3 | \$ 25 |
| Research and development | 2 | 159 | 31 | 159 |
| Selling and marketing | 8 | 417 | 175 | 583 |
| General and administrative | 61 | | 296 | |
| Total | \$ 72 | \$ 601 | \$ 505 | \$ 767 |

Of the total amounts for the nine months ended September 30, 2011 and 2010, an amount of \$0.4 million and \$0.7 million was accrued for and included in the accrued compensation and related benefits in the condensed consolidated balance sheet as of September 30, 2011 and 2010, respectively.

Stock Option Plans

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

As of September 30, 2011, an aggregate of approximately 0.3 million granted options were outstanding under Director Option Plan and 1997 Stock Option Plan, 0.3 million granted options were outstanding under the 2000 Stock Option Plan, 1.4 million granted options were outstanding under the 2007 Plan, and 0.2 million granted options were outstanding under the 2011 Plan. These outstanding options remain exercisable in accordance with the terms of the original grant agreements under the respective plans.

The following table summarizes information about options outstanding as of September 30, 2011:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|-----------------------|--|--|-----------------------|--|
| | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| \$ 1.51 - \$ 2.40 | 481,706 | 4.98 | \$ 2.26 | 260,386 | \$ 2.32 |
| \$ 2.41 - \$ 2.61 | 310,862 | 7.68 | 2.43 | 78,378 | 2.44 |
| \$ 2.62 - \$ 2.64 | 452,316 | 9.41 | 2.63 | 452,316 | 2.63 |
| \$ 2.65 - \$3.12 | 536,960 | 4.37 | 2.99 | 460,219 | 2.99 |
| \$ 3.13- \$10.74 | 406,648 | 4.14 | 4.11 | 372,670 | 4.11 |
| \$ 1.51- \$10.74 | 2,188,492 | 5.97 | \$ 2.88 | 1,623,969 | \$ 3.01 |

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A summary of the activity under the Company's stock-based compensation plans for the nine months ended September 30, 2011 is as follows:

| | Shares Available for Grant | Number Outstanding | Stock Options | | Remaining Contractual Life (in years) | Stock Awards | |
|--|----------------------------|--------------------|----------------------------------|---------------------------|---------------------------------------|----------------|--------------|
| | | | Average Exercise Price per share | Aggregate Intrinsic Value | | Number Granted | Fair Value |
| Balance at December 31, 2010 | 7,542,277 | 1,810,188 | \$ 3.56 | \$ 128,300 | 4.66 | | |
| Authorized | 4,000,000 | | | | | | |
| Granted | (1,002,504) | 630,077 | \$ 2.57 | | | 372,427 | \$ 1,434,000 |
| Cancelled or Expired | 23,053 | (230,772) | \$ 7.31 | | | | |
| Exercised | | (21,001) | \$ 2.36 | | | | |
| Balance at September 30, 2011 | 10,562,826 | 2,188,492 | \$ 2.88 | \$ 25,097 | 5.97 | | |
| Vested or expected to vest at September 30, 2011 | | 2,021,763 | \$ 2.92 | \$ 19,108 | 5.78 | | |
| Exercisable at September 30, 2011 | | 1,623,969 | \$ 3.01 | \$ 5,712 | 5.67 | | |

The weighted-average grant date fair value per option for options granted during the three and nine months ended September 30, 2011 was \$2.31 and \$2.57, respectively. The weighted-average grant date fair value per option for options granted during the three and nine months ended September 30, 2010 was \$0.16 and \$0.95, respectively. During the three and nine months ended September 30, 2011, zero and 21,001 options, respectively, were exercised. Cash proceeds from the exercise of stock options were zero and \$56,591 during the three and nine months ended September 30, 2011, respectively. During the three and nine months ended September 30, 2010, no options were exercised. At September 30, 2011, there was \$0.5 million of unrecognized stock-based compensation expense, net of estimated forfeitures related to non-vested options, that is expected to be recognized over a weighted-average period of three years.

Stock-Based Compensation Expense (Stock Options)

The following table illustrates the stock-based compensation expense resulting from stock options included in the condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|--------|---------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenue | \$ 3 | \$ 3 | \$ 11 | \$ 13 |
| Research and development | 8 | (48) | 73 | (16) |
| Selling and marketing | 51 | 59 | 168 | 179 |
| General and administrative | 32 | (19) | (10) | 108 |
| Stock-based compensation expense before income taxes | \$ 94 | \$ (5) | \$ 242 | \$ 284 |
| Income tax benefit | | | | |
| Stock-based compensation expense after income taxes | \$ 94 | \$ (5) | \$ 242 | \$ 284 |

Common Stock Reserved for Future Issuance

As of September 30, 2011, the Company has reserved an aggregate of approximately 14.4 million shares of its common stock for future issuance under its various equity incentive plans, of which approximately 8.1 million shares are reserved for future grants under the 2011 Plan and 2010 Plan, approximately 2.2 million shares are reserved for future issuance pursuant to outstanding options under all stock options and incentive plans, 2.0 million shares are reserved for future issuance under the ESPP and approximately 2.1 million shares are reserved for future issuance under the Bluehill Plans.

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As of September 30, 2011, the Company has reserved an aggregate of approximately 3.3 million shares of common stock for future issuance in connection with its acquisition of Bluehill ID, consisting of approximately 2.0 million shares for the options converted at the closing of the Bluehill ID acquisition and approximately 1.3 million shares for the noncontrolling shareholders of Bluehill ID.

As of September 30, 2011, the Company has reserved an aggregate of approximately 2.5 million shares of common stock for future issuance in connection with its acquisition of idOnDemand, consisting of approximately 2.4 million shares for the contingent consideration and approximately 0.1 million shares for the noncontrolling shareholders.

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As of September 30, 2011, the Company has reserved an aggregate of approximately 0.2 million shares of common stock for future issuance for the contingent consideration in connection with its acquisition of RockWest and polyright, consisting of approximately 136,000 shares for polyright and approximately 23,000 shares for the RockWest .

As of September 30, 2011, the Company has reserved an aggregate of approximately 8.6 million shares of common stock for future issuance pursuant to outstanding warrants, consisting of approximately 3.7 million shares pursuant to outstanding warrants in connection with the November 2010 private placement as described above and approximately 4.9 million shares pursuant to outstanding warrants in connection with the Hirsch acquisition.

Comprehensive Loss Attributable to Identive Group, Inc.

Comprehensive loss consists of the following (in thousands):

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---------------------------------|------------|--------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net loss | \$ (3,919) | \$ (2,134) | \$ (7,441) | \$ (9,292) |
| Other comprehensive (loss) income | | | | |
| Change in foreign currency translation adjustment | (45) | 2,744 | 2,712 | (2,196) |
| Total comprehensive (loss) income | (3,964) | 610 | (4,729) | (11,488) |
| Less: comprehensive loss (income) attributable to noncontrolling interest | 131 | (127) | 377 | 749 |
| Comprehensive loss (income) attributable to Identive Group, Inc. | \$ (3,833) | \$ 483 | \$ (4,353) | \$ (10,739) |

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

Basic and diluted net loss per share is based upon the weighted average number of common shares outstanding during the period. For the three months and nine months ended September 30, 2011 and 2010, we excluded common stock equivalents consisting of outstanding stock options and warrants from the calculation of diluted loss per share because these securities were anti-dilutive due to the net loss in the respective period. For the three and nine months ended September 30, 2011, the total number of shares excluded from diluted loss per share relating to these securities was 2,120,060 in each period and for the three and nine months ended September 30, 2010, the total number of shares excluded from diluted loss per share relating to these securities was 2,091,091 shares in each period.

6. Inventories

Inventories consist of (in thousands):

| | September 30, 2011 | December 31, 2010 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$ 4,435 | \$ 4,164 |
| Work-in-process | 565 | 241 |
| Finished goods | 5,067 | 6,179 |
| Total | \$ 10,067 | \$ 10,584 |

Table of Contents**7. Goodwill and Intangible Assets***Goodwill*

The following table presents goodwill by segment as of September 30, 2011 and December 31, 2010 and changes in the carrying amount of goodwill (in thousands):

| | Total | Identity Management | ID Products |
|--|------------------|--------------------------------|--------------------|
| Balance at December 31, 2010 | \$ 47,126 | \$ 37,955 | \$ 9,171 |
| Goodwill acquired during the period | 10,518 | 10,518 | |
| Goodwill measurement period adjustment | 118 | | 118 |
| Currency translation adjustment | 1,234 | 778 | 456 |
| Balance at September 30, 2011 | \$ 58,996 | \$ 49,251 | \$ 9,745 |

During the nine months ended September 30, 2011, the Company recorded goodwill of \$10.5 million in connection with its acquisition of idOnDemand and polyright as described in Note 3 above. In addition, the Company also adjusted the goodwill by \$0.1 million in connection with its acquisition of Smartag as a measurement period adjustment as described in Note 3 above. The goodwill related to the Bluehill acquisition and polyright acquisition is designated in a currency other than United States Dollars and is adjusted each reporting period for the change in foreign exchange rates between the balance sheet dates. In accordance with its accounting policy and ASC 350, the Company tests its goodwill and any other intangibles with indefinite lives annually for impairment and assesses whether there are any indicators of impairment on an interim basis. The Company performed its annual impairment test for all reporting units on December 1, 2010 and concluded that there was no impairment to goodwill during the year ended December 31, 2010. Management did not identify any impairment indicators during the nine months ended September 30, 2011.

Table of Contents*Intangible Assets*

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

| (In thousands) | Order Backlog | Trade Secrets | Patents | Existing Technology | Customer Relationship | Trade Name | Total |
|--|---------------|---------------|----------|---------------------|-----------------------|---------------------------|-----------|
| Cost: | | | | | | 1 -3 years and Indefinite | |
| Amortization period | 0.25-1 year | 1 -2 years | 12 years | 6 -15 years | 4 -15 years | | |
| Balance at December 31, 2010 | \$ 724 | \$ | \$ | \$ 5,462 | \$ 22,742 | \$ 9,221 | \$ 38,149 |
| Acquired as a part of idOnDemand acquisition | 17 | 300 | 790 | 2,700 | 390 | 60 | \$ 4,257 |
| Acquired as a part of polyright acquisition | 246 | | | | 1,290 | | \$ 1,536 |
| Currency translation adjustment | (13) | | | 35 | 711 | 127 | \$ 860 |
| Balance at September 30, 2011 | \$ 974 | \$ 300 | \$ 790 | \$ 8,197 | \$ 25,133 | \$ 9,408 | \$ 44,802 |
| Accumulated Amortization | | | | | | | |
| Balance at December 31, 2010 | \$ 718 | \$ | \$ | \$ 595 | \$ 2,970 | \$ 1 | \$ 4,284 |
| Amortization expense | 122 | 75 | 27 | 500 | 2,183 | 25 | \$ 2,932 |
| Currency translation adjustment | 23 | | | (4) | 90 | | \$ 109 |
| Balance at September 30, 2011 | \$ 863 | \$ 75 | \$ 27 | \$ 1,091 | \$ 5,243 | \$ 26 | \$ 7,325 |
| Intangible assets, net at September 30, 2011 | \$ 111 | \$ 225 | \$ 763 | \$ 7,106 | \$ 19,890 | \$ 9,382 | \$ 37,477 |
| Intangible Assets, net at December 31, 2010 | \$ 6 | \$ | \$ | \$ 4,867 | \$ 19,772 | \$ 9,220 | \$ 33,865 |

During the nine months ended September 30, 2011, the Company recorded intangible assets of \$5.8 million in connection with its acquisition of idOnDemand and polyright as described in Note 3 above. The intangibles acquired in connection with acquisitions of polyright and Bluehill ID are designated in a currency other than United States Dollars and are adjusted each reporting period for the change in foreign exchange rates between the balance sheet dates.

Intangible assets of \$37.5 million and \$33.9 million as of September 30, 2011 and December 31, 2010, respectively, include intangible assets which are not subject to amortization of \$9.3 million and \$9.2 million as of September 30, 2011 and December 31, 2010, respectively. Intangible assets subject to amortization will be amortized over their useful lives as mentioned in the table above.

The following table illustrates the amortization expense included in the unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Cost of revenue | \$ 378 | \$ 256 | \$ 724 | \$ 827 |
| Selling and marketing | 818 | 638 | 2,208 | 1,862 |

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| | | | | |
|-------|----------|--------|----------|----------|
| Total | \$ 1,196 | \$ 894 | \$ 2,932 | \$ 2,689 |
|-------|----------|--------|----------|----------|

As of September 30, 2011, the estimated future amortization expense of purchased intangible assets with definite lives for the next five years is as follows (in thousands):

| | |
|-------------------------------|-----------|
| 2011 (remaining three months) | \$ 1,099 |
| 2012 | 4,397 |
| 2013 | 3,962 |
| 2014 | 2,990 |
| 2015 | 2,989 |
| 2016 and thereafter | 12,732 |
| Total | \$ 28,169 |

Table of Contents**8. Related-Party Transactions**

Prior to the acquisition of Hirsch by the Company, effective November 1994, Hirsch had entered into a settlement agreement (the 1994 Settlement Agreement) with two limited partnerships, Secure Keyboards, Ltd. (Secure Keyboards) and Secure Networks, Ltd. (Secure Networks). Secure Keyboards and Secure Networks were related to Hirsch through certain common shareholders and limited partners, including Hirsch's President Lawrence Midland, who is now an Executive Vice President and a director of the Company. Following the acquisition, Mr. Midland continues to own 30% of Secure Keyboards and 9% of Secure Networks.

On April 8, 2009, Secure Keyboards, Secure Networks and Hirsch amended and restated the 1994 Settlement Agreement to replace the royalty-based payment arrangement under the 1994 Settlement Agreement with a new, definitive installment payment schedule with contractual payments to be made in future periods through 2020 (the 2009 Settlement Agreement). Hirsch's annual payment to Secure Keyboards and Secure Networks in any given year under the 2009 Settlement Agreement is subject to increase based on the percentage increase in the Consumer Price Index during the prior calendar year.

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

The Company recognized \$0.2 million and \$0.6 million expense during the three and nine months ended September 30, 2011, respectively, and \$0.2 million and \$0.6 million expense during the three and nine months ended September 30, 2010, respectively, in its condensed consolidated statements of operations for the interest accreted on the discounted liability amount.

As of September 30, 2011, related-party liability payment amounts for the next five years are as follows (in thousands):

| | |
|-------------------------------|--------------|
| 2011 (remaining three months) | \$ 262 |
| 2012 | 1,109 |
| 2013 | 1,153 |
| 2014 | 1,200 |
| 2015 | 1,248 |
| 2016 and thereafter | 7,027 |
| Present value discount factor | (3,543) |
| Total | \$ 8,456 |

Table of Contents**9. Debt Note, Mortgage Loan and Line of Credit Payable to Bank**

In connection with its acquisition of Smartag, the Company issued a debt note with a face value of \$2.2 million to FCI Asia Pte. Ltd., as discussed in Note 3 above. The debt note carries an interest rate of 6% per year, compounded daily and is payable within 30 months from the closing date. The Company is obligated to pay the principal and accrued interest on a quarterly basis beginning February 19, 2011. The Company may at any time prepay the principal amount of this debt note, in whole or in part, together with accrued interest thereon, without penalty. The discount for prepayment shall be 10% on any remaining amount outstanding under the debt note. The debt note is secured by the grant of first-priority ranking legal security over all the shares and assets of Smartag. The Company recorded interest expense on the debt note of \$24,000 and \$113,000 during the three and nine months ended September 30, 2011, respectively.

In connection with its acquisition of Bluehill ID, the Company acquired an obligation for a mortgage loan and a related revolving line of credit payable to a bank. The mortgage loan and the revolving line of credit are related to one of the 100% owned subsidiaries of Bluehill ID and are secured by the land and building to which it relates as well as total inventory, machinery, stock, products and raw materials of the subsidiary. Amounts outstanding under the mortgage loan accrue interest at 5.50%, and interest is payable monthly. The mortgage loan will mature in 2026. The Company is obligated to pay a monthly amount of approximately \$4,900, over the life of the mortgage loan towards the principal amount in addition to monthly interest payments. The total amount that can be advanced under the line of credit is approximately \$340,000. The advances on the revolving line of credit accrue interest at a base rate determined by the bank plus 2%, payable quarterly. Any advances over the limit will accrue interest at 10.75%. The revolving line of credit is ongoing with no specific end date. The Company recorded interest expense of approximately \$21,000 and \$57,000 during the three and nine months ended September 30, 2011, respectively, and recorded interest expense of approximately \$18,000 and \$53,000 during the three and nine months ended September 30, 2010, respectively. As of September 30, 2011 and December 31, 2010, approximately \$0.9 million was outstanding under the mortgage loan. As of September 30, 2011 and December 31, 2010, zero and approximately \$0.2 million in advances were outstanding under the revolving line of credit.

In addition, one of the Company's subsidiaries had a revolving line of credit payable to a bank. The revolving line of credit matured on March 10, 2011 and the balance was fully paid off on April 7, 2011. The Company recorded interest expense on the line of credit of zero and \$5,600 during the three and nine months ended September 30, 2011, respectively. As of December 31, 2010, approximately \$0.2 million was outstanding under the revolving line of credit.

10. Segment Reporting, Geographic Information and Major Customers

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

The Company currently has two business segments that reflect the Company's current organizational structure and focus on providing secure identification solutions. The Company's reportable segments are Identity Management and ID Products. Each business segment is comprised of two or more businesses within the Company that focus on specific markets and technologies. Business units in the Identity Management segment include Hirsch, idOnDemand, Multicard and polyright; the ID Products segment includes the results of our SCM Microsystems and Sycan ID business units and our Transponder division.

The CODM reviews financial information and business performance along the Identity Management and ID Products segments. The Company evaluates the performance of its segments at the revenue and gross margin level. The Company's reporting systems do not track or allocate operating expenses by segment.

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Summary information by segment for the three and nine months ended September 30, 2011 and 2010 is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Identity Management: | | | | |
| Revenues from external customers | \$ 15,148 | \$ 12,231 | \$ 42,248 | \$ 33,572 |
| Intersegment revenue | (2) | | 314 | 152 |
| Total revenue for reportable segment | 15,146 | 12,231 | 42,562 | 33,724 |
| Elimination of intersegment revenues | 2 | | (314) | (152) |
| Total Identity Management revenue | \$ 15,148 | \$ 12,231 | \$ 42,248 | \$ 33,572 |
| Gross profit | 6,816 | 6,174 | 18,971 | 17,451 |
| Gross profit % | 45% | 50% | 45% | 52% |
| ID Products: | | | | |
| Revenues from external customers | \$ 11,604 | \$ 8,280 | \$ 32,536 | \$ 23,463 |
| Intersegment revenue | 1,991 | | 5,699 | 317 |
| Total revenue for reportable segment | 13,595 | 8,280 | 38,235 | 23,780 |
| Elimination of intersegment revenues | (1,991) | | (5,699) | (317) |
| Total ID Product revenue | \$ 11,604 | \$ 8,280 | \$ 32,536 | \$ 23,463 |
| Gross profit | 5,014 | 2,774 | 12,453 | 8,078 |
| Gross profit % | 43% | 34% | 38% | 34% |
| Total: | | | | |
| Net revenue | \$ 26,752 | \$ 20,511 | \$ 74,784 | \$ 57,035 |
| Gross profit | \$ 11,830 | \$ 8,948 | \$ 31,424 | \$ 25,529 |
| Gross profit % | 44% | 44% | 42% | 45% |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net revenue | | | | |
| Europe and Middle-East | \$ 11,943 | \$ 5,717 | \$ 30,587 | \$ 16,050 |
| Americas | 11,673 | 12,749 | 33,465 | 35,336 |
| Asia-Pacific | 3,136 | 2,045 | 10,732 | 5,649 |
| Total | \$ 26,752 | \$ 20,511 | \$ 74,784 | \$ 57,035 |
| % of net revenue | | | | |
| Europe and Middle-East | 45% | 28% | 41% | 28% |
| Americas | 43% | 62% | 45% | 62% |
| Asia-Pacific | 12% | 10% | 14% | 10% |

No customers exceeded 10% of total revenue during the three and nine months ended September 30, 2011 or 2010. No customer represented 10% of the Company's accounts receivable balance at September 30, 2011 or December 31, 2010.

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Long-lived assets by geographic location as of September 30, 2011 and December 31, 2010, are as follows (in thousands):

| | September 30, 2011 | December 31, 2010 |
|------------------------------|-----------------------|----------------------|
| Property and equipment, net: | | |
| Europe | \$ 3,412 | \$ 3,695 |
| Americas | 669 | 411 |
| Asia-Pacific | 1,325 | 1,267 |
| Total | \$ 5,406 | \$ 5,373 |

11. Commitments

The Company leases its facilities, certain equipment, and automobiles under non-cancelable operating lease agreements. Those lease agreements existing as of September 30, 2011 expire at various dates during the next five years.

The Company recognized rent expense of \$0.4 million and \$1.6 million for the three and nine months ended September 30, 2011, respectively, and recognized rent expense of \$0.3 million and \$1.3 million for the three and nine months ended September 30, 2010, respectively, in its condensed consolidated statement of operations.

Purchases for inventories are highly dependent upon forecasts of customer demand. Due to the uncertainty in demand from its customers, the Company may have to change, reschedule, or cancel purchases or purchase orders from its suppliers. These changes may lead to vendor cancellation charges on these purchases or contractual commitments. The following table summarizes the Company's principal contractual obligations as of September 30, 2011:

| (In thousands) | Operating Lease | Purchase Commitments | Other Contractual Obligations | Total |
|-------------------------------|--------------------|-------------------------|-------------------------------------|-----------|
| 2011 (remaining three months) | \$ 897 | \$ 7,501 | \$ 489 | \$ 8,887 |
| 2012 | 2,279 | 2,081 | 4 | 4,364 |
| 2013 | 1,461 | | | 1,461 |
| 2014 | 622 | | | 622 |
| 2015 and thereafter | 202 | | | 202 |
| | \$ 5,461 | \$ 9,582 | \$ 493 | \$ 15,536 |

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

12. Legal Proceedings

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

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

We also caution you that such forward-looking statements are subject to risks, uncertainties and other factors, not all of which are known to us or within our control, and that actual events or results may differ materially from those indicated by these forward-looking statements. Such factors include our ability to successfully integrate strategic businesses that we acquire, our ability to reduce costs associated with strategic acquisitions, our ability to anticipate product demand, our ability to obtain supplies for products in a timely manner, and our ability to retain key personnel, as well as those additional factors listed in the Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2010. These cautionary statements qualify all of the forward-looking statements included in this Quarterly Report on Form 10-Q that are attributable to us or persons acting on our behalf.

The following information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto set forth in Part I - Item 1 of this Quarterly Report on Form 10-Q and with the audited financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2010.

Overview

Identive Group, Inc. (Identive, the Company, we or us) is an international technology company focused on building the world's signature group in secure identification-based technologies. The business units within Identive have deep industry expertise and are well-known global brands in their individual markets, providing products and solutions in the areas of identity management, physical and logical access control, near field communication (NFC) and radio frequency identification (RFID) systems to governments, commercial and industrial enterprises and consumers. Our growth model is based on a combination of strong technology-driven organic growth from the businesses within the group and disciplined acquisitive development. Our common stock is listed on the NASDAQ Global Market in the U.S. under the symbol INVE and the Frankfurt Stock Exchange in Germany under the symbol INV.

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

In our Identity Management segment we provide solutions and services that enable the secure management of credentials in diverse markets. These credentials are used for the identification of people and the granting of rights and privileges based on defined security policies. The business units in our Identity Management segment specialize in the design, supply and management of products and integrated systems that can enhance security and better meet compliance and regulatory requirements while providing users the benefits and convenience of simple and secure solutions. Our Identity Management customers operate in the government, commercial, enterprise and consumer markets and can be found in multiple vertical market segments including healthcare, finance, industrial, retail and critical infrastructure. Our Identity Management segment includes the results of our Hirsch, idOnDemand, Multicard and polyright business units. Sales in this segment are typically made to high-level dealer / integrators, enterprises, and less frequently, directly to end users.

In our ID Products segment we design and manufacture both standard and highly specialized RFID products and components that help identify people, animals and objects in a multitude of applications and markets. Products and components in our ID Products segment include semiconductors, cards, tags, inlays, readers and terminals that are used by original equipment manufacturers and system integrators to deliver identity-based systems and solutions. These products are used for applications such as eHealth,

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eGovernment, mobile banking, loyalty schemes, transportation and event ticketing, corporate identification, logical access, physical access and passport control in the government, enterprise and financial markets. Within the ID Products segment we also offer commercial digital media readers that are used in digital kiosks to transfer digital content to and from various flash media. Our ID Products segment includes the results of our SCM Microsystems and Syscan ID business units and our Transponder division.

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

Our corporate headquarters are located in Santa Ana, California (U.S.) and our European and operational headquarters are located in Ismaning, Germany. We maintain facilities in Chennai, India for research and development and in Australia, Canada, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Switzerland, the UK and the U.S. for individual business unit operations and sales. The Company was founded in 1990 in Munich, Germany and incorporated in 1996 under the laws of the State of Delaware.

Recent Acquisitions

On July 18, 2011, through our Multicard AG subsidiary we acquired polyright SA, a Swiss provider of identity management platforms and open-ended rights and services management solutions for higher education, healthcare and industry ("polyright"). The acquisition was made using a combination of cash and payment of outstanding indebtedness in the aggregate amount of CHF 2.55 million (or approximately \$3.1 million). The sellers included Securitas AG, Kudelski SA and members of polyright's management team. The sellers may receive aggregate potential earn-out payments payable in shares of our common stock, over the 30-month period following the closing of the acquisition, subject to achievement of specific financial and sales performance targets over such period. The number of shares, if any, issued under the earn-out will be based on the average share price during the month preceding the date of announcement of our annual results, and will be subject to a two-year lockup. In November 2011, polyright will be integrated into the Company's existing Multicard Switzerland business. polyright's operating results have been included in our consolidated results since the date of acquisition.

On May 2, 2011, we acquired 95.8% of the shares of idOnDemand, Inc., a privately-held provider of identity management services based in Pleasanton, California (idOnDemand). The acquisition was pursuant to a Stock Purchase Agreement dated April 29, 2011, under which we paid the selling shareholders of idOnDemand initial consideration at closing of approximately \$2.4 million in cash and 995,675 shares of our common stock. In addition, the selling shareholders may receive aggregate potential earn-out payments payable in shares of our common stock subject to achievement of specific financial and sales performance targets over a period of three years and eight months from the closing date of the acquisition. Any shares issued in connection with the earn-out will be subject to a 12-month lock-up from date of issuance. Shares issued as consideration to the selling shareholders at closing are subject to a three-year lock-up from the closing date of the acquisition. Of the total initial share consideration paid to the selling shareholders, 407,289 shares will be released from lock-up six months after the closing date. Beginning on the second anniversary of the closing date, the remaining shares will be released from the lock-up in equal amounts on a monthly basis until the expiration of the lock-up period. idOnDemand's operating results have been included in our consolidated results since the date of acquisition.

On November 19, 2010, we acquired FCI Smartag Pte. Ltd. (Smartag), a Singapore-based manufacturer of high frequency and ultra high frequency radio frequency identification (RFID) inlays and inlay-based solutions and a subsidiary of FCI Asia Pte. Ltd., FCI SA and FCI Connectors Singapore Pte. Ltd. (collectively, FCI). The acquisition was pursuant to a Share Purchase Agreement dated October 29, 2010, under which we paid FCI approximately \$3.2 million, consisting of a one-time payment at the close of the transaction of approximately \$1.0 million and a debt note for approximately \$2.2 million. The debt note carries an interest rate of 6% per year and is payable within 30 months from the closing date. Smartag's operating results have been included in our consolidated results since the date of acquisition.

On April 14, 2010, we acquired RockWest Technology Group, a privately-held provider of identification and security solutions based in Denver, Colorado (RockWest), pursuant to the Share Purchase Agreement dated March 30, 2010 and amended on April 9, 2010, under which we issued an aggregate of 2.6 million shares of our common stock. In addition, the selling shareholders may receive aggregate potential earn-out payments, payable in shares of our common stock subject to the satisfaction of conditions specified in the Share Purchase Agreement over a period of one year and nine months from the closing date of the acquisition. Any shares issued in connection with the earn-out will be subject to a 12-month lock-up from date of issuance. RockWest's operating results have been included in our consolidated results since the date of acquisition. Following its acquisition, in September 2010 RockWest changed its name to Multicard U.S.

Recent Trends and Strategies for Growth

Identive is focused on building the world's leading company in Secure ID by providing products, systems and services in the areas of access control, identity management and RFID technologies for employee ID, citizen ID and consumer ID applications. Our growth strategy is focused both around technology-driven organic growth and disciplined acquisitive activity, acting as a consolidator in a rapidly growing, yet highly

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fragmented industry. With each acquisition we seek to expand our business, reinforce our market position in targeted areas and fully leverage our strengths and opportunities to enter new markets.

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

As part of our organic growth strategy, we are focused on the ongoing development of our core RFID technology base and of a broad range of new contactless infrastructure products to enable fast growing contactless consumer ID applications and services such as electronic transactions (including payment and ticketing) and various employee and citizen ID electronic security programs within the government and enterprise sectors. Our RFID inlays and inlay-based tags, stickers and other products, and our contactless readers, modules and tokens are intended to address markets such as national/citizen ID, electronic passports, physical and logical (computer) security, ticketing for transit and events, cashless payments and mobile transactions, among others. With the rise of market activity and expectation around NFC technology, we have created a new dedicated group focused on NFC and mobility applications, and have begun to devote additional resources to develop and deliver products and solutions for the NFC market. To meet the growing demand for cloud based credential issuance and management, we are investing in the development of trusted identity Software as a Service or SaaS solutions and capabilities, in particular through our idOnDemand business unit.

To unify our sourcing, production and sales activities among our RFID component businesses, during the first quarter of 2011 we combined the TagStar, Smartag and ACiG business units into a new Transponder division that we believe will help us improve the efficiency and global capabilities of our RFID manufacturing and distribution operations. Additionally, during the third quarter of 2011 we began expanding our production capacity for RFID inlays and finished transponder products to meet increasing customer demand. We expect to complete our expansion activities by the end of the current fiscal year.

Trends in our Business

Sales Trends

Our sales increased 31% in the first nine months of 2011 compared with the first nine months of 2010, as a result of both organic growth and incremental revenue from acquisitions. Incremental revenue from the acquired Multicard U.S., Smartag, idOnDemand and polyright businesses was approximately \$8.1 million in the first nine months of 2011, accounting for 14% growth, and the revenue in our existing businesses increased to \$66.7 million, reflecting an organic growth rate of 17%.

Sales in the Americas. Sales in the Americas accounted for 45% of revenue in the first nine months of 2011, and decreased 5% compared with the first nine months of 2010. Sales of products and systems for employee ID programs within various U.S. government agencies comprise a significant proportion of our revenues in the Americas region, which also includes Canada and Latin America. In our Hirsch business unit, revenue levels have been impacted throughout 2011 by project delays in the deployment of access control systems for U.S. government agencies. Additionally, in the 2011 third quarter, an uncertain economic and political environment caused many of Hirsch's government customers to hold back disbursement of available funds, even when already approved and allocated. As a result, Hirsch sales to federal government agencies have been constrained. A stronger focus on delivering professional services and on pursuing sales in the commercial sector and in other non-federal markets has partly offset lower sales from federal government customers. As a general trend, demand for Hirsch's integrated physical access control systems and other solutions has been strong and increasing, as U.S. federal agencies have continued to improve their security systems as mandated under programs such as Homeland Security Presidential Directive-12 (HSPD-12) and reiterated in memoranda from the Office of Management and Budget (OMB M-11-11). We believe that demand for Hirsch's security systems will remain strong as various agencies work towards compliance with applicable directives and standards; however budget and funding constraints will continue to impact revenue levels as long as they are present.

In our SCM Microsystems business unit, revenue decreased by approximately one-fourth in the first nine months of 2011 compared with the prior year, primarily the result of a continued shift in sales of reader technology used for PC and network access by military and other federal employees, as over the last few years, sales of external card readers in the U.S. have been replaced by sales of embedded chipsets in Asia. Sales in our Multicard U.S. business unit remained stable in the first nine months of 2011 and reflected continued demand for identity management solutions from the education and healthcare markets, as well as local and state governments. U.S. revenue in our Transponder business remained fairly constant in the first nine months of 2011 compared with the same period last year.

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Sales in Europe and the Middle East. Sales in Europe and the Middle East accounted for 41% of revenue in the first nine months of 2011 and increased 91% compared with the first nine months of 2010. The main drivers of this increase were sales of RFID contactless smart card readers related to the German electronic national ID program; sales of eHealth terminals for the German electronic healthcard program; increased sales of core RFID components in our Transponder division; and in the third quarter, incremental revenue from our acquired polyright business. During 2010, SCM and Multicard were each selected to supply secure card readers for the German government's implementation of a new electronic citizen ID card, and received customer orders that are to be fulfilled over several quarters. Our German Multicard business was selected by Germany's Federal Ministry of the Interior to act as project manager for the distribution of several hundred thousand German electronic ID readers, along with application software and related services. During the first nine months of 2011, shipments for the German electronic ID program accounted for approximately \$6.2 million of revenue for SCM and Multicard. To date, SCM and Multicard have fulfilled approximately 91% of the total original orders received, which has generated approximately \$12.1 million in aggregated revenue from the program. Shipments to fulfill remaining original orders are expected to continue through the fourth quarter of 2011. In our European Transponder division, sales demand has continued to grow in each of the last several quarters, driven by demand for RFID inlays and other products for a variety of consumer ID applications, including ticketing for transit systems, ski resorts and theme parks, secure tracking for libraries, and various applications using near field communication (NFC) technology.

Sales in Asia/Pacific. Sales in the Asia/Pacific region accounted for 14% of revenue in the first nine months of 2011 and increased 90% compared with the first nine months of 2010. The increase was primarily the result of incremental revenue from the acquired Smartag business, as well as increased demand for Multicard identity management solutions in Australia. Through our SCM business, we sell reader chipsets to keyboard manufacturers in China whose final computer products are used by U.S. government agencies, and this business is subject to significant variability. Sales of our SCM smart card reader products in the Asia/Pacific region decreased by approximately one-fourth in the 2011 period compared with the prior year primarily as a result of variability in the timing of orders for embedded reader technology. During the same period, our business in Japan has continued to be steady and our Asian customer base outside the government market has expanded during 2011 into additional countries including Singapore, Thailand and Malaysia, and into additional markets, such as telecommunications and corporate enterprise.

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

Seasonality and Other Factors. In our business overall, we may experience significant variations in demand for our products quarter to quarter, and overall we typically experience a slightly stronger demand cycle in the second half of our fiscal year. Sales of our Hirsch physical access control systems are subject to U.S. government budget cycles and are generally highest in the third quarter of each year. Sales of our SCM smart card readers and chips for government programs are impacted by testing and compliance schedules of government bodies as well as roll-out schedules for application deployments, both of which contribute to variability in demand from quarter to quarter. Further, this business is typically subject to seasonality based on governmental budget cycles, with lowest sales in the first half and highest sales in the second half of each year. In our U.S. Multicard business unit, demand is affected by local and state government budget cycles as well as educational calendars, and therefore is typically strongest in the second half of the year. In general, sales of our global Transponder products also are marginally stronger in the second half of the year.

Operating Expense Trends

Our base operating expenses (research and development, sales and marketing and general and administrative) increased 14% in the first nine months of 2011 compared with the first nine months of 2010, primarily as a result of the inclusion of additional expenses from the acquired Multicard U.S., Smartag, idOnDemand and polyright businesses, which also reflect strategic investment in market areas that we feel hold significant opportunity for Identive.

Over the past several quarters, we have invested in new products and additional sales resources to enhance our ability to address additional areas of the secure identification market. In our Hirsch business unit, we continue to invest to develop Hirsch's next generation product offering of software, controllers and other products. In our idOnDemand business unit, we are investing in trusted identity Software as a Service (SaaS) solutions and capabilities for cloud based credential issuance and management. In our SCM business unit, our research and development activities are focused on the development of new contactless readers, tokens and modules and on extending our contactless platforms, in particular to address the growing demand for NFC-enabled devices. In our Transponder division, we continue to invest in enhancing and broadening our inlay designs and technology in the areas of NFC, payment, tag on metal, document management, and library and pharmaceutical applications, and we have a number of new patent applications in process. In our Multicard business unit we continue to make investments to enhance our cashless payment, smart city and ID software systems. We attempt to balance these investments with careful

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management of our development resources so that our increased development activities do not result in unexpected or significant changes in our overall spending on research and development. Additionally, we continue to work to further reduce our ongoing expenses.

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The comparability of our operating results in the three and nine months ended September 30, 2011 with the three and nine months ended September 30, 2010 is impacted by our acquisitions of RockWest (now Multicard U.S.) on April 14, 2010, Smartag on November 19, 2010, idOnDemand on May 2, 2011 and polyright on July 18, 2011. Results of the Multicard U.S., Smartag, idOnDemand and polyright businesses have been included since their respective acquisition dates.

Revenue

Summary information by business segment for the three and nine months ended September 30, 2011 and 2010 is shown below:

| | Three months ended | | % change period to period | Nine months ended | | % change period to period |
|-----------------------------|--------------------|-----------|------------------------------------|-------------------|-----------|------------------------------------|
| | September 30, | | | September 30, | | |
| (In thousands) | 2011 | 2010 | | 2011 | 2010 | |
| Identity Management: | | | | | | |
| Revenue | \$ 15,148 | \$ 12,231 | 24% | \$ 42,248 | \$ 33,572 | 26% |
| % of total revenue | 57% | 60% | | 56% | 59% | |
| Gross profit | 6,816 | 6,174 | | 18,971 | 17,451 | |
| Gross profit % | 45% | 50% | | 45% | 52% | |
| ID Products: | | | | | | |
| Revenue | \$ 11,604 | \$ 8,280 | 40% | \$ 32,536 | \$ 23,463 | 39% |
| % of total revenue | 43% | 40% | | 44% | 41% | |
| Gross profit | 5,014 | 2,774 | | 12,453 | 8,078 | |
| Gross profit % | 43% | 34% | | 38% | 34% | |
| Total: | | | | | | |
| Revenue | \$ 26,752 | \$ 20,511 | 30% | \$ 74,784 | \$ 57,035 | 31% |
| Gross profit | \$ 11,830 | \$ 8,948 | | \$ 31,424 | \$ 25,529 | |
| Gross profit % | 44% | 44% | | 42% | 45% | |

Total revenue for the third quarter of 2011 was \$26.8 million, up 30% compared to \$20.5 million for the third quarter of 2010. For the first nine months of 2011, revenue was \$74.8 million, up 31% compared to \$57.0 million for the first nine months of 2010. The increase in both the third quarter and the first nine months of 2011 resulted from higher sales in both our Identity Management and ID Products segments. Organic growth accounted for approximately 15% of the sales increase in the third quarter and 17% in the first nine months of 2011, while incremental revenue from the acquired Multicard U.S., Smartag, idOnDemand and polyright businesses totaled \$3.2 million and \$8.1 million in the third quarter and first nine months of 2011, respectively.

Identity Management Segment Revenue. In our Identity Management segment we provide solutions and services that enable the secure management of credentials in diverse markets. Our Identity Management segment includes the results of Hirsch, Multicard, idOnDemand and polyright. These businesses specialize in the design, supply and management of highly secure integrated systems and software solutions to enhance security and better meet compliance and regulatory requirements while providing users the benefits and convenience of simple and secure solutions. The majority of sales in our Identity Management segment are made to customers in the government, commercial and enterprise markets and encompass vertical market segments including healthcare, finance, industrial, retail and critical infrastructure.

Revenue in our Identity Management segment was \$15.1 million in the third quarter of 2011, accounting for 57% of total revenue and up 24% from \$12.2 million in the third quarter of 2010. For the first nine months of 2011, Identity Management revenue was \$42.2 million, accounting for 56% of total revenue and up 26% from \$33.6 million in the first nine months of 2010. Higher revenue in both periods primarily was the result of significantly higher sales from our worldwide Multicard business unit, including strong sales from Multicard Germany as a result of its selection as a distributor of secure card readers for the German electronic ID program. Sales activity from Multicard Australia was also significantly higher in the 2011 periods, resulting from increased volume with a government identity management program and the initial deployment of a cashless payment card solution for a large fuel retailer. Higher Multicard sales were partially offset by lower sales from our Hirsch business unit, primarily as a result of deferrals of projects and budgeted spending in the U.S. government sector. Polyright accounted for \$1.4 million of revenue in the third quarter and first nine months of 2011. Revenue from idOnDemand was nominal in both the third quarter and the first nine months of 2011, as this business is still in the early start up phase of sales development. Organic growth accounted for 11% sales increase in the Identity Management segment in the third quarter and for 15% of growth in the first nine months of 2011.

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ID Products Segment Revenue. In our ID Products segment we focus on the design and manufacture of both standard and highly specialized RFID products and components that help identify people, animals and objects in a multitude of applications and markets. Products and components in our ID Products segment include semiconductors, cards, tags, inlays, readers and terminals that are used by original equipment manufacturers, systems integrators and end users to deliver identity based systems and solutions. Our ID Products segment includes the results of SCM Microsystems, Syscan and our Transponder division.

Sales in our ID Products segment were \$11.6 million in the third quarter of 2011, accounting for 43% of revenue and up 40% from sales of \$8.3 million in the third quarter of 2010. For the first nine months of 2011, ID Products sales were \$32.5 million, accounting for 44% of revenue and up 39% from \$23.5 million for the first nine months of 2010. Higher revenue in both periods was driven by a combination of organic growth, which accounted for 21% and 20% of the sales increase in the third quarter and first nine months of 2011, respectively; and incremental revenue from the acquired Smartag business. Sales of our Transponder products were driven by demand for a variety of applications, in particular transit, theme park and ski ticketing. While still small as a proportion of our overall revenues, sales of near field communication, or NFC, tags are among our fastest growing. Reported sales in the SCM business unit were up 36% in the third quarter and 15% in the first nine months of 2011 as compared with the same periods of the prior year, reflecting continued sales of eHealth terminals for the German electronic health card program, strong demand for employee ID, government and corporate programs in Europe and steady demand from a variety of markets in Asia, partially offset by lower demand for PC/network access applications from the U.S. government market and for embedded reader technology in China. Not reflected in the reported figures for SCM were sales of intercompany shipments of secure card readers to Multicard Germany for the German electronic ID program, which totaled approximately \$1.4 million in the third quarter and \$5.1 million in the first nine months of 2011.

Gross Profit

Gross profit for the third quarter of 2011 was \$11.8 million, or 44% of revenue, compared to \$8.9 million, or 44% of revenue in the third quarter of 2010. For the first nine months of 2011, gross profit was \$31.4 million, or 42% of revenue, compared to \$25.5 million, or 45% of revenue for the first nine months of 2010.

By segment, gross profit margin for our Identity Management segment was 45% in the third quarter of 2011, compared to 50% in the third quarter of 2010. For the first nine months of 2011, Identity Management gross profit margin was 45%, compared to 52% for the first nine months of 2010. Gross profit margin in our Identity Management segment in the third quarter and first nine months of 2011 was somewhat affected by an unfavorable, lower margin product mix in our Multicard Germany business unit and lower sales in our Hirsch business unit due to project deferrals. However, gross profit margin in the third quarter was positively affected by strong margins from polyright and by improving margins in our Hirsch and Multicard business units.

Gross profit margin for our ID Products segment was 43% for the third quarter of 2011, compared to 34% in the third quarter of 2010. For the first nine months of 2011, ID Products gross profit margin was 38%, compared to 34% for the first nine months of 2010. Gross profit margin in our ID Products segment in the third quarter and first nine months of 2011 was affected by favorable product mix in both our SCM business unit and our Transponder division, as well as better yields on Transponder inlays and other products.

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

Research and Development

| | Three months ended | | % change | Nine months ended | | % change |
|------------------------------|--------------------|---------------|----------|-------------------|---------------|----------|
| | September 30, | September 30, | period | September 30, | September 30, | period |
| (In thousands) | 2011 | 2010 | to | 2011 | 2010 | to |
| | | | period | | | period |
| Expenses | \$ 2,286 | \$ 1,035 | 121% | \$ 4,823 | \$ 3,513 | 37% |
| Percentage of total revenues | 9% | 5% | | 6% | 6% | |

Research and development expenses consist primarily of employee compensation and fees for the development of hardware, software and firmware products. We focus the bulk of our research and development activities on the development of products for new and emerging market opportunities. Due to the timing of their respective acquisitions, the results of the Smartag, idOnDemand and polyright business units are not included in research and development expenses for 2010. Additionally, only three months of expenses for polyright and five months of expenses

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for idOnDemand are included in the first nine months of 2011. There were no research and development expenses in the acquired Multicard U.S. business unit in any of the periods presented.

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Research and development expenses in the third quarter of 2011 were \$2.3 million, or 9% of revenue, up 121% from \$1.0 million, or 5% of revenue in the third quarter of 2010. For the first nine months of 2011, research and development expenses were \$4.8 million, representing 6% of revenue, up 37% from \$3.5 million, or 6% of revenue for the first nine months of 2010. The increase in research and development expenses in the 2011 periods was due both to the addition of expenses from the acquired Smartag, idOnDemand and polyright businesses totaling \$0.7 million in the third quarter and \$1.1 million in the first nine months of 2011, as well as to increased investment levels in new product development at idOnDemand, in our SCM business unit.

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

Selling and Marketing

| | Three months ended September 30, | | % change | Nine months ended September 30, | | % change |
|------------------------------|-------------------------------------|----------|------------------------|------------------------------------|-----------|------------------------|
| (In thousands) | 2011 | 2010 | period to period | 2011 | 2010 | period to period |
| Expenses | \$ 6,198 | \$ 4,823 | 29% | \$ 17,432 | \$ 14,877 | 17% |
| Percentage of total revenues | 23% | 24% | | 23% | 26% | |

Selling and marketing expenses consist primarily of employee compensation as well as tradeshow participation, advertising and other marketing and selling costs. We focus a significant proportion of our sales and marketing activities on new and emerging market opportunities. Due to the timing of their respective acquisitions, the results of the Smartag, idOnDemand and polyright business units are not included in sales and marketing expenses for 2010 and only six months of expenses for Multicard U.S. are included for 2010. Additionally, only three months of expenses for polyright and five months of expenses for idOnDemand are included in the first nine months of 2011.

Selling and marketing expenses were \$6.2 million in the third quarter of 2011, or 23% of revenue, up 29% from \$4.8 million in the third quarter of 2010, which represented 24% of revenue. For the first nine months of 2011, sales and marketing expenses were \$17.4 million, representing 23% of revenue, up 17% from \$14.9 million, or 26% of revenue for the first nine months of 2010. The sales and marketing expenses in the 2011 periods primarily reflect additional expenses from the acquired Multicard U.S., Smartag, idOnDemand and polyright businesses, which totaled \$0.9 million in the third quarter and \$1.7 million in the first nine months of 2011. Excluding the impact of these additional expenses, sales and marketing expenses were 10% higher and 5% higher in the third quarter of 2011 and the first nine months of 2011, respectively as compared with the same periods of 2010. Higher sales and marketing expenses primarily resulted from investments in additional resources and programs to address existing and new market opportunities.

General and Administrative

| | Three months ended September 30, | | % change | Nine months ended September 30, | | % change |
|------------------------------|-------------------------------------|----------|------------------------|------------------------------------|-----------|------------------------|
| (In thousands) | 2011 | 2010 | period to period | 2011 | 2010 | period to period |
| Expenses | \$ 6,372 | \$ 5,341 | 19% | \$ 17,212 | \$ 16,201 | 6% |
| Percentage of total revenues | 24% | 26% | | 23% | 28% | |

General and administrative expenses consist primarily of compensation expenses for employees performing administrative functions, and professional fees arising from legal, auditing and other consulting services. Due to the timing of their respective acquisitions, the results of the Smartag, idOnDemand and polyright business units are not included in general and administrative expenses for 2010 and only six months of expenses for Multicard U.S. are included for 2010. Additionally, only three months of expenses for polyright and five months of expenses for idOnDemand are included in the first nine months of 2011.

In the third quarter of 2011, general and administrative expenses were \$6.4 million, or 24% of revenue, up 19% from \$5.3 million, or 26% of revenue in the third quarter of 2010. For the first nine months of 2011, general and administrative expenses were \$17.2 million, representing 23% of revenue, up 6% from \$16.2 million, or 28% of revenue for the first nine months of 2010. The increase in general and administrative expenses in the 2011 periods was the result of the addition of expenses from the acquired Multicard U.S., Smartag, idOnDemand and polyright

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businesses, which totaled \$1.0 million in the third quarter and \$1.8 million in the first nine months of 2011. Also included in the first nine months of 2011 were \$0.2 million of transaction expenses related to the acquisition of idOnDemand. Included in general and administrative expenses for the third quarter and first nine months of 2010 were approximately \$0.3 million and \$1.3 million, respectively, of transaction expenses related to previous acquisitions. Excluding the impact of the additional expenses from acquisitions and transaction costs, general and administration expenses were 8% higher and 2% higher in the third quarter of 2011 and first nine months of 2011, respectively as compared with the same periods of 2010, due to transition and integration costs of acquired businesses.

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Restructuring

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

Other Income, Net

We recorded other income, net of \$25,000 and \$0.3 million in the third quarter and first nine months of 2011, respectively. Other income in the first nine months of 2011 mainly includes a dividend distribution made by SCM PC-Card GmbH in which we had made an investment in 1998, and which investment was written off in prior periods. The dividend distribution was made as a result of the entity's plan to close its operations.

Interest Expense, Net

Interest expense, net of \$0.2 million and \$0.8 million in the third quarter and first nine months of 2011, respectively, and interest expense of \$0.2 million and \$0.7 million in the third quarter and first nine months of 2010, respectively, consists of interest accretion expense for a liability to related party in the Hirsch business unit and interest paid on a debt note, mortgage loan and bank line of credit, offset by interest earned on invested cash during the respective periods.

Foreign Currency Gains (Losses), Net

We recorded foreign currency losses of \$(0.6) million and \$(0.4) million in the third quarter and first nine months of 2011, respectively. We recorded a foreign currency gain of \$0.4 million in the third quarter of 2010 and foreign currency loss of \$(0.2) million in the first nine months of 2010. Changes in currency valuation in the periods presented mainly were the result of exchange rate movements between the U.S. dollar and the euro and Swiss franc. Accordingly, they are predominantly non-cash items.

Income Taxes

During the third quarter and first nine months of 2011, we recorded a net provision for income taxes of \$0.1 million and a net benefit for income taxes of \$1.6 million, respectively, which resulted primarily from accounting treatment following the acquisition of idOnDemand. In connection with the acquisition of idOnDemand, we recorded deferred tax liabilities of \$1.5 million, which were netted against the Company's existing deferred tax assets. As a result the Company released valuation allowance of \$1.5 million in the second quarter of 2011. This tax benefit was offset by estimated tax expense of \$0.2 million on deemed income upon an intra-group sale of one of the Company's subsidiaries, as the sales price was less than the fair market value of the subsidiary.

During the third quarter and first nine months of 2010, we recorded a net provision for income taxes of \$39,000 and a net benefit for income taxes of \$0.9 million, respectively. The income taxes recorded in the nine months period primarily resulted from accounting treatment following the acquisition of RockWest (now Multicard US), under which deferred tax liabilities of \$0.6 million were netted against the Company's existing deferred tax assets, and a \$0.6 million release of the Company's valuation allowance was recorded in the second quarter of 2010.

Liquidity and Capital Resources

As of the nine months ended September 30, 2011, our working capital, which we have defined as current assets less current liabilities, was approximately \$19.4 million, compared to approximately \$9.3 million as of December 31, 2010, an increase of approximately \$10.1 million. The increase in working capital for the first nine months of 2011 reflects a \$6.9 million increase in cash and cash equivalents, a \$1.1 million increase in income taxes receivable and other current assets, an aggregate \$5.3 million decrease in accounts payable, mortgage loan and line of credit, debt note and accrued expenses, offset by an aggregate \$2.2 million increase in accrued compensation and related benefits, deferred revenue, income taxes payable and liabilities to related parties and a \$1.0 million decrease of accounts receivable and inventories.

Cash and cash equivalents were \$17.7 million as of September 30, 2011, an increase of approximately \$6.9 million compared to \$10.8 million as of December 31, 2010 as a result of the addition of approximately \$18.2 million in proceeds from our common stock offering, approximately \$1.1 million in proceeds from the exercise of common stock warrants and stock options, partly offset by approximately \$5.2 million used for the acquisitions of idOnDemand and polyright, approximately \$0.9 million used for capital expenditures primarily related to adding Transponder manufacturing capacity, a total of approximately \$1.5 million for payments on a debt note, mortgage loan and bank line of credit, and approximately \$4.8 million used for acquisition, transition and integration costs, and to fund working capital.

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The following summarizes our cash flows for the nine months ended September 30, 2011 and 2010 (in thousands):

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2011 | 2010 |
| Cash used in operating activities from continuing operations | \$ (5,529) | \$ (4,753) |
| Cash used in operating activities from discontinued operations | | (778) |
| Cash (used in) provided by investing activities | (6,051) | 5,258 |
| Cash provided by financing activities | 17,881 | 1,844 |
| Effect of exchange rate changes on cash and cash equivalents | 620 | (236) |
| | | |
| Increase (decrease) in cash and cash equivalents | 6,921 | 1,335 |
| Cash and cash equivalents at beginning of period | 10,799 | 4,836 |
| | | |
| Cash and cash equivalents at end of period | \$ 17,720 | \$ 6,171 |

Significant commitments that will require the use of cash in operating activities in future periods include obligations under operating leases, liability to a related party, a debt note, a mortgage bank loan, inventory purchase commitments and other contractual agreements. Gross committed lease obligations were approximately \$5.5 million, the mortgage bank loan was approximately \$0.9 million, the debt note was approximately \$1.5 million, liability to related party was approximately \$8.5 million and inventory and other and purchase commitments were approximately \$10.1 million at September 30, 2011. Total commitments due for the remainder of fiscal 2011 were approximately \$8.9 million and commitments due thereafter were approximately \$6.6 million at September 30, 2011.

The cash used in investing activities primarily reflects cash payment of approximately \$5.2 million for the acquisition of idOnDemand and polyright and approximately \$0.9 million spent for capital expenditures.

Cash provided by financing activities primarily reflects \$18.2 million in net proceeds from our common stock offering, approximately \$1.1 million in proceeds from the exercise of common stock warrants and stock options, and \$1.5 million paid on a debt note, mortgage loan and net cash paid on bank line of credit.

We currently expect that our current capital resources, including existing cash, cash equivalents, anticipated cash flows from operating activities, savings from our continued cost reduction activities, and available borrowings should be sufficient to meet our operating and capital requirements through at least the next twelve months. Our plans may be adversely impacted if we fail to realize our assumed levels of revenues and expenses or savings from our cost reduction activities. If these events occur, we may need to raise additional funds through additional debt or equity financings. The sale of additional debt or equity securities may cause dilution to existing stockholders. If sufficient funds are not available or are not available on acceptable terms, our ability to address any unexpected changes in our funding plan, to take advantage of unexpected business opportunities or to respond to competitive pressures could be limited or severely constrained. Furthermore, there can be no assurance that we will be able to raise such funds if and when they are required. Failure to obtain future funding when needed or on acceptable terms would materially adversely affect our results of operations.

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Critical Accounting Policies and Estimates

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

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

During the three and nine months ended September 30, 2011, management believes there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2010, except the following due to newly adopted accounting pronouncements and changes in our business strategy:

Revenue Recognition We derive revenue from sales of products and services, primarily from sales of hardware products, and to a lesser extent, from the license of proprietary software products and sales of service contracts. Revenue is generated from sales to direct end-users and to distributors. Revenue arrangements may include one of these single elements, or may incorporate one or more elements in a single transaction or combination of related transactions. Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements* (ASU 2009-13) affects accounting and reporting for all multiple-deliverable arrangements. We recognize revenue from the sale of hardware products to direct end-users and distributors pursuant to Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition* (ASC 605). Accordingly, revenue from product sales is recognized upon product shipment, provided that risk and title have transferred, a purchase order has been received, the sales price is fixed and determinable and collection of the resulting receivable is probable. There are no formal customer acceptance terms or further obligations related to the sale of hardware products, outside of our standard product warranty. Provisions for estimated warranty repairs and returns and allowances are provided for at the time of sale.

Certain sales of our hardware products are bundled with our software products. In such arrangements, both the software and hardware products are delivered simultaneously. We account for software sales in accordance with ASC Subtopic 985-605, *Software-Revenue Recognition* (ASC 985-605), whereby the revenue from the sale of software products is recognized at the time the software is delivered to the customer, provided all the revenue recognition criteria noted above have been met. All proprietary application software sold by the Company is not essential to the functionality of the security hardware. Therefore, in multiple-element arrangements containing hardware and software, the hardware elements are excluded from ASC 985-605 and are accounted for in accordance with ASU 2009-13. Revenue from such bundled arrangements is generally recognized upon delivery of the hardware products, assuming all other basic revenue recognition criteria are met, as both the hardware and software products are simultaneously delivered elements and no undelivered elements exist. Certain sales of our hardware products are bundled with our installation services and maintenance contracts. For transactions entered into subsequent to the adoption of ASU 2009-13 that include multiple elements, arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy as required by ASU 2009-13. In such bundled arrangements, the revenue from hardware products is generally recognized upon delivery, assuming all other basic revenue recognition criteria are met. The revenue from installation contracts is recognized upon completion of such services which happens within a short period after the delivery of hardware products and the revenue from maintenance contracts is deferred and amortized ratably over the period of the maintenance contracts.

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

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ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable in revenue arrangements. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, or our best estimated selling price (ESP) if neither VSOE nor TPE are available. We then recognize revenue on each deliverable in accordance with our policies for product and service revenue recognition. VSOE of fair value is based on the price charged when the element is sold separately. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. The best estimate of selling price is established considering multiple factors including, but not limited to, pricing practices in different geographies and through different sales channels, gross margin objectives, internal costs, competitor pricing strategies, and industry technology lifecycles. Some of our products contain a significant element of proprietary technology and our solutions offer substantially different features and functionality; as a result, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as we are unable to reliably determine what competitors products' selling prices are on a stand-alone basis, we typically are not able to determine TPE for such products. Therefore ESP is used for such products in the selling price hierarchy for allocating the total arrangement consideration. We evaluate each deliverable in an arrangement to determine whether they represent separate units of accounting in accordance with the provisions of ASU 2009-13. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. Allocation of the consideration is determined at arrangement inception on the basis of each unit's relative selling price.

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

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

The reporting units are identified in accordance with ASC 350-20-35-33 through 35-46. Prior to January 1, 2011, our reporting units were the Hirsch and Multicard businesses in the Identity Management reporting segment, and the SCM, Tagstar (including Smartag), ACiG and Syscan businesses in the ID Products reporting segment. Following the acquisition of Smartag, we began to reallocate its internal resources to our existing reporting units. During the first quarter of 2011, we implemented a new management structure to unify our sourcing, production and sales activities for our RFID components business. As a result, we combined the TagStar (including Smartag) and ACiG reporting units into a new reporting unit called Transponders and, in accordance with ASC 350-20-35-45, the goodwill assigned to the ACiG reporting unit is now reassigned to the Transponder reporting unit. As discussed in Note 3 above, we recorded goodwill of \$7.8 million in connection with our acquisition of idOnDemand and \$2.7 million in connection with our acquisition of polyright during the nine months ended September 30, 2011 and we are in the process of assigning the reporting unit for this goodwill amount. The recorded goodwill in connection with the acquisition of polyright is designated in currency other than United States Dollars and is valued at \$2.4 million as of September 30, 2011 for the change in foreign exchange rates from the acquisition date. As of September 30, 2011, of the total goodwill of \$48.8 million (excluding goodwill recorded in connection with idOnDemand and polyright acquisitions), \$21.9 million was allocated to the Hirsch reporting unit, \$17.1 million to Multicard, \$1.3 million to SCM, \$7.1 million to Transponders, \$1.4 million to the Syscan reporting unit.

Recent Accounting Pronouncements

See Note 2, *Summary of Significant Accounting Policies*, in the Notes to Condensed Consolidated Financial Statements in Item 1 of Part I of this Quarterly Report on Form 10-Q, for a full description of recent accounting pronouncements, including the actual and expected dates of adoption and estimated effects on our consolidated results of operations and financial condition, which is incorporated herein by reference.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

There has been no significant change in our exposure to market risk during the three months ended September 30, 2011. For discussion of the Company's exposure to market risk, refer to Item 7A. Quantitative and Qualitative Disclosures About Market Risk, contained in our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

As of the end of the fiscal quarter ended September 30, 2011, the Company carried out an evaluation, as required in Rule 13a-15(b) under the Exchange Act, under the supervision and with the participation of members of our senior management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act.

Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of September 30, 2011, our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls over Financial Reporting

In connection with our continued monitoring and maintenance of our controls procedures as part of the implementation of section 404 of the Sarbanes-Oxley Act of 2002, we continue to review, revise and improve the effectiveness of our internal controls. There were no changes to our internal control over financial reporting, as defined in Rules 13a-15(e) and 15(d)-15(e) under the Exchange Act, during the three months ended September 30, 2011 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A. Risk Factors, of our Annual Report on Form 10-K for the fiscal year ending December 31, 2010.

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

None

Item 3. Defaults upon Senior Securities

None

Item 4. Removed and Reserved

None.

Item 5. Other Information

None

Item 6. Exhibits

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

IDENTIVE GROUP, INC.

November 10, 2011

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

November 10, 2011

By: /s/ MELVIN DENTON-THOMPSON
Melvin Denton-Thompson
Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)

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| Exhibit Number | Description |
|-----------------------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Pursuant to Rule 406T of Regulation S-T, the interactive files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.