IDENTIVE GROUP, INC.
Form 10-Q
August 16, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from ______ to ______

COMMISSION FILE NUMBER: 0-29440

IDENTIVE GROUP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	**77-0444317**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**(I.R.S. EMPLOYER IDENTIFICATION NUMBER)**

1900 Carnegie Avenue, Building B

Santa Ana, California 92705

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES INCLUDING ZIP CODE)

(949) 250-8888

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller Reporting Company	x

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

At August 12, 2010, 43,893,951 shares of common stock were outstanding, including 618,400 shares held in treasury.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net revenue	$ 21,178	$ 10,961	$ 36,524	$ 16,116
Cost of revenue	11,334	5,194	19,943	8,146
Gross profit	9,844	5,767	16,581	7,970
Operating expenses:				
Research and development	1,062	1,304	2,478	1,923
Selling and marketing	4,962	3,111	10,054	4,968
General and administrative	5,405	3,208	10,860	6,322
Restructuring and other charges	73		337	
Gain on sale of assets				(249)
Total operating expenses	11,502	7,623	23,729	12,964
Loss from operations	(1,658)	(1,856)	(7,148)	(4,994)
Loss on equity investments		(281)		(570)
Interest (expense) income, net	(215)	(125)	(446)	(99)
Foreign currency (losses) gains, net	(248)	(87)	(562)	166
Loss from continuing operations before income taxes and noncontrolling interest	(2,121)	(2,349)	(8,156)	(5,497)
Benefit for income taxes	1,066	1,739	905	1,740
Loss from continuing operations	(1,055)	(610)	(7,251)	(3,757)
Less: Net loss attributable to noncontrolling interest	196		417	
Loss from continuing operations attributable to Identive Group, Inc.	(859)	(610)	(6,834)	(3,757)
Gain from discontinued operations, net of income taxes	130	84	10	151
Gain on sale of discontinued operations, net of income taxes	40	38	83	75
Net loss attributable to Identive Group, Inc.	$ (689)	$ (488)	$ (6,741)	$ (3,531)
Basic and diluted loss per share attributable to Identive Group, Inc.:				
Loss from continuing operations	$ (0. 02)	$ (0. 03)	$ (0.17)	$ (0.20)
Income from discontinued operations	$ 0.00	$ 0.01	$ 0.00	$ 0.01

Net loss per share	$ (0.02)	$ (0.02)	$ (0.17)	$ (0.19)
Weighted average shares used to compute basic and diluted loss per share	42,668	22,039	41,211	18,891

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(unaudited)

	June 30, 2010	December 31, 2009 (A)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,563	$ 4,836
Accounts receivable, net of allowances	10,618	6,739
Inventories, net	7,202	5,379
Income taxes receivable	614	274
Other current assets	2,475	1,647
Total current assets	25,472	18,875
Property and equipment, net	4,149	683
Goodwill	42,695	21,895
Intangible assets, net	34,534	22,082
Other assets	367	1,036
Total assets	$ 107,217	$ 64,571
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,811	$ 5,530
Bank line of credit	308	
Liability to related party	1,034	1,027
Accrued compensation and related benefits	3,033	2,884
Mortgage loan payable to bank	52	
Other accrued expenses and liabilities	7,292	5,132
Income taxes payable		188
Total current liabilities	22,530	14,761
Long-term liability to related party	7,767	7,899
Long-term mortgage loan payable to bank	800	
Deferred tax liability	4,390	3,515
Long-term income taxes payable	770	456
Total liabilities	36,257	26,631
Commitments and contingencies (see Notes 12 and 14)		
Equity:		
Identive Group, Inc. Stockholders equity:		
Common stock, $0.001 par value: 110,000 shares authorized; 43,894 and 25,753 shares issued as of June 30, 2010 and December 31, 2009, respectively	44	26
Additional paid-in capital	295,953	253,910
Treasury stock, 618 as of June 30, 2010 and December 31, 2009	(2,777)	(2,777)
Accumulated deficit	(223,119)	(216,378)
Other accumulated comprehensive (loss) income	(1,322)	3,159

Total Identive Group, Inc. Stockholders equity	68,779	37,940
Noncontrolling interest	2,181	
Total Equity	70,960	37,940
Total liabilities and equity	$ 107,217	$ 64,571

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

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE LOSS

Year Ended December 31, 2009 and Six Months Ended June 30, 2010

(unaudited)

	Identive Group, Inc. Stockholders								
	Common Stock		Additional Paid-in	Treasury	Accumulated	Other Accumulated Comprehensive Income	Noncontrolling	Total	Comprehensive
(In thousands)	**Shares**	**Amount**	**Capital**	**Stock**	**Deficit**	**(Loss)**	**Interest**	**Equity**	**Loss**
Balances, December 31, 2008	16,362	$ 16	$ 229,788	$ (2,777)	$ (202,199)	$ 3,298	$	$ 28,126	
Issuance of common stock in connection with acquisition	9,391	10	23,775					23,785	
Stock-based compensation expense			347					347	
Comprehensive loss:									
Net loss					(14,179)			(14,179)	$ (14,179)
Foreign currency translation adjustment						(139)		(139)	(139)
Comprehensive loss									$ (14,318)
Balances, December 31, 2009	25,753	$ 26	$ 253,910	$ (2,777)	$ (216,378)	$ 3,159	$	$ 37,940	
Issuance of common stock in connection with Bluehill ID acquisition	15,300	15	34,562					34,577	
Issuance of common stock in connection with RockWest acquisition	2,600	3	4,196					4,199	
Issuance of stock options in connection with Bluehill ID acquisition			3,007					3,007	
Repurchase of Identive treasury stock in connection with Bluehill ID acquisition				(2,880)				(2,880)	
Issuance of common stock			(402)	2,880				2,478	
Issuance of common stock for executive bonus	60		100					100	
Issuance of common stock to affiliates for conversion of loan	181		291					291	
Noncontrolling interest in a subsidiary							3,057	3,057	
Stock-based compensation expense			289					289	
Comprehensive loss:									

Net loss					(6,741)		(417)	(7,158)	$ (7,158)
Foreign currency translation adjustment						(4,481)	(459)	(4,940)	(4,940)
Comprehensive loss									$ (12,098)
Balances, June 30, 2010	43,894	$ 44	$ 295,953	$ (2,777)	$ (223,119)	$ (1,322)	$ 2,181	$ 70,960	

See notes to condensed consolidated financial statements.

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended June 30, 2010	2009
Cash flows from operating activities:		
Net loss	$ (7,158)	$ (3,531)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss (gain) from discontinued operations	(93)	(225)
Deferred income taxes	(605)	(1,935)
Depreciation and amortization	2,335	351
Gain on disposal of property and equipment		(249)
Accretion of liability to related party discount	389	
Stock-based compensation expense	450	191
Interest on bank line of credit and mortgage loan	36	
Loss on equity investments		570
Changes in operating assets and liabilities:		
Accounts receivable	(774)	1,798
Inventories	38	(901)
Other assets	(854)	35
Income taxes receivable		319
Accounts payable	2,349	338
Liability to related party	(559)	132
Accrued expenses	(1,964)	(1,193)
Other liabilities		6
Income taxes payable	(195)	(19)
Net cash used in operating activities from continuing operations	(6,605)	(4,313)
Net cash (used in) provided by operating activities from discontinued operations	(430)	401
Net cash used in operating activities	(7,035)	(3,912)
Cash flows from investing activities:		
Capital expenditures	(502)	(246)
Cash paid for Hirsch acquisition		(14,167)
Cash acquired in acquisitions	4,881	3,275
Proceeds from sale of assets, net		249
Maturities of short-term investments	1,015	
Net cash provided by (used in) investing activities	5,394	(10,889)
Cash flows from financing activities:		
Payment on mortgage loan	(26)	
Payment on bank line of credit, net	(146)	
Issuance of common stock	1,936	
Net cash provided by financing activities	1,764	

Effect of exchange rates on cash and cash equivalents	(396)	(440)
Net decrease in cash and cash equivalents	(273)	(15,241)
Cash and cash equivalents at beginning of period	4,836	20,550
Cash and cash equivalents at end of period	$ 4,563	$ 5,309

See notes to condensed consolidated financial statements.

IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Identive Group, Inc. (Identive or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of Company s unaudited condensed consolidated financial statements have been included. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or any future period. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. The preparation of unaudited condensed consolidated financial statements necessarily requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

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

Reclassifications

During the three and six months ended June 30, 2010, the Company reclassified certain general and administration costs, that were previously recorded as cost of revenues. Accordingly, $0.2 million and $0.3 million of costs reported in the three and six months ending June 30, 2009 have been reclassified from cost of revenues to general and administration to conform to the current period s presentation. In addition, the Company reclassified certain amounts of research and development and sales and marketing to general and administration for three and six months ended June 30, 2009 to conform to the current period s presentation. The reclassification did not impact the Company s previously reported net revenues, segment results, operating income, net income, or earnings per share.

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

Discontinued Operations

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

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

Recent Accounting Pronouncements and Accounting Changes

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

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

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

2. Acquisitions

Acquisition of RockWest

The Company completed the acquisition of RockWest on April 14, 2010 (the RockWest acquisition date), pursuant to a Share Purchase Agreement between the Company, RockWest and certain sellers of RockWest dated March 30, 2010 and amended April 9, 2010 (the Share Purchase Agreement). RockWest provides ID management solutions and services to the education, government, corporate, casino and healthcare markets in the U.S. RockWest is based in Denver, Colorado, with branch offices in California, Arizona and New Mexico, employing approximately 43 people. The Company believes that RockWest s focus on identity credential issuance and personalization and identification system integration complements the Company s focus on providing identity management solutions. RockWest is expected to be integrated into the Company s Multicard business in the second half of 2010 and provide a portal for Multicard s entry into the U.S. marketplace.

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

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

Fair value of common stock	$ 4,199

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

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

The fair value of the shares of the Company s common stock issued in connection with the acquisition was determined using the closing market price of the Company s common stock as of the RockWest acquisition date of $1.90 per share and then discounted to reflect the restriction on the sale of shares as may be the case under Rule 144 of the Securities and Exchange Commission. The fair value of the earn-out consideration was based on achieving certain revenue and profit targets as defined under the Share Purchase Agreement. These contingent payments were probability weighted and also discounted to reflect the restriction on the sale of shares.

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

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

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

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

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

Of the total purchase consideration, $2.9 million was recognized as goodwill which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the RockWest acquisition is largely attributable to the synergies expected to be realized and is assigned to the Company s Identity Management Solutions & Services reportable segment in accordance with ASC Topic 350 *Intangibles Goodwill and Other* (ASC 350). None of the goodwill recorded as part of the RockWest acquisition will be deductible for United States federal income tax purposes.

Deferred tax assets and liabilities resulting from the acquisition of RockWest have been netted, where applicable. As a result, deferred tax liabilities of $0.6 million have been considered in the purchase price allocation. Following the RockWest acquisition, RockWest has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $0.6 million, as described above, has been netted with the Company s existing deferred tax assets. The carrying value of the

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

Company s net deferred tax assets reflects that the Company has been unable to generate sufficient taxable income in certain tax jurisdictions. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefit, or that future deductibility is uncertain. As a result of netting the deferred tax liability of $0.6 million with the Company s existing deferred tax assets, there is a $0.6 million release of the Company s valuation allowance. In accordance with ASC 805, the release of the valuation allowance was booked as a tax benefit in the 2010 second quarter financial statements.

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

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

Revenues	$ 2,067
Net loss	$ 96

Acquisition of Bluehill ID

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

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

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

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

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

Fair value of common stock	$ 34,577
Fair value of options converted	3,007
Fair value of total consideration transferred	37,584
Fair value of noncontrolling interest	3,057
Fair value of controlling and noncontrolling interest	40,641
Fair value of Bluehill ID net identifiable assets acquired	(19,665)
Goodwill	$ 20,976

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

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

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

Cash and cash equivalents	$ 4,266
Short-term investments	1,080
Accounts receivable	2,914
Inventories	1,554
Other current assets	623
Property and equipment	4,136
Mortgage loan line of credit payable to bank	(1,382)
Accounts payable	(2,653)
Capital lease obligations	(753)
Liability to related party	(357)

Accrued expenses and other liabilities	(4,995)
Income taxes payable	(548)
Amortizable intangible assets:	
Developed technology	784
Customer relationships	10,918
Order backlog	734
Intangible assets with indefinite lives (not subject to amortization):	
Trade names	1,491
Deferred tax liabilities in connection with acquired intangible assets and inventory fair value adjustment, net	(1,027)
	16,785
Fair value of Bluehill s investment in the Company s common stock	2,880
Fair value of Bluehill ID net identifiable assets acquired	$ 19,665

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IDENTIVE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

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

Of the total purchase consideration, $21.0 million was recognized as goodwill, which represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net assets acquired and liabilities assumed. The goodwill arising from the Bluehill ID acquisition is largely attributable to the synergies expected to be realized. Bluehill ID s results are included in both of the Company s two reportable segments, Identity Management Solutions & Services and Identification Products & Components. The Company is in the process of determining the amount of goodwill that will be assigned to various reporting units as required in accordance with ASC Topic 350. None of the goodwill recorded as part of the Bluehill ID acquisition will be deductible for United States federal income tax purposes.

The Company recognized $0.7 million and $1.0 million of acquisition-related costs of Bluehill ID that were expensed in the three and six months ended June 30, 2010, respectively. These costs are included as a part of general and administration costs in the condensed consolidated statement of operations.

Deferred tax assets and liabilities resulting from the acquisition of Bluehill ID have been netted, where applicable. As the identified intangible asset trade names has an indefinite life, the deferred tax liability of $0.3 million relating to the value of the trade names cannot be offset with deferred tax assets with a definite life. Resulting from these procedures, deferred tax liabilities of $0.7 million after netting with deferred tax assets and $0.3 million deferred tax liabilities relating to the indefinite life intangible asset have been considered in the purchase price allocation.

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

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

Revenues	$ 4,973
Net loss	$ 2,407

Acquisition of Hirsch

The Company completed the acquisition of Hirsch on April 30, 2009 (the Hirsch acquisition date). In exchange for all of the outstanding capital stock of Hirsch, the Company paid approximately $14.2 million in cash, issued approximately 9.4 million shares of the Company s common stock, and issued warrants to purchase approximately 4.7 million shares of the Company s common stock at an exercise price of $3.00 with a five-year term. In addition, each warrant to purchase shares of Hirsch common stock outstanding immediately prior to the effective date of the Hirsch acquisition was converted into a warrant to purchase shares of the Company s common stock. Immediately following the close of the transaction, approximately 37% of the outstanding shares of the Company were held by the former Hirsch shareholders. Hirsch s results are included in the Company s reportable segment, Identity Management Solutions and Services.

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The Hirsch acquisition was accounted for under the acquisition method of accounting under ASC 805. 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 calculate the fair value of certain components of the consideration transferred and to measure the identifiable intangible assets acquired and liabilities to related parties assumed. The total purchase consideration was determined to be $38.0 million as of the Hirsch acquisition date. The fair value of the shares of the Company s common stock issued in connection with the Hirsch acquisition was determined using the closing price of the Company s common stock as of the Hirsch acquisition date of $2.37 per share.

The Company recognized identified intangible assets of $22.8 million which consisted of core technology, trade names and customer relationships and goodwill of $21.9 million was allocated to the Hirsch reporting unit which is included in the ID Management Solutions and Services reporting segment. The Company expects to amortize developed technology and customer relationships on a straight-line basis over their expected useful life of 15 years.

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

Following the Hirsch acquisition, Hirsch Electronics LLC has become part of the U.S. tax group of the Company s entities. Accordingly, the deferred tax liability of $1.7 million, as described above, has been netted with the Company s existing deferred tax assets. The carrying value of the Company s net deferred tax assets reflects that the Company has been unable to generate sufficient taxable income in certain tax jurisdictions. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefit, or that future deductibility is uncertain. As a result of netting the deferred tax liability of $1.7 million with the Company s existing deferred tax assets, there is a $1.7 million release of the Company s valuation allowance. In accordance with ASC 805, the release of the valuation allowance was booked as a tax benefit in the 2009 second quarter financial statements.

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

Revenues	$ 4,573
Net income	$ 1,838

Pro forma financial information:

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues	$ 21,178	$ 19,128	$ 37,936	$ 35,742
Net loss attributable to Identive Group, Inc.	(689)	(8,746)	(7,162)	(14,653)
Weighted average common shares outstanding used in loss per common share - basic and diluted	42,668	39,939	41,211	36,791
Net loss per common share - basic and diluted	$ (0.02)	$ (0.22)	$ (0.17)	$ (0.40)

3. Fair Value Measurements

The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is defined as the price that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value: ASC Topic 820 *Fair Value Measurement and Disclosures* (ASC 820)

Level 1 Quoted prices for identical instruments in active markets;

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

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

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

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

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

	June 30, 2010				December 31, 2009			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Money market fund deposits	$ 221	$	$	$ 221	$ 1,327	$	$	$ 1,327

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

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

	June 30, 2010				December 31, 2009			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Goodwill	$	$	$ 42,695	$ 42,695	$	$	$ 21,895	$ 21,895
Acquired intangibles			34,534	34,534			22,082	22,082
Total:	$	$	$ 77,229	$ 77,229	$	$	$ 43,977	$ 43,977

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

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

4. Shareholders Equity of Identive Group, Inc.

Stock Option Plans

The Company has a stock-based compensation program that provides its Board of Directors discretion in creating employee equity incentives. This program includes incentive and non-statutory stock options under various plans, the majority of which are stockholder approved. Stock options are generally time-based and expire seven to ten years from the date of grant. Vesting varies, with some options vesting 25% each year over four years; some vesting 1/12th 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 Company had a Director Option Plan and a 1997 Stock Option Plan, both of which expired in March 2007, and as a result, options can no longer be granted under these plans. As of June 30, 2010, an aggregate of approximately 0.5 million granted options were outstanding under these two plans which remain exercisable in accordance with the terms of the original grant agreements. In addition, the Company has a 2000 Stock Option Plan, pursuant to which options to purchase 0.7 million shares of the Company s common stock may be granted. As of June 30, 2010, 0.4 million granted options were outstanding under the 2000 Stock Option Plan. In November 2007, the Company s Board of Directors and stockholders approved the 2007 Stock Option Plan, pursuant to which options to purchase 1.5 million shares of our common stock may be granted. In October 2009, stockholders approved an increase of 2.0 million shares to the number of shares of common stock reserved for issuance under the 2007 Stock Option Plan, resulting in an aggregate of 3.5 million shares available for grant. As of June 30, 2010, 1.1 million granted options were outstanding under the 2007 Stock Option Plan.

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

	Available for Grant	Number of Options Outstanding	Weighted Average Exercise Price per share	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (in years)
Balance at December 31, 2009	2,487,374	2,345,271	$ 4.57	$ 21,736	5.48
Options granted	(46,750)	46,750	$ 2.01		
Options cancelled or expired	450,582	(431,310)	$ 5.01		
Balance at June 30, 2010	2,891,206	1,960,711	$ 4.64	$ 10,263	4.91
Vested or expected to vest at June 30, 2010		2,095,015	$ 4.52	$ 9,152	4.86
Exerciseable at June 30, 2010		1,096,321	$ 6.12	$ 2,012	3.85

The weighted-average grant date fair value per option for options granted during the three and six months ended June 30, 2010 was $1.29 and $1.36, respectively. The weighted-average grant date fair value per option for options granted during both the three and six months ended June 30, 2009 was $1.35. During the three and six months ended June 30, 2010 and 2009, no options were exercised. At June 30, 2010, there was $1.0 million of unrecognized stock-based compensation expense, net of estimated forfeitures related to non-vested options, that is expected to be recognized over a weighted-average period of 2.3 years.

Stock Bonus and Incentive Plans

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

An aggregate of 3.0 million shares of our common stock may be issued under the 2010 Plan as equity-based awards, including shares, nonqualified stock options, restricted stock or deferred stock awards. The shares issued pursuant to equity awards granted under this 2010 Plan may be shares that are authorized and unissued or shares that were reacquired by the Company, including shares purchased in the open market. During the three and six months ending June 30, 2010, 60,000 shares were issued pursuant to the 2010 Plan as disclosed in the statements of stockholders equity.

In addition, the Company assumed the Bluehill ID AG Executive Share Option Plan and the Bluehill ID AG Executive Bonus Plan (the Bluehill Plans) in connection with its acquisition of Bluehill ID AG in January 2010. An aggregate of 2.1 million shares of our common stock may be issued under the Bluehill Plans to executives, key employees and other service providers to Bluehill ID, including our Chief Executive Officer and Chief Financial Officer, based upon the achievement of certain performance targets or other terms and conditions as determined by the administrator of the plans.

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Stock-Based Compensation Expense

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cost of revenue	$ 5	$ 7	$ 10	$ 13
Research and development	16	16	33	27
Selling and marketing	58	44	119	74
General and administrative	63	63	127	77
Stock-based compensation expense before income taxes	$ 142	$ 130	$ 289	$ 191
Income tax benefit	0	0	0	0
Stock-based compensation expense after income taxes	$ 142	$ 130	$ 289	$ 191

During the second quarter of 2010, the Compensation Committee granted incentive bonus awards to certain executive officers, including the CEO and CFO, under our 2010 Bonus and Incentive Plan. These awards provide the executives with the opportunity to earn shares of common stock depending on the extent to which certain performance goals are met. For services rendered, the executives shall be paid an incentive bonus to be received 50% in cash and 50% in shares of the Company with certain lock-up periods. During the three and six months ended June 30, 2010, the Company recognized $161,000 for the 50% portion of the bonus payable in shares as stock-based compensation expense and $161,000 for the 50% portion of the bonus payable in cash pursuant to the 2010 Plan and Bluehill Plans described above and has been included in general and administration expenses in the condensed consolidated statement of operations.

Comprehensive Loss Attributable to Identive Group, Inc.

Comprehensive loss consists of the following (in thousands):

	Three Months Ended June 30 2010	Three Months Ended June 30 2009	Six Months Ended June 30 2010	Six Months Ended June 30 2009
Net loss	$ (885)	$ (488)	$ (7,158)	$ (3,531)
Other comprehensive loss				