L-1 IDENTITY SOLUTIONS, INC.
Form 10-Q
May 09, 2007

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 March 31, 2007.

OR

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

For the Transition Period from _______ to _______.

Commission File Number 001-21559

L-1 IDENTITY SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**04-3320515** **(I.R.S. Employer Identification No.)**
177 Broad Street, 12th Floor, Stamford, CT **(Address of principal executive offices)**	**06901** **(Zip Code)**

(203) 504-1100
Registrant s telephone number, including area code

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

Indicate by a check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

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

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

Class	Outstanding at May 8, 2007

Common stock, $.001 par value	72,841,528

L-1 IDENTITY SOLUTIONS, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2007

INDEX

PART 1 FINANCIAL INFORMATION

ITEM 1 UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

L-1 IDENTITY SOLUTIONS, INC.

Condensed Consolidated Balance Sheets

(in thousands)

(Unaudited)

	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 4,077	$ 4,993
Accounts receivable, net	54,094	61,513
Inventory	14,078	10,967
Other current assets	4,135	4,529
Total current assets	76,384	82,002
Property and equipment, net	20,025	19,928
Goodwill	972,455	951,443
Intangible assets, net	168,046	170,098
Other assets, net	4,714	3,754
Total assets	$ 1,241,624	$ 1,227,225
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 53,958	$ 54,807
Current portion of deferred revenue	11,732	10,331
Other current liabilities	4,918	5,206
Total current liabilities	70,608	70,344
Deferred tax liability	5,435	4,394
Deferred revenue, net of current portion	3,977	3,734
Long-term debt	98,000	80,000
Other long-term liabilities	966	1,668
Total liabilities	178,986	160,140
Shareholders equity	1,062,638	1,067,085
Total liabilities and shareholders equity	$ 1,241,624	$ 1,227,225

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

L-1 IDENTITY SOLUTIONS, INC.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(Unaudited)

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
Revenues	$ 70,007	$ 23,438
Cost of revenues:		
Cost of revenues	46,177	15,171
Amortization of purchased intangible assets	6,474	1,868
Total cost of revenues	52,651	17,039
Gross Profit	17,356	6,399
Operating expenses:		
Sales and marketing	5,461	2,369
Research and development	4,661	1,611
General and administrative	12,817	4,577
Amortization of purchased intangible assets	431	117
Total operating expenses	23,370	8,674
Operating Loss	(6,014)	(2,275)
Interest income	67	671
Interest expense	(1,771)	(6)
Other (expense) income, net	(25)	17
Loss before income taxes	(7,743)	(1,593)
Provision for income taxes	(1,088)	(565)
Net Loss	$ (8,831)	$ (2,158)
Basic and diluted net loss per share	$ (0.12)	$ (0.07)
Weighted average basic and diluted common shares outstanding	72,540	29,008

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

L-1 IDENTITY SOLUTIONS, INC.

Condensed Consolidated Statements of Changes in Shareholders Equity and Comprehensive Loss

(In thousands)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total	Comprehensive Loss
Balance, January 1, 2006	$ 29	$ 333,456	$ (56,427)	$ (2,398)	$ 274,660	
Exercise of employee stock options	1	7,180			7,181	
Common stock issued for directors fees		288			288	
Common stock issued under employee stock purchase plan		53			53	
Common stock issued for acquisition, net of issuing costs	43	769,931			769,974	
Fair value of vested stock options and warrants assumed for acquisition		35,103			35,103	
Retirement plan contributions paid in common stock		288			288	
Stock-based compensation expense		7,492			7,492	
Comprehensive loss:						
Foreign currency translation adjustment				3,083	3,083	$ 3,083
Net loss			(31,037)		(31,037)	(31,037)
Comprehensive loss						$ (27,954)
Balance, December 31, 2006	73	1,153,791	(87,464)	685	1,067,085	
Exercise of employee stock options		1,706			1,706	
Common stock issued for directors fees		136			136	
Common stock issued under employee stock purchase plan		511			511	
Retirement plan contributions paid in common stock		148			148	
Stock-based compensation expense		1,781			1,781	
Comprehensive loss:						
Foreign currency translation adjustment				102	102	$ 102
Net loss			(8,831)		(8,831)	(8,831)

Comprehensive loss						$ (8,729)
Balance, March 31, 2007	$ 73	$ 1,158,073	$ (96,295)	$ 787	$ 1,062,638	

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

L-1 IDENTITY SOLUTIONS, INC.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three Months Ended	
	March 31, 2007	March 31, 2006
Cash Flow from Operating Activities:		
Net loss	$ (8,831)	$ (2,158)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	9,060	4,094
Stock-based compensation expense	2,579	659
Retirement plan contributions paid in common stock	148	
Deferred income taxes	1,041	508
Amortization of deferred financing costs	134	
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	10,244	(373)
Inventory	(1,800)	(862)
Other assets	(172)	(969)
Accounts payable and accrued expenses	(10,174)	1,877
Deferred revenue	(836)	925
Net cash provided by operating activities	1,393	3,701
Cash Flow from Investing Activities:		
Cash paid for acquisitions, net of cash acquired	(20,441)	(29,362)
Capital expenditures	(1,817)	(1,311)
Other assets	(65)	
Net cash used in investing activities	(22,323)	(30,673)
Cash Flow from Financing Activities		
Borrowings under revolving credit agreement, net	18,000	
Principal payments on long-term debt	(59)	(131)
Financing costs	(106)	
Proceeds of issuance of common stock and warrants	2,105	1,159
Net cash provided by financing activities	19,940	1,028
Effect of exchange rate changes on cash and cash equivalents	74	(13)
Net decrease in cash and cash equivalents	(916)	(25,957)
Cash and cash equivalents, beginning of period	4,993	72,385

Cash and cash equivalents, end of period	$ 4,077	$ 46,428
Supplemental Cash Flow Information:		
Cash paid for interest	$ 1,511	$ 7
Cash paid for income taxes	$ 790	$ 317

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

6

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

1. DESCRIPTION OF BUSINESS

L-1 Identity Solutions, Inc. and its subsidiaries (L-1 or the Company) provide a full range of identity protection and security solutions that enable governments, law enforcement agencies and businesses to enhance security, reduce identity theft and protect personal privacy. L-1 s identity solutions are specifically designed for the identification of people and include secure credentialing, biometrics, automated document authentication, real-time identity databases, automated testing of identity and identity information, and biometrically-enabled background checks, as well as systems design, development, integration and support services. These identity solutions enable L-1 s customers to manage the entire life cycle of an individual s identity for a variety of applications including civil identification, criminal identification and border management and security. L-1 also provides comprehensive security solutions to the U.S. Government.

The Company operates in two reportable segments: the Identity Solutions segment and the Services segment. The Identity Solutions segment provides biometric and identity solutions to federal, state and local government agencies, foreign governments and commercial entities. The Services segment provides fingerprinting services to federal and state governments and commercial enterprises, primarily financial institutions, as well as comprehensive security solutions to the U.S. intelligence community.

The Company has developed and acquired complimentary technologies and businesses that allow it to offer a full range of secure credentialing and biometric solutions, including facial, fingerprint and iris recognition solutions and technologies to customers, as well as provide security solutions to the U.S. Government.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that in the opinion of management are necessary for a fair presentation of the financial statements for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC) for interim financial statements, and in accordance with SEC rules, omit or condense certain information and footnote disclosures. Results for the interim periods are not necessarily indicative of results to be expected for any other interim period or for the entire year. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

The accompanying condensed consolidated financial statements include the accounts of L-1 and its subsidiaries, all of which are wholly owned. All material intercompany transactions and balances have been eliminated.

Use of Estimates

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

Revenue Recognition

The Company derives its revenue from solutions that include products and services, as well as sales of stand alone services, hardware, components, consumables and software. Identity Solutions revenue includes revenues from maintenance, consulting and training services related to sales of hardware and software solutions. Services revenue includes fingerprinting services and security consulting services. A customer, depending on its needs, may order hardware, equipment, consumables or software products or services or combine hardware products, consumables, equipment, software products and services to create a multiple element arrangement. The Company s revenue recognition policies are described in the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Stock Based Compensation

On January 1, 2006, L-1 adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, which requires share-based payment transactions to be accounted for using a fair value-based method and the recognition of the related expense in the results of operations. L-1 uses the Black-Scholes valuation method to estimate the fair value of option awards. The compensation expense related to share based payments is recognized over the vesting period for awards granted after January 1, 2006 and over the remaining service period for the unvested portion of awards granted prior to January 1, 2006.

Determining the appropriate valuation method and related assumptions requires judgment, including estimating common stock price volatility, forfeiture rates and expected terms. The following weighted average assumptions were utilized in the valuation of stock option awards for the three months ended March 31, 2007 and 2006:

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
Expected common stock price volatility	91.3%	110.0%
Risk free interest rate	4.3%	4.4%
Expected life of options	6.3 Years	6.3 Years
Expected annual dividends		

The expected volatility rate is based on the historical volatility of the Company s common stock. The expected life of options is based on the average life of 6.3 years pursuant to the guidance from Staff Accounting Bulletin No. 107. The Company estimated forfeitures when recognizing compensation expense based on historical rates. The risk free interest rate is based on the 7 year treasury security as it approximates the 6.3 expected life of the options. The Company updates these assumptions on at least an annual basis and on an interim basis if significant changes to the assumptions are warranted.

Stock-based compensation expense was $2.7 million and $0.7 million for the three months ended March 31, 2007 and 2006, respectively, and includes $0.1 million related to restricted stock for both periods and for the 2007 period, approximately $0.1 million of retirement contributions paid in common stock. The Company recognized the full cost impact of the awards issued under its equity incentive plans in the condensed consolidated statements of operations for the three months ended March 31, 2007 and 2006 and did not capitalize any such costs. The following tables presents stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
Cost of revenues	$ 143	$ 85
Research and development	225	97
Sales and marketing	405	171
General and administrative	1,954	306
Stock-based compensation expense	$ 2,727	$ 659

Computation of Net Loss per Share

The basic and diluted net loss per share calculation is computed based on the weighted average number of shares of common stock outstanding during the period. The impact of approximately 4,646,000 and 4,407,000 common equivalent shares for three-month periods ended March 31, 2007 and March 31, 2006, respectively, consisting of all outstanding options and warrants were not reflected in the dilutive net loss per share calculations as their effect would be anti-dilutive.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* , which is effective for fiscal years beginning after December 15, 2006. The interpretation provides that a tax position is recognized if the enterprise determines that it is more likely than not that a tax position will be sustained based on the technical merits of the position, on the presumption that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods and transition. The adoption of Interpretation No. 48 on January 1, 2007 did not have a material impact on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which for the Company will be as of the beginning of 2008. The Company is in the process of evaluating the impact that the adoption of SFAS No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Options for the Financial Assets and Financial Liabilities*, which permits entities to choose to measure certain financial assets and liabilities at fair value. SFAS No. 159 is effective for years beginning after November 15, 2007. The Company has not determined whether it will adopt the fair value option method permitted by SFAS No. 159.

3. STOCK OPTIONS

Stock Options

The following table summarizes the stock option activity from January 1, 2007 through March 31, 2007:

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2007	6,370,051	$ 12.96		
Granted	131,000	15.78		
Exercised	(210,701)	8.96		
Canceled/expired/forfeited	(50,505)	15.93		
Outstanding at March 31, 2007	6,239,845	13.36	6.82	$ 24,702,094
Vested or expected to vest at March 31, 2007 (1)	4,717,323	$ 10.10	6.82	$ 18,674,783
Exercisable at March 31, 2007	3,771,429	$ 12.31	5.28	$ 20,433,087

(1) Options expected to vest are determined by applying the pre-vesting forfeiture rate assumptions to total outstanding options.

The aggregate unearned compensation cost of unvested options outstanding as March 31, 2007 was $20.5 million and will be amortized over a weighted average period of 3.2 years. The total intrinsic value of options exercised during the three months ended March 31, 2007 was $1.5 million. The intrinsic value is calculated as the difference between the market value of the Company s common stock and the exercise price of options.

The recognition of a tax benefit related to the exercise of stock options and subsequent sale of the underlying stock is being deferred per SFAS No. 123(R) and will be recognized when net operating loss carryforwards are fully utilized.

4. INCOME TAXES

The income tax provision for the three month periods ended March 31, 2007 and 2006 includes approximately $1.1 million and $0.5 million, which represent the aggregate increase of a deferred tax asset resulting from losses incurred during the periods, a full valuation allowance against such deferred tax asset, and, pursuant to SFAS No. 109, an additional provision related to the amortization of tax deductible goodwill for which the period of reversal of the related temporary difference is indefinite. This related deferred tax liability cannot be used to offset the deferred tax asset in determining the valuation allowance. The income tax provision also includes state income tax expense for the three month period ended March 31, 2007 of $0.1 million and $0.1million for the three months ended March 31, 2006.

The Company is subject to income tax examinations by U.S. Federal and other jurisdictions for tax years ended, subsequent to December 31, 2002. The condensed financial statements do not include any provision for interest or penalties. In the event interest and penalties are incurred, the Company may make an election to account for interest expense and penalties related for income tax issues as income tax expense.

5. RELATED PARTY TRANSACTIONS

Aston Capital Partners, L.P. (Aston), an affiliate of L-1 Investment Partners LLC, Lau Technologies (Lau), an affiliate of Mr. Denis K. Berube, a member of the board of directors of the Company, and Mr. Buddy Beck, also a member of the board of directors of the Company beneficially own approximately 10.5%, 3.0%, and 3.0%, respectively, of L-1 s outstanding common stock. Mr. Robert V. LaPenta, Mr. James DePalma, Mr. Joseph Paresi and Ms. Doni Fordyce, each executive officers of the Company, directly and indirectly hold all the beneficial ownership in L-1 Investment Partners LLC and Aston Capital Partners GP LLC, the investment manager and general partner of Aston Capital Partners, L.P., respectively. Mr. LaPenta is also the Chairman of the Board of Directors, Chief Executive Officer and President of the Company. Mr. DePalma is also the Chief Financial Officer and Treasurer of the Company.

The Company has consulting agreements with Mr. Berube and his spouse, Ms. Joanna Lau, under which each receives annual compensation of $0.1 million. Each agreement terminates on the earlier of July 10, 2012 or commencement of full time employment elsewhere. During the three months ended March 31, 2007, $0.04 million, and for the three months ended March 31, 2006, $0.04 million was paid in the aggregate to Mr. Berube and Ms. Lau for these services.

Under the terms of a 2002 acquisition agreement of Lau Security Systems, the Company is obligated to pay Lau a royalty of 3.1% on certain of its face recognition revenues through June 30, 2014, up to maximum royalties of $27.5 million. Royalty expense included in cost of revenues was approximately $0.01 million and $0.01 million for the three months ended March 31, 2007 and 2006, respectively.

In connection with a consulting agreement which terminated in April 2006, Mr. Beck received annual compensation of $0.3 million. For the three months ended March 31, 2006, Mr. Beck was paid $0.1 million for these services. At March 31, 2007 there was no outstanding balance owed to Mr. Beck.

In connection with the merger of Identix Incorporated (Identix) and the acquisition of SecuriMetrics, Inc. (SecuriMetrics) in 2006, the Company paid L-1 Investment Partners LLC a one time fee of $2.5 million for professional services related to these acquisitions. Approximately $2.0 million and $0.5 million of this fee have been included in the cost of the acquisition of Identix and SecuriMetrics, respectively.

In connection with the merger with Identix, Aston and L-1 agreed in principle that the Company may, subject to approval of the Company s board of directors, purchase AFIX Technologies, Inc., a portfolio company of Aston, which provides fingerprint and palmprint identification software to local law enforcement agencies, at fair market value to be determined by an independent appraiser retained by the Company s board of directors.

In connection with the relocation of the corporate headquarters of L-1 in the third quarter of 2006 to the offices of L-1 Investment Partners LLC in Stamford, Connecticut, L-1 entered into a sublease with L-1 Investment Partners LLC under which L-1 will reimburse L-1 Investment Partners LLC for the rent and other costs payable by L-1, which is estimated at $0.7 million annually. For the three months ended March 31, 2007, L-1 incurred costs of $0.2 million and at March 31, 2007 the Company was obliged to pay the landlord $0.1 million.

In connection with the merger with Identix, L-1 entered into an agreement with Bear Stearns Companies, Inc. (Bear Stearns) pursuant to which Bear Stearns provided financial advisory services related to the merger. The spouse of Ms. Fordyce, Executive Vice President, Corporate Communications is an executive and senior investment banker at Bear Stearns involved with the engagement and certain employees of Bear Stearns have substantial personal investments in Aston. Pursuant to the letter agreement, Bear Stearns was entitled to a fee of $2.5 million upon the closing of the merger, plus expense reimbursement, as well as exclusive rights to act as underwriter, placement agent and/or financial advisor to L-1 with respect to certain financings and other corporate transactions until August 2008. L-1 waived any claims it may have against Bear Stearns with respect to any actual or potential conflicts of interest that may arise with respect to these relationships in the context of the Bear Stearns engagement.

The Company has employment and non-competition agreements with all of the Company s executive officers. Such agreements provide for employment and related compensation and restrict the individuals from competing with the Company. The agreements also provide for the grant of stock options under the Company s stock option plans and for severance upon termination under circumstances defined in such agreements.

As a condition to the closing of the Identix Merger, the Company and L-1 Investment Partners LLC entered into a Termination and Noncompete Agreement which, among other things, (1) terminated all arrangements whereby L-1 Investment Partners LLC and its affiliates provided financial, advisory, administrative or other services to the Company or its affiliates, and (2) prohibited L-1 Investment Partners LLC and its affiliates from engaging or assisting any person that competes directly or indirectly with the Company in the business of biometric, credentialing and ID management business anywhere in the United States or anywhere else in the world where the Company does business, or plans to do business or is actively evaluating doing business during the restricted period; provided however that the foregoing does not restrict L-1 Investment Partners LLC and its affiliates from retaining its investment in and advising AFIX Technologies, Inc. The restricted period runs co-terminously with the term of Robert V. LaPenta s employment agreement with the Company, dated as of August 29, 2006, and for a twelve (12) month period following the expiration of the term of Mr. LaPenta s employment agreement.

In December 2005, Aston completed at $100.0 million investment in and became the beneficial owner of more than 5% of L-1 s outstanding common stock. In accordance with the terms of the investment agreement, L-1 issued to Aston warrants to purchase an aggregate of 1,600,000 shares of L-1 s common stock at an exercise price of $13.75 per share.

In connection with the acquisition of IBT in December 2005, the Company issued warrants to purchase 440,000 shares of common stock with an exercise price of $13.75 per share to L-1 Investment Partners LLC, of which 160,000 will vest upon IBT meeting a specified level of operating performance.

On April 23, 2007 the Company entered into an employee arrangement with Mr. Robert LaPenta, Jr., the son of the Company's Chief Executive Officer.

6. REPORTABLE SEGMENTS, GEOGRAPHICAL INFORMATION AND CONCENTRATIONS OF RISK

SFAS No. 131, *Disclosures about Segments of a Business Enterprise and Related Information*, establishes standards for reporting information regarding reportable and operating segments. Operating segments are defined as components of a company which the chief operating decision maker evaluates regularly in deciding how to allocate resources and assess performance. The Company s chief operating decision maker is its Chief Executive Officer. Effective with the acquisition of IBT in December 2005, the Company operates in two operating segments, the Identity Solutions segment and the Services segment. The Identity Solutions segment provides solutions that enable governments, law enforcement agencies, and businesses to enhance security, reduce identity theft, and protect personal privacy utilizing secure credential provisioning and authentication systems, biometric technology and the creation, enhancement and/or utilization of identity databases. The Services segment provides fingerprinting services to government, civil, and commercial customers, as well as security consulting services to U.S. Government agencies.

The Company measures segment performance primarily based on revenues and operating income (loss) and Adjusted EBITDA. Operating results by segment for the three months ended March 31, 2007 and March 31, 2006 were as follows (in thousands):

	Three months ended March 31, 2007	Three months ended March 31, 2006	As of March 31, 2007

	Three months ended March 31, 2007		Three months ended March 31, 2006		As of March 31, 2007	
	Revenues	**Operating Loss**	**Revenues**	**Operating Loss**	**Total Assets**	**Goodwill**
Identity Solutions	$ 36,303	$ (7,017)	$ 17,850	$ (2,241)	$ 1,025,913	$ 820,056
Services	33,704	1,003	5,888	(34)	209,516	152,399
Corporate					6,195	
	$ 70,007	$ (6,014)	$ 23,438	$ (2,275)	$ 1,241,624	$ 972,455

Corporate assets consist mainly of cash and cash equivalents and deferred financing costs. Effective January 1, 2007, the Company began allocating corporate costs using a three factor formula based on sales, payroll and capital assets. Prior to the merger with Identix, all corporate costs were allocated to the Identity Solutions segment.

Revenues by market are as follows for the three months ended March 31, 2007 and 2006 (in thousands):

	Three months ended	
	March 31, 2007	March 31, 2006
State and local	$ 28,557	$ 17,561
Federal	40,305	5,670
Commercial	1,145	207
	$ 70,007	$ 23,438

The Company s operations outside the United States include a wholly owned subsidiary in Bochum, Germany and ConnetiX, which has operations in Ontario, Canada. Revenues are attributed to each region based on the location of the customer. The following is a summary of revenues and total assets by geographic region (in thousands):

	Three months ended		Total assets as of	
	March 31, 2007	March 31, 2006	March 31, 2007	March 31, 2006
United States	$ 61,476	$ 21,259	$ 1,189,273	$ 275,475
Rest of the World	8,531	2,179	52,351	26,188
	$ 70,007	$ 23,438	$ 1,241,624	$ 301,663

The Company did not have significant international sales to individual countries for the periods presented.

For the three month period ended March 31, 2007, one Federal government agency accounted for 26% of the Company s consolidated revenues. For the three month period ended March 31, 2006, two Federal government agencies accounted for 37% of the Company s consolidated revenues. As of March 31, 2007, the Company had an accounts receivable balance of approximately $13.4 million from one Federal government agency which was the only customer that had a balance of greater than 10% of consolidated accounts receivable. As of March 31, 2006, one Federal government agency was the only customer that had a balance of greater than 10% of consolidated accounts receivable, which was approximately $2.9 million.

7. ACQUISITIONS

On February 21, 2007, the Company acquired ComnetiX, Inc. (ComnetiX) which provides biometric identification and authentication technologies to private and public sector companies in Canada and the United States. The Company acquired ComnetiX because of its significant presence in the fingerprint services segment of the Canadian market and complimentary base of customers, particularly within the law enforcement community. ComnetiX is included in the Services reporting segment. The results of operations of ComnetiX have been included in the condensed consolidated statement of operations from the date of acquisition.

The aggregate purchase price of ComnetiX was approximately $18.6 million, including $0.8 million in transaction costs, all of which was funded by borrowings under the revolving credit facility. Preliminarily, the purchase price has been allocated as follows:

Current assets	$	4,566
Other assets		491
Current liabilities		(5,732)
Note payable - long- term		(50)
Intangible assets		4,899
Goodwill		14,391
	$	18,565

The purchase price allocation is preliminary. The final allocation will be based on final analyses of identifiable intangible assets, contingent liabilities and income taxes, among other things, and will be finalized after the data necessary to compare the analyses of fair value of assets and liabilities is obtained and analyzed. Differences between preliminary and final allocations are not expected to have a material impact on the consolidated results of operations. None of the goodwill is deductible for income tax purposes.

The following gives effect to the acquisition of ComnetiX as if it had occurred at the beginning of each period presented (in thousands except per share amounts):

	Three months ended			
	March 31, 2007		March 31, 2006	
Revenues	$	71,533	$	25,979
Net loss		(10,488)		(4,051)
Basic and dilutive loss per share		(0.14)		(0.14)

The pro-forma data is presented for informational purposes only and may not necessarily be indicative of future results of operations or what the results of operations would have been had the Company acquired ComnetiX on the date indicated.

8. ADDITIONAL FINANCIAL INFORMATION

Inventory (in thousands):

	March 31, 2007		December 31, 2006	
Purchased parts and materials	$	8,337	$	8,482
Work in progress		572		209
Finished goods		5,169		2,276
Total Inventory	$	14,078	$	10,967

Approximately $2.2 million and $3.2 million of inventory was maintained at customer sites at March 31, 2007 and December 31, 2006, respectively.

Property and equipment (in thousands):

	March 31, 2007		December 31, 2006	
System assets	$	48,900	$	48,437
Computer office equipment and software		3,935		4,377
Software		2,175		1,944
Machinery and equipment		1,166		3,273
Leasehold improvements		1,087		423
Other- including tooling and demo equipment		3,360		2,595

	March 31, 2007	December 31, 2006
	60,816	58,504
Less accumulated depreciation and amortization	40,792	38,576
Property and equipment, net	$ 20,025	$ 19,928

For the three months ended March 31, 2007and 2006, depreciation and amortization expense of property and equipment was $2.2 million and $1.9 million, respectively.

Goodwill (in thousands):

The following summarizes the activity in goodwill for the three months ended March 31, 2007 (in thousands):

	Identity Solutions	Services	Total
Balance beginning of period	$ 813,435	$ 138,008	$ 951,443
ComnetiX acquisition		14,391	14,391
Iridian acquisition purchase price allocation adjustment	6,000		6,000
Other adjustments	621		621
	$ 820,056	$ 152,399	$ 972,455

Intangible Assets (in thousands):

	March 31, 2007		December 31, 2006	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Completed technology	$ 124,452	$ (12,473)	$ 124,452	$ (7,462)
Core technology	6,020	(1,119)	5,500	(785)
Trade names and trademarks	27,778	(919)	25,600	(557)
Customer contracts and relationships	34,092	(11,048)	31,692	(9,785)
Other	2,103	(840)	2,103	(660)
	$ 194,445	$ (26,399)	$ 189,347	$ (19,249)

Amortization of intangible assets was $7.2 million and $2.0 million for the three months ended March 31, 2007 and March 31, 2006, respectively. Amortization for the current and subsequent five years and thereafter is as follows: $21.9 million, $26.9 million, $22.3 million, $20.5 million, $19.2 million, $19.2 million and $37.8 million.

Products and Services Revenues

The following represents details of the products and services for revenues for the three months ended March 31, 2007 and 2006 (in thousands):

	Three months ended	
	March 31, 2007	March 31, 2006
Government consulting services	$ 18,026	$
Fingerprinting services	14,084	5,588
Drivers licenses	7,999	8,099
Software, hardware, consumables and components	21,074	5,731
Maintenance & other services	8,824	4,020
Total revenues	$ 70,007	23,438

9. CONTINGENCIES

In March and April 2005, eight putative class action lawsuits were filed in the United States District Court for the District of Massachusetts against L-1, Mr. Bernard C. Bailey, Mr. William K. Aulet (the Company s former Chief Financial Officer) and Mr. Denis K. Berube and other members of the Board of Directors of Viisage Technology, Inc. These lawsuits have been consolidated into one action under one case name: In re: Viisage Technology Securities Litigation, Civil Action No. 05-10438-MLW. The so-called Turnberry Group has been designated as lead plaintiff and its counsel has been designated as lead counsel. The amended consolidated complaint that was filed in February 2006 alleges violations of the federal securities laws by Viisage (now named L-1 Identity Solutions, Inc.) and certain officers and directors arising out of purported misstatements and omissions in Viisage s SEC filings related to certain litigation involving the Georgia drivers' license contract and related to the Viisage s reported material weaknesses in internal controls over financial reporting, which allegedly artificially inflated the price of the Company s stock during the period May 12, 2004 through March 2, 2005. In April 2006, the Company filed a motion to dismiss this case. In February 2007, the judge dismissed all claims related to the Georgia drivers' license contract and permitted the case to proceed on claims associated with purported internal control weaknesses over financial reporting. The Company believes that the plaintiff s remaining claims in this lawsuit are without merit and the Company intends to defend the action vigorously. The Company is not able to estimate the ultimate amount of the loss, if any, allegedly suffered by members of the putative class or the ultimate amount of legal costs and internal efforts associated with defending the company and officers and directors. The Company s insurance carrier is currently paying the defense costs of the Company and the individual defendants. Based on all facts and circumstances, including available insurance policies, management believes that it is unlikely that the eventual resolution of the litigation will have a material adverse effect on the consolidated financial statements.

In April 2005, two purported shareholder derivative actions also were filed against directors, naming Viisage as a nominal defendant. The suits claim that these directors breached their fiduciary duties to its shareholders and to Viisage generally in connection with the same set of circumstances alleged in the class action lawsuit. The complaints are derivative in nature and do not seek relief from the Company. One of these actions was filed in Massachusetts Superior Court and the other was filed in the United States District Court for the District of Massachusetts. In July 2005, the state court action was dismissed with prejudice at the plaintiff s request. An amended complaint in the federal court derivative action was filed in July 2006 in which the plaintiff added allegations regarding disclosures by Viisage s representatives that generally appear to be intended to support her contention that she was excused from making a demand on the board of directors before filing a derivative complaint. Oral arguments have not yet been scheduled by the court. The Company has filed a motion to dismiss the federal court action. The Company believes that the allegations and claims made in the remaining derivative lawsuit are likewise without merit and intends to defend the action vigorously.

In January 2004, LG Electronics USA, Inc. and LG Electronics, Inc. (a Korean corporation.) (LG) filed a lawsuit against Iridian Technologies, Inc., a wholly owned subsidiary of the Company, in federal court in New Jersey seeking to cancel Iridian s federal trademark registration for its IrisAccess trademark, and alleging that Iridian had made false statements by announcing that it had discontinued its IrisAccess line of products. At the time LG filed this lawsuit, the parties had been engaged in an ongoing negotiation regarding Iridian s introduction of new standard pricing for its licenses. LG contended that Iridian was not entitled to impose its new standard per user pricing on LG pursuant to the terms of the parties 2000 Amended and Restated Development, Distribution and Supply agreement (the License Agreement). In August 2004, LG filed a demand for arbitration before the American Arbitration Association, seeking a finding that its fee for using Iridian s iris recognition technology remained at the original per unit pricing structure under the License Agreement. Shortly thereafter, Iridian terminated the License Agreement due to LG s failure to pay royalties as required under Iridian s new standard pricing. In response, LG filed another lawsuit in New Jersey federal court, asking the court to enter a finding that Iridian s termination of the License Agreement was improper and that LG s continued use of Iridian s technology did not infringe upon Iridian s patent rights. The issues in all three cases have since been consolidated into one action pending in New Jersey federal court, and are being litigated pursuant to a series of amended complaints filed by LG. Iridian vigorously denies all of LG s claims and is counterclaiming for LG s breach of contract, infringement of Iridian s patents and copyrights, and misappropriation of Iridian s trade secrets. LG has replied to Iridian s counterclaims and has asserted defenses that include, among other things, the alleged invalidity or unenforceability of Iridian s patents, copyrights and trade secrets. Late in 2006, the court (1) allowed LG to further amend its complain to add additional allegations of antitrust violations by Iridian and (2) rejected LG s attempt to add L-1 and SecuriMetrics as defendants in the litigation. At the time, the parties are continuing extensive fact discovery. The court has not entered a formal scheduling order, but has set a conference for June 6, 2007 at which time the parties are expected to discuss scheduling and the possibility of further amending their claims and counter claims. Iridian believes that it has strong defenses to all of LG s claims and a strong basis to pursue all of Iridian s counterclaims, and intends to vigorously defend against LG s claims and pursue its own counterclaims. At this time, it is not possible to predict with certainty the outcome of this litigation. However, a material adverse ruling against Iridian respecting either the underlying contract claims or enforceability of Iridian s intellectual property rights could materially adversely impact the value of the Company s investment in Iridian and its iris recognition technology.

In July 2006, Identix received an ordinary course call from the Office of Export Enforcement (BIS) requesting copies of shipping documentation related to a prior shipment of Identix products. In the process of retrieving the documentation, Identix determined that its shipping department had incorrectly completed the relevant documentation, and Identix promptly informed BIS of the error. Identix promptly thereafter initiated an internal review of compliance with its own export compliance policies and export regulations. During the course of the internal review, additional shipping documentation discrepancies were identified. In September 2006, Identix voluntarily disclosed such discrepancies to BIS and retained an independent consultant to supplement Identix internal review of export compliance. In January 2007, Identix notified BIS of its final findings arising from the internal review. While monetary penalties arising out of Identix inadvertent discrepancies are a possible result of Identix s findings and voluntary disclosures to BIS, based on information currently available, L-1 does not believe that liabilities or penalties arising out of these discrepancies will have a material adverse effect on the business, operations or financial results of L-1.

10. SUBSEQUENT EVENT

On May 2, 2007, the Company entered into a Stock Purchase Agreement with Advanced Concepts, Inc., (ACI) and the selling stockholders, pursuant to which the Company will purchase all of the issued and outstanding shares of common stock of ACI from a newly-formed holding company for a base purchase price of $71.5 million in cash, subject to adjustment based on ACI s Closing Working Capital. In addition, pursuant to the Stock Purchase Agreement, if ACI achieves certain financial targets in 2007 and 2008, the Company will make additional payments of a maximum aggregate amount equal to $6.0 million.

ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and the accompanying notes contained in our 2006 Annual Report on Form 10-K and in this Quarterly Report on Form 10-Q.

Business Overview

L-1 Identity Solutions, Inc. (L-1 or the Company) provides identity protection solutions that enable governments, law enforcement agencies and businesses to enhance security, reduce identity theft, and protect personal privacy. Our solutions are specifically designed for the identification of people and include secure credentialing, biometrics, automated document authentication, real-time identity databases, automated testing of identity and identity information, and biometrically-enabled background checks, as well as systems design, development, integration and support services. These identity solutions enable our customers to manage the entire life cycle of an individual s identity for a variety of applications including civil identification, criminal identification, border management, anti-terrorism, and security. The Company also provides comprehensive security solutions to U. S. government intelligence agencies.

The market for identity protection solutions has continued to develop at a rapid pace. In particular, consumers of identity protection solutions are demanding end-to-end solutions with increased functionality that can solve their spectrum of needs across the identity life cycle. Our objective is to meet those growing needs by continuing to broaden our product and solution offerings to meet our customer needs, leveraging our existing customer base to provide additional products and services, expanding our customer base both domestically and abroad, and augmenting our competitive position through strategic acquisitions. We evaluate our business primarily through financial metrics such as revenue, operating income (loss) and earnings before interest, depreciation, amortization and stock based compensation expense (Adjusted EBITDA).

Our revenues increased to $70.0 million for the three months ended March 31, 2007 from $23.4 million for the three months ended March 31, 2006. Our net loss for the three months ended March 31, 2007 increased to $8.8 million from $2.2 million for the same period in 2006. The results for 2007 also include amortization expense of intangible assets of $5.3 million related to businesses acquired after March 31, 2006 and additional stock compensation expense of $1.9 million.

Sources of Revenues

Our Secure Credentialing Division, formerly known as Viisage, which prior to December 15, 2005 comprised our sole business, generates revenues from the sales of biometric solutions consisting of bundled proprietary software with commercial off-the-shelf equipment and related maintenance and services, the sale of secure printing solutions and related consumables, and the design, customization and installation of secure credential issuance systems which generate revenues as the credentials are issued by the customer.

Our Identix Incorporated (Identix) division generates revenues from the sale of biometric solutions incorporating fingerprint, facial and skin biometrics and system components necessary for the biometric capture and knowledge discovery. Solution offerings include Live Scan and mobile systems and services for biometric capture and identification, and systems, modules and software for biometric matching and verification. Revenues are generated by sales of hardware, software and maintenance services.

Our SecuriMetrics, Inc. (SecuriMetrics) / Iridian Technologies, Inc. (Iridian) division generates revenues through the development, customization and sale of biometrics solutions using iris technology which typically consists of proprietary biometrics capture devices bundled together with our proprietary software, as well as sales of licenses and software.

Our Integrated Biometric Technology, Inc. (IBT)/Identix Identification Services, Inc. (IIS) division generates revenues through the sales o background screening products and services.

Our SpecTal, LLC (SpecTal) division provides comprehensive security consulting services to U.S. government intelligence agencies.

Our ComnetiX, Inc. (ComnetiX) division provides background screening services and fingerprint solutions to state and law enforcement agencies.

We market our solutions and services primarily to U.S. and foreign federal, state and local government agencies and law enforcement agencies. We also are working to expand the use of our solutions in commercial markets, particularly financial services, transportation and healthcare. In a typical contract with a government entity for an identity solution, we design the system, supply and install equipment and software and integrate the solution within the entity s existing network infrastructure and provide maintenance services. These contracts may be structured as fixed price contracts with payments made upon completion of agreed milestones or deliveries and with each milestone or delivery typically having a value specified in the contract. Alternatively, these contracts may be paid at a fixed price per credential issued as is typical in the drivers license market, per fingerprint delivered in the case of our fingerprinting services or on a time and material and fixed price level of effort basis for our security consulting services.

Since the fourth quarter of 2003 our growth in revenues is due principally to acquisitions we consummated, as well as increased demand for our identity solutions related to heightened emphasis on secure credential issuance, document authentication and biometrics. We anticipate that the U.S. Department of State and another U.S. government agency will continue to be major customers for the foreseeable future. We also anticipate steadily increasing funding for major government programs such as TWIC, HSPD-12, REAL ID and e-passport. Any delay or other changes in the rollout of these programs could cause our revenues to fall short of expectations. We also expect to experience increased demand from a number of other government entities as they deploy identity solutions, particularly document authentication, at points of entry and exit, including borders, seaports and airports and in connection with national identification programs. Notwithstanding our expectations regarding demand for these solutions, the quantity and timing of orders from both U.S. and foreign government entities depends on a number of factors outside of our control, such as the level and timing of budget appropriations.

Acquisitions

We have pursued strategic acquisitions to complement and expand our existing products, and solutions. Our acquisitions since January 1, 2006 include:

Our February 2007 acquisition of ComnetiX, Inc. , which creates an important presence for us in the Canadian market by adding a complementary base of customers to our portfolio, particularly within the law enforcement community.

Our October 2006 acquisition of SpecTal, which provides comprehensive security and intelligence solutions, specializing in government consulting, training and technology development;

Our August 2006 merger with Identix, whose multi-biometric technology provides a broad range of fingerprint and facial recognition technology offerings, which we believe will expand and better serve our markets;

Our August 2006 acquisition of Iridian, which holds the leading iris recognition technology in the industry; and

Our February 2006 acquisition of SecuriMetrics, a provider of the world s only full-function handheld iris recognition and multi-modal biometric devices, enabling us to now offer multiple and multi-modal biometric capabilities that include finger, face and iris technologies.

Impact of the Acquisitions

The acquisitions have been included in the consolidated financial statements subsequent to the dates of acquisition.

The Identix merger and the acquisitions of Iridian, SecuriMetrics, SpecTal, and ComnetiX, which have resulted in the consolidation of certain marketing resources, facilities and corporate functions of the separate entities in Stamford, Connecticut are expected to have a continuing material effect on our operations resulting from, but not limited to:

Expected synergies resulting from providing a comprehensive product line to current and future customers.

Expected future growth in revenues and profits from expanded markets for identity solutions.

Enhancement of technical capabilities resulting from combining the intellectual capital of the combined entities.

Rationalization of technology costs and research and development activities.

Realignment of business divisions to complement each division s unique capabilities and rationalizing costs.

Leveraging the Company s infracture to achieve higher revenues and profitability.

Reportable Segments and Geographic Information

Starting with our 2006 year, we changed the reporting of our segments to be aligned with our market opportunities and how we manage our various businesses. We currently operate in two reportable segments, the Identity Solutions segment and the Services segment. We measure segment performance based on revenues, Adjusted EBITDA and operating income (loss). Operating results by segment for the three months ended March 31, 2007 and 2006 follow (in thousands):

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
Identity Solutions:		
Revenues	$ 36,303	$ 17,850
Operating loss	(7,017)	(2,241)
Services:		
Revenues	33,704	5,888
Operating income (loss)	1,003	(34)
Corporate		
Revenues		
Operating loss		
Consolidated:		
Revenues	$ 70,007	$ 23,438
Operating loss	(6,014)	(2,275)

Effective January 1, 2007 the Company began allocating corporate costs using a three factor formula based on assets, payroll, capital assets. Prior to the merger with Indentix all corporate costs were allocated to the Identity Solutions segment.

Revenues by market for the three months ended March 31, 2007 and March 31, 2006 were as follows (in thousands):

	Three months ended	
	March 31, 2007	**March 31, 2006**
State and local	$ 28,557	$ 17,561
Federal	40,305	5,670
Commercial	1,145	207
	$ 70,007	$ 23,438

Revenues are attributed to each region based on the location of the customer. The following is a summary of revenues by geographic region (in thousands):

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
United States	$ 61,476	21,259
Rest of world	8,531	2,179
	$ 70,007	23,438

DEPENDENCE ON SIGNIFICANT CUSTOMERS

For the three month period ended March 31, 2007, one Federal government agency accounted for 26% of our consolidated revenues. For the three month period ended March 31, 2006, two Federal government agencies accounted for 37% of our consolidated revenues. As of March 31, 2007, we had an accounts receivable balance of approximately $13.4 million for one Federal government agency which was the only customer that had a balance of greater than 10% of consolidated accounts receivable. As of March 31, 2006, one Federal government agency was the only customer that had a balance of greater than 10% of consolidated accounts receivable, which was approximately $2.9 million.

RESULTS OF OPERATIONS

Consolidated Results of Operations

The 2007 results of operations were significantly affected by the August 2006 Identix merger and the August 2006 acquisition of Iridian, October 2006 acquisition of SpecTal, and the 2007 acquisition of ComnetiX. Approximately $1.9 million of the operating loss recorded in 2007 is related to the aforementioned acquisitions.

Revenues

	Three months ended	
	March 31, 2007	March 31, 2006
Revenues	$ 70,007	$ 23,438

Revenues for the three months ended March 31, 2007 were $70.0 million, which included $43.3 million related to the acquisition of Iridian, Identix, SpecTal and ComnetiX. Excluding the impact of the aforementioned acquisitions, revenues increased $3.3 million or 14% from the prior year period. Approximately $1.3 million of this increase is due to increased secured credentialing sales to federal and the state governments which include programs at U.S. State Department, U.S. Department of Defense, and the State of North Carolina, sales of document authentification readers. The remaining increase was due to increased sales of fingerprint services and sales of the Company s hardware for iris and multi-modal biometric recognition devices.

Cost of revenues and gross margins

	Three months ended	
	March 31, 2007	March 31, 2006
Cost of revenues	$ 46,177	$ 15,171
Amortization of purchased intangible assets	6,474	1,868
Cost of revenues	$ 52,651	$ 17,039
Gross profit	17,356	6,399
Gross margins	25%	27%

Cost of revenues increased by $35.6 million for the three months ended March 31, 2007, of which $34.7 million related to the acquisitions of Iridian, Identix, SpecTal and ComnetiX. Gross Margins in 2007 were impacted by an increase in fingerprint services sales and higher costs in the state drivers license contracts, which lowered margins compared to the prior year period. Included in the cost of revenues for the first quarter of 2007 was $6.5 million of amortization of purchased intangible assets, which increased by approximately $4.6 million from the prior year due to the acquisitions of Iridian, Identix, SpecTal and ComnetiX. Excluding the acquisitions, gross margins increased to 32% in 2007, as a result of higher sales of higher margin multi-modal biometric products.

Sales and marketing expenses

	Three months ended	
	March 31, 2007	March 31, 2006
Sales and marketing expenses	$ 5,461	$ 2,369
As a percentage of revenues	8%	10%

Sales and marketing expenses increased by approximately $3.1 million for the three month period ended March 31, 2007 from the prior year period, of which the acquisitions of Iridian, Identix, SpecTal and ComnetiX accounted for $2.3 million. The remaining increases is attributable additional investments in marketing resources. Sales and marketing expenses consists primarily of salaries and related personnel costs including stock-based compensation, commissions, travel and entertainment expenses, promotions and other marketing and sales support expenses. We expect our sales and marketing expenses to decline as a percentage of revenues in future quarters as we increase sales while leveraging our current cost structure.

Research and development expenses

Three months ended

	March 31, 2007	March 31, 2006
Research and development expenses	$ 4,661	$ 1,611
As a percentage of revenues	7%	7%

Research and development expenses increased by approximately $3.1 million for the three months ended March 31, 2007, from the prior year period, of which approximately $2.3 million is due to the acquisitions of, Iridian, Identix and ComnetiX. Excluding the effects of the acquired businesses, expenses in 2007 increased by $0.7 due to the investment made in our corporate research center, which focuses on the development of biometric technologies. Research and development expense consists primarily of salaries, stock-based compensation and related personnel costs and prototype costs related to the design, development, testing and enhancement of our products. We expect our research and development expenses to decline as a percentage of revenues in future quarters as we increase sales while leveraging our current cost structure.

General and administrative expenses

	Three months ended	
	March 31, 2007	March 31, 2006
General and administrative expenses	$ 12,817	$ 4,577
As a percentage of revenues	18%	20%

General and administrative expenses increased by approximately $8.2 million for the three months ended March 31, 2007, from the prior year period of which approximately $5.5 million is due to the acquisitions of Iridian, Identix, SpecTal and ComnetiX. Excluding the effects of acquired businesses, the increase for the three months ended March 31, 2007 compared to the prior year period, relate to stock based compensation expense, legal, professional and outside services incurred and the integration of several of our acquisitions. General and administrative expenses consist primarily of salaries and related personnel costs, including stock-based compensation for our executive and administrative personnel, professional and board of directors fees, public and investor relations and insurance. We expect our general and administrative expenses to decline as a percentage of revenues in future quarters as we increase sales while leveraging our current cost structure.

Amortization of purchased intangible assets

	Three months ended	
	March 31, 2007	**March 31, 2006**
Amortization of purchased intangible assets	$ 431	$ 117

Amortization expense of purchased intangible assets increased for the three month period ending March 31, 2007 from the comparable period in the prior year due to the acquisitions of Iridian, Identix, SpecTal, and ComnetiX.

Interest income and expense

	Three months ended	
	March 31, 2007	**December 31, 2006**
Interest income	$ 67	$ 671
Interest expense	(1,771)	(6)
Interest (expense) income, net	$ (1,704)	$ 665

For the three months ended March 31, 2007, net interest income decreased by approximately $2.4 million, as a result of the borrowings incurred under our credit facility in connection with the acquisitions of SpecTal in October 2006 and ComnetiX in February 2007. The 2006 acquisitions which were paid in cash decreased the cash balance from the $100.0 million investment made by L-1 Investment Partners LLC in late 2005.

Income Taxes

	Three months ended	
	March 31, 2007	**March 31, 2006**
Income taxes	$ 1,088	$ 565

The provision for income taxes represents a deferred tax provision related to the amortization of tax deductible goodwill and state and local income tax provisions. The provision increased as a result of increased amortization of the tax deductible goodwill resulting from the acquisition of SpecTal.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

As of March 31, 2007, we had $5.8 million of working capital including $4.1 million in cash and cash equivalents. In addition, we have financing arrangements, as further described below, available to support our ongoing liquidity needs. We believe that our existing cash and cash equivalent balances, existing financing arrangements and cash flows from operations will be sufficient to meet our operating and debt service requirements for the next 12 months. However, we will require additional financing to further implement our acquisition strategy and in that connection evaluate financing needs and the terms and conditions and availability under of our credit facility on a regular basis and consider other financing options. We may seek to raise additional capital, either in the form of debt or equity. There can be no assurance that such financing will be available on commercially reasonable terms, or at all. Our ability to meet our business plan is dependent on a number of factors, including those described in the section of this report entitled Risk Factors.

On October 19, 2006, we entered into an Amended and Restated Credit Agreement (the Agreement) by and among the Company, Bank of America, N.A. (the Bank), Bear Stearns, Wachovia Bank, Credit Suisse, Societe Generale and TD Bank North, to amend and restate the Credit Agreement, dated as of August 16, 2006, by and between the Company and the Bank. The Agreement provides for a revolving credit facility of up to $150 million, with the potential for up to $50 million in additional borrowings. In order to borrow under the facility, we are required to comply with certain covenants as more fully described below, some of which may limit the amounts borrowed or available. The Agreement provides that up to $25 million of the total facility amount may be used for the issuance of letters of credit. At March 31, 2007 we had approximately $47.7 million available under our revolving credit facility.

Amounts borrowed under the Agreement bear interest for any interest period (as defined in the Agreement) at the British Bankers Association LIBOR Rate, plus a margin of 1.75% (subject to adjustment to a minimum margin of 1.50% and a maximum margin of 2.00% based on the Company s indebtedness to EBITDA ratio described below), and must be repaid on or before October 19, 2011. We also have the option to borrow at a fluctuating rate per annum equal to the higher of (a) the Federal Funds Rate plus 1/2 of 1% and (b) the rate of interest in effect for such day as publicly announced from time to time by Bank of America as its prime rate , with respect to base rate loans plus the margin described above. If we have not borrowed all available amounts under the facility, we must pay a commitment fee of 0.375% per annum on such unutilized amounts. At March 31, 2007, the interest rate was 6.8%. (1.5% over LIBOR).

In accordance with the Agreement, borrowings are secured by all assets of the Company and certain of its affiliates. The Company is required to maintain the following financial covenants under the Agreement:

As of the end of any fiscal quarter, the ratio of the Company s consolidated EBITDA (as defined in the Agreement) to consolidated interest charges (as defined in the Agreement) for the period of the prior four fiscal quarters may not be less than 2.50: 1.00, beginning with the fiscal quarter ending on December 31, 2006. At March 31, 2007 the ratio was 5.65:1.0.

As of the end of any fiscal quarter, the ratio of the Company s consolidated funded indebtedness (as defined in the Agreement) to its consolidated EBITDA for the period of the prior four fiscal quarters may not be more than: (i) 5.00: 1.00 at December 3 I, 2006, March 31, 2007 and June 30, 2007, (ii) 4.75:1.00 at September 30,2007, (iii) 4.50:1.00 at December 31, 2007, March 31, 2008 and June 30, 2008, (iv) 4.25: 1.00 at September 30, 2008, and (v) 4.00: 1.00 at December 31, 2008 and at the end of each fiscal quarter thereafter. At March 31, 2007 the ratio was 2.7:1.00.

Under the terms of the Agreement, we may incur, assume or guarantee unsecured subordinated indebtedness of up to $200 million and a future parent holding company of the Company may incur an additional $200 million of unsecured subordinated indebtedness. Among other restrictions, the Agreement limits our ability to (i) pay dividends or repurchase capital stock, except with the proceeds of equity issuances or permitted subordinated debt, (ii) incur indebtedness (subject to the exceptions described above, among others), (iii) incur liens upon the collateral pledged to the Bank, (iii) sell or otherwise dispose of assets, including capital stock of subsidiaries, (iv) merge, consolidate, sell or otherwise dispose of substantially all of our assets, (v) make capital expenditures above certain thresholds, (vi) make investments, including acquisitions for cash in excess of $300,000,000 in the aggregate and (vii) enter into transactions with affiliates. These covenants are subject to a number of additional exceptions and qualifications. The Agreement provides for customary events of default which include (subject in certain cases to customary grace and cure periods), among others: nonpayment, breach of covenants or other agreements in the Agreement, payment defaults or acceleration of other indebtedness, a failure to pay certain judgments and certain events of bankruptcy, insolvency or reorganization. Generally, if an event of default occurs, the Bank, with the consent of lenders holding a majority of the aggregate commitments under the facility, may declare all outstanding indebtedness under the Agreement to be due and payable. At March 31, 2007 we were in compliance with covenants of the revolving credit facility.

	Three Months Ended	
	March 31, 2007	**March 31, 2006**
Consolidated Cash Flow Data:		
Net cash provided by (used in):		
Operating activities	$ 1,393	$ 3,701
Investing activities	(22,323)	(30,673)
Financing activities	19,440	1.028
Effect of exchange rates on cash and cash equivalents	74	(13)
Net decrease in cash and cash equivalents	$ (916)	$ (25,957)

Cash flows from operating activities decreased by approximately $2.3 million for the three months ended March 31, 2007 as compared to the corresponding period of the prior year. The net loss for the three months ending March 31, 2007 was $8.8 million, which included non-cash charges of $9.1 million for depreciation and amortization, $2.6 million for stock-based compensation, approximately $1.0 million for deferred income taxes and $0.2 million of other non-cash expenses. Excluding the impact of working capital changes described below, cash flows from operating activities increased to $4.1 million from $3.1 million for the three months ended March 31, 2007 compared to the corresponding period in the prior year. Other changes in operating assets and liabilities resulted in a net decrease in cash and cash equivalents as discussed below.

Cash paid for acquisitions in 2007 includes cash used to consummate the acquisition of ComnetiX as well as additional payments made in connection with a prior acquisition. Cash paid for acquisitions in 2006 related primarily to the acquisition of SecuriMetrics. Capital expenditures were approximately $1.8 million and $1.3 million for the three months ended March 31, 2007 and March 31, 2006, respectively, and was primarily related to the Company s drivers licenses product line.

Net cash provided by financing activities was $19.9 million for the three months ended March 31, 2007, and was primarily related to our net borrowings of $18.0 million from our revolving credit agreement which was due to our purchase of ComnetiX and the proceeds received from exercises of common stock options by our employees, which was offset by the cost of financing fees. In the comparable period of 2006, cash from financing activities related primarily to proceeds from the issuance of stock options.

20

Working Capital

Accounts receivable related to our February 2007 acquisition of ComnetiX was approximately $2.6 million at March 31, 2007. Excluding ComnetiX, accounts receivable decreased by approximately $10.0 million as of March 31, 2007, from December 31, 2006, primarily due to improved collections.

Inventory increased by $3.1 million as of March 31, 2007 compared to December 31, 2006. Inventory related to the ComnetiX acquisition approximated $0.5 million as of March 31, 2007. Excluding ComnetiX, inventory increased by $2.6 million primarily as result of the Company building inventory for future contract deliveries.

Other current assets decreased by approximately $0.4 million. Excluding the acquisition of ComnetiX, other current assets decreased by $0.5 million primarily the result of changes in prepaid insurance and other decreases.

Accounts payable, accrued expenses and other current liabilities related to the acquisition of ComnetiX were $1.7 million at March 31, 2007. Excluding the impact of ComnetiX, accounts payable, accrued expenses and other current liabilities decreased to $57.2 million at March 31, 2007 from $60.0 million at December 31, 2006, primarily due to payment of legal, professional fees, insurance, and other expenses, including fees and expenses related to acquisitions, offset by additional accruals related to acquisitions.

Total deferred revenue related to the acquisition of ComnetiX was $2.3 million at March 31, 2007. Excluding the impact of the ComnetiX acquisition, the decrease was $0.9 million. The decrease is due to recognition of maintenance revenue and payments received on customer projects for which revenue recognition criteria was not met as of March 31, 2007.

CONTRACTUAL OBLIGATIONS

The following table sets forth our contractual obligations as of March 31, 2007 (in thousands):

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating lease obligations	$ 13,227	$ 2,911	$ 6,263	$ 1,517	$ 2,536
Debt and capital lease obligations	$ 136,318	$ 4,998	$ 19,992	$ 111,328	

Included in debt is $98.0 million outstanding under our revolving debt facility that has a term of five years and bears interest at a variable rate, which was 6.8% at March 31, 2007. Additionally, the Company had capital lease obligations of approximately $0.2 million at March 31, 2007. The amount shown for debt includes interest assuming the revolving debt facility is paid at the end of its term.

The Company has consulting agreements with two related parties under which each receives annual compensation of $0.1 million through the earlier of July 2012 or commencement of full time employment elsewhere.

In addition, the Company is subject to a royalty arrangement with a related party whereby the Company is subject to royalty payments on certain of its face recognition software revenue through June 30, 2014, up to maximum royalties of $27.5 million.

In connection with the merger with Identix, Aston Capital Partners, LLC, an affiliated company, and L-1 have agreed in principle that the Company may, subject to the approval of the board of directors, purchase AFIX Technologies, Inc., a portfolio company of Aston, which provides fingerprint and palmprint identification software to local law enforcement agencies, at fair market value to be determined by an independent appraiser retained by the Company s board of directors.

CONTINGENT OBLIGATIONS

Our principal contingent obligations consist of cash payments that may be required upon achievement of acquired businesses performance incentives.

INFLATION

Although some of our expenses increase with general inflation in the economy, inflation has not had a material impact on our financial results to date.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. Consistent with U.S. GAAP, we have adopted accounting policies that we believe are most appropriate given the facts and circumstances of our business. The application of these policies has a significant impact on our reported results of operations. In addition, some of these policies require management to make assumptions and estimates. These assumptions and estimates, which are based on historical experience and analysis of current conditions, have a significant impact on our reported results of operations and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. The most significant assumptions and estimates relate to the allocation of purchase price of the acquired businesses, assessing the impairment of goodwill, other intangible assets and property and equipment, revenue recognition, income taxes, contingencies, litigation and valuation of financial instruments, including warrants and stock options. If actual results differ significantly from these estimates, there could be a material effect on our consolidated financial statements.

Valuation of goodwill and other long-lived and intangible assets

Our long-lived assets include property and equipment, intangible assets and goodwill. As of March 31, 2007 the balances of property, plant and equipment, identifiable intangible assets and goodwill, all net of accumulated depreciation and amortization, were $20.0 million, $168.0 million and $972.5 million, respectively.

We depreciate property and equipment and intangible assets that have finite lives over their estimated useful lives. For purposes of determining whether there are any impairment losses, as further discussed below, our management has evaluated the carrying amounts of identifiable long-lived tangible and intangible assets, including their estimated useful lives when indicators of impairment are present. For all long-lived tangible assets, if an impairment loss is identified based on the fair value of the asset, as compared to the carrying amounts of the asset, such loss is charged to expense in the period we identify the impairment. Furthermore, based on our review of the carrying amounts of the long-lived tangible and intangible assets with finite lives, we may determine that shorter estimated useful lives are more appropriate. In that event, we record depreciation and amortization over shorter future periods, which would reduce our earnings. Based on our review of the estimated useful lives of property and equipment used in state drivers licenses contracts for which we receive extensions, we may determine that longer estimated useful lives are more appropriate, which would increase our gross and operating margins in future periods.

Factors we generally consider important and which could trigger an impairment review of the carrying value of long-lived tangible and intangible assets include the following:

Significant underperformance relative to expected operating results;

Significant changes in the manner of use of assets or the strategy for our overall business;

Underutilization of our tangible assets;

Discontinuance of product lines by ourselves or our customers;

Significant negative industry or economic trends:

Significant decline in our stock price for a sustained period; and

Significant decline in our market capitalization relative to net book value.

Although we believe that the carrying values of our long-lived tangible and intangible assets were realizable as of March 31, 2007, future events could cause us to conclude otherwise.

As a result of our acquisitions beginning in 2004, material amounts of goodwill and other intangible assets were recorded. These represent estimates of fair values which are based on valuations made as of the dates of acquisition. With respect to our merger with Identix and the acquisition of Iridian, the valuations are substantially complete. With respect to the acquisitions of ConnetiX and SpecTal, the valuations are preliminary and subject to adjustment based on additional analyses of values as additional information is obtained. Management believes that any differences between the preliminary and final allocations will not be material to our consolidated financial statements.

We follow SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires us to test goodwill for impairment on an annual basis, or earlier if indicators of potential impairment exist, and to write-down goodwill when impaired. These events or circumstances generally would include the incurrence of operating losses or a significant decline in earnings associated with the asset. We evaluate goodwill for impairment using the two-step process as prescribed in SFAS No. 142. The first step is to compare the fair value of the reporting unit to the carrying amount of the reporting unit. If the carrying amount exceeds the fair value, a second step must be followed to calculate impairment. Otherwise, if the fair value of the reporting unit exceeds the carrying amounts, the goodwill is not considered to be impaired as of the measurement date. We perform the initial step by comparing the fair value of our reporting units as determined by considering a number of factors, including an assessment of the fair value of the reporting units based on comparable companies using the guideline company method, the comparable transactions and the present value of future discounted cash flows, and comparing the results to the carrying amounts of the reporting units. Based upon these analyses, we have determined that the fair value of the reporting units exceeded their carrying amounts resulting in no goodwill impairment as of October 31, 2006, the date of the annual impairment test.

Purchase price allocations of acquired businesses

Valuations of acquired businesses require us to make significant estimates, which are derived from information obtained from the management of acquired businesses, our business plans for the acquired business or intellectual property and other sources. Critical assumptions and estimates used in the initial valuation of goodwill and other intangible assets include, but are not limited to:

Assessments of appropriate valuation methodologies in the circumstances;

- Future expected cash flows from product sales, customer contracts and acquired developed technologies, patents and other intellectual property;

- Expected costs to complete any in-process research and development projects and commercialize viable products and estimated cash flows from sales of such products;

- The acquired companies brand awareness and market position;

- Assumptions about the period of time over which we will continue to use the acquired brand and intangible assets; and

- Discount rates.

The estimates and assumptions may not materialize because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be different from actual results, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairment, which will require us to record an impairment charge in the period in which it is identified.

Revenue Recognition

Our revenue is derived primarily from sales to federal and state government customers, some of which are fulfilled through the delivery of consumables, hardware and software components, as well as providing software maintenance, technical support, training, installation, consulting and security services. Depending on the nature of the arrangements, revenue is recognized in accordance with Statement of Position No. 97-2 (SOP 97-2), *Software Revenue Recognition*, as amended, Staff Accounting Bulletin No. 104 (SAB 104), *Revenue Recognition*, and related interpretations, Statement of Position No. 81-1 (SOP 81-1) *Accounting for Performance of Construction-Type and Certain Production Type Contracts*, and Accounting Research Bulletin No. 43 (ARB 43), *Government Contracts.* When a customer arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met:

Persuasive evidence of an arrangement exists We require evidence of an agreement with a customer specifying the terms and conditions of the products or services to be delivered typically in the form of a signed contract or purchase order.

Delivery has occurred For products, delivery generally takes place when title to the products, which in certain instances includes hardware and software licenses, are shipped to or accepted by the customer. For services, delivery takes place as the services are performed.

The fee is fixed or determinable Fees are fixed or determinable if they are not subject to a refund or cancellation and do not have payment terms that exceed our standard payment terms. Typical payment terms are net 30 days.

Collection is probable We perform a credit review of all customers with significant transactions to determine whether a collection is probable.

Transactions which typically do not involve significant production, modification or customization of software, or do not include services considered to be essential to the functionality of the software, include:

Document issuance solutions, primarily to federal and state government customers;

Sale of stand alone hardware products including Live Scan equipment and related maintenance services

Printing system components and consumables including printers, secure coating, ribbon, film, and other parts, primarily to federal government customers;

Portable devices that provide iris and multi-modal identification and recognition;

Licenses of off-the-shelf versions of face and iris recognition software;

Stand alone sales of software including ABIS, AFIS, IBIS, BioLogon and software developer kits;

Services and software to scan, collect and transmit fingerprints for identity and background verification;

Document authentication products and services, which typically include sales of hardware, software, maintenance and support; and

Security consulting services and provided to the U.S. government agencies

Revenue on the transactions within the scope of SAB 104 is recognized upon transfer of title for product sales, and performance for services, provided the four revenue criteria listed above are met at that time. In certain cases, customer acceptance is required, in which case revenue is deferred until customer acceptance is obtained. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. Security, consulting, training and other similar services are typically recognized as the services are performed. Software maintenance, hardware maintenance, and technical support for such products, are typically recognized ratably over the contract term, which approximates the timing of the services rendered. Revenue from time and material and fixed price level effort contacts is recognized as the services are rendered. Revenue from the collection of fingerprints for identity and background verification is recognized when the fingerprint is transmitted to the applicable background vetting agency, and is recognized on a gross basis where we are the prime contractor and on a net basis where we are the subcontractor. Expenses on all services are recognized when the costs are incurred. Our contractual arrangements generally do not provide for a right to return.

Revenue from hardware sales that require no installation, as well as printers and other peripheral devices, is recognized in accordance with the terms of the sale, generally when we ship the product, provided no significant obligations remain and collection is deemed reasonably assured. Certain of our hardware sales to end users require installation subsequent to shipment and transfer of title. Revenue related to hardware sales that are contingent on installation is deferred until installation is complete, title has transferred and customer acceptance has been obtained. When hardware products are sold through authorized representatives, dealers, distributors or other third party sales channels, the obligation to install the machines generally does not remain our responsibility, but is rather an obligation of the authorized representative, dealer, distributor or other third party to its ultimate customer. As a result, sales to third party distributors, revenue is recognized at the time title is transferred, which is generally upon shipment. On rare occasions, we will be required to install our products on behalf of our third party distributors. In these cases, revenue is recorded in the same manner as products sold to end users where acceptance of product by the third party distributor is contingent upon successful installation of product.

With respect to stand-alone software sales and licenses, including software developer kits, revenue is recognized in accordance with SOP 97-2, as amended, and Statement of Position No. 98-9, *Modification of SOP 97-2, Software Revenue, With Respect to Certain Transactions*, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants. We recognize revenue of software products when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, vendor specified objective evidence (VSOE) of fair value exists to allocate the total fee to all undelivered elements of the arrangement and collection fee is deemed probable.

In the event that a multiple element arrangement includes hardware, software and services and the software is more than incidental to the arrangement, but not essential to the functionality of the hardware, we apply the guidance of EITF No. 03-05*, Applicability of the AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*, which allows the non-software elements and related services to be accounted for under SAB 104 and EITF 00-21 and the software elements and related services to be accounted for under SOP 97-2.

Many of our arrangements include multiple elements that are subject to provisions of EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. Such elements may include one ore more of the following: consumables, equipment, hardware, software, rights to additional software, when and if available software, hardware maintenance, software maintenance, hardware repair or replacement, technical support services, training, installation and consulting services. For multiple-element arrangements not within the scope of SOP 97-2 or SOP 81-1, we allocate value to each of the elements based on estimated relative fair value, if fair value exists for each element of the arrangement. For arrangements within the scope of SOP 97-2, which do not involve significant production, modification or customization of software or services that are considered essential to the functionality of software we allocate fair value based on VSOE of fair value, which is determined based on the price charged when each element is sold separately, considering renewals and other evidence of fair value, as appropriate. If fair value exists for all undelivered elements, but does not exist for the delivered element, the residual method is used to allocate value to each element. Under the residual method, each undelivered element is allocated value based on fair value for that element, and the remainder of the total arrangement consideration is allocated to the delivered element. If fair value does not exist for all undelivered elements, revenue is deferred until evidence of fair value of the undelivered elements are established, at which time revenue is recognized for all delivered elements. Revenue of maintenance and support is recognized ratably over the remaining term of any maintenance and support period.

When multiple-element arrangement otherwise within the scope of SOP 97-2 involve significant production, modification or customization of the software, or involve services that are considered to be essential to the functionality of the software, we apply contract accounting under SOP 97-2 and SOP 81-1. When VSOE of fair value exists for the software maintenance, technical support or other services in arrangements requiring contract accounting, revenue for software maintenance, technical support on other services is recognized as the services are performed and the rest of the arrangement is accounted for under SOP 81-1. When VSOE of fair value is not available for such services the entire arrangement is accounted for under SOP 81-1 and the related revenue is recognized with the rest of the contract deliverables under the percentage of completion method.

In general, transactions that involve significant production, modification or customization of software, or services considered to be essential to the functionality of the software include:

Contracts for the production of drivers licenses and other identification credentials, which generally include multiple elements. Under these contracts, title to equipment and systems installed to produce the credentials does not pass to the customer and the first element consists of consumables, hardware, system design, implementation, training, consumables management, maintenance and support the accounting for which is described below. The second element consists of customized software which is accounted for as a long-term contract in accordance with SOP 81-1, and revenue is recognized on the percentage of completion method; and

Identity solutions contracts, typically providing for the development, customization and installation of fingerprinting, face and iris recognition systems for government agencies, law enforcement agencies and commercial businesses. These contracts are generally for a fixed price, and include milestones and acceptance criteria for various deliverable under the contract. These contracts are accounted for as long-term contracts in accordance with SOP 97-2 and SOP 81-1, and revenue is recognized on a percentage of completion method.

We also utilize contract accounting for government contracts within the scope of ARB 43 and SOP 81-1.

We measure the percentage of completion using either input measures (e.g. costs incurred) or output measures (e.g. contract milestones), whichever provides the most reliable and meaningful measure of performance in the circumstances. Milestones are specific events or deliverables clearly identified in the contract and can include delivering customized systems, installation and services as defined by the contract. When milestone measures are used, revenue is recognized based on total milestones billable to the customer less revenue related to any future maintenance requirement. On contracts where milestones are not used, we generally recognize revenue on a cost-to-cost basis using direct labor dollars method. The cumulative impact of any revision in estimates to complete or recognition of losses on contracts is reflected in the period in which the changes or losses become known. We record costs and estimated earnings in excess of billings under these contracts as current assets.

Our contracts related to the delivery of drivers licenses and identification credentials typically provide that the state departments of motor vehicles, or similar agencies, will pay fixed price per credential produced utilizing equipment systems that we design, implement and support. The price includes charges for materials and the data that is stored on the credentials. Prices for these contracts vary depending on these things:

Design and integration complexities;

Nature and number of workstations and sites installed;

Projected number of credentials to be produced;

Size of the database;

Cost of consumable materials expected to be used;

Level of post-installation involvement; and

Competitive environment.

Drivers licenses or credentials contracts or contract elements within such contracts generally require that we incur up front costs related to the software, hardware and other equipment. Such costs are capitalized and are depreciated over the contract term or life, beginning when the system goes into service. The delivery of the licenses or credentials typically also require us to customize, design, and install equipment and software at customer locations, as well as perform training, supply consumables, maintain the equipment and provide support services. Costs related to the customized software used in drivers license contracts are capitalized during the period in which we are designing and installing the system and are amortized over the contract term beginning when the system goes into service. Revenue on these contracts is earned based on, and is contingent upon, the production of licenses or credentials utilizing the deployed system and is therefore recognized as the licenses or credentials are produced. If the contractual arrangement includes the sale of consumables whose title is transferred to the customer, we recognize revenue when title is transferred.

Income Taxes

We have recorded net deferred tax assets of $75.7 million at December 31, 2006, including the tax benefits of net operating losses aggregating $308.6 million. As a result of cumulative losses, we have concluded that pursuant to SFAS No. 109, it is more likely than not that the deferred tax assets will not be realized and accordingly have provided a full valuation allowance. In addition the Company has tax deductible goodwill and intangible assets of approximately $180.0 million as of December 31, 2006. Utilization of net operating loss carryforwards and future tax deductions is dependent upon achieving profitable results. Approximately $243.0 million of the net operating loss carryforwards are subject to limitations imposed by Section 382 of the Internal Revenue Code. The determination of the limitations is complex and requires significant judgment and analyses of past transactions. For federal income tax purposes, the Identix merger is accounted for as an acquisition of the Company by Identix, accordingly, L-1 s net operating loss carryforwards are also subject to limitations imposed by Section 382 of the Internal Revenue Code. In addition, the net operating carryforwards if Iridian and SecuriMetrics, as well as other previously acquired companies of both Identix and L-1, are subject to separate limitations imposed by Section 382.

The valuation allowance will be eliminated as the Company realizes pre-tax financial reporting income, adjusted for permanent differences. When it is no longer more likely than not that the tax benefits will not be realized, the entire valuation allowance will be reversed either as a benefit in the income statement or as a reduction of goodwill if the reversal of the valuation allowance is related to pre-acquisition net operating losses carryforwards.

We have provided an income tax provision for a deferred tax liability related to the amortization of tax deductible goodwill resulting from the acquisitions of Auto Test, Trans Digital Technologies, Inc., IBT and SpecTal. The resulting deferred tax liability cannot be used to reduce deferred tax assets in determining the required valuation allowance since the period over which the associated temporary differences will reverse is indefinite.

Stock-Based Compensation

On January 1, 2006, we began accounting for our employee and director stock option plans and employee stock purchase plans in accordance with the provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)). SFAS No. 123(R) replaced SFAS No. 123, *Accounting for Stock-Based Compensation,* and superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the option to account for share-based payment transactions with employees and other third parties, eliminates the option to account for share-based payments using APB Opinion No. 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statements of operations based upon the grant-date fair value of those instruments. We used the modified prospective method of transition as provided by SFAS No. 123(R), and as a result, compensation expense related to share based payments is recorded for periods beginning January 1, 2006. Under the modified prospective method, stock based compensation is recognized over the vesting period for new awards granted after January 1, 2006 and for unvested awards outstanding at January 1, 2006.

Determining the appropriate fair value model and related assumptions requires judgment, including estimating common stock price volatility, forfeiture rates and expected terms. The following weighted average assumptions were utilized in the valuation of stock option awards for 2007 and 2006:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Expected volatility	91%	110%
Risk free interest rate	4.3%	4.4%
Expected life of options	6.3 Years	6.3 Years
Expected annual dividends		

The expected volatility rate is based on the historical volatility of the Company s common stock. The expected life of options is based on the average life of 6.3 years pursuant to the guidance from SAB No. 107. The Company estimated forfeitures when recognizing compensation expense based on historical rates. The risk free interest rate is based on the 7 year treasury security as it approximates the estimated 6.3 year expected life of the options. The Company will update these assumptions on at least an annual basis and on an interim basis if significant changes to the assumptions are warranted.

Contingencies and Litigation

There are various lawsuits and claims pending against us incidental to our business. The final results of such suits and proceedings cannot be predicted with certainty. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in our assumptions or the effectiveness of our strategies related to these proceedings.

ITEM 3 ***Quantitative and Qualitative Disclosure About Market Risk***

The Company is exposed to interest rate risks primarily as it relates to borrowings under its revolving credit agreement which as of March 31, 2007 aggregated to $98 million and are denominated in dollars. These borrowings bear interest at variable rates, 6.8% at March 31, 2007; as a result the market value of the debt approximates its carrying amount. However the Company is exposed to increases in interest rates and benefits from decreasing interest rates.

Our international operations results from transactions by our German and Canadian subsidiaries which are denominated in euros and Canadian dollars, respectively. Financial assets and liabilities denominated in foreign currencies consist primarily of accounts receivable and accounts payable and accrued expenses. Financial assets and liabilities denominated in euros aggregate $1.3 million and $1.2 million respectively. Financial assets and liabilities denominated in Canadian dollars aggregate $ 0.6 million and $0.8 million, respectively. As of March 31, 2007, the cumulative gain from foreign currency translation adjustments was approximately $0.8 million.

Hardware and consumables purchases related to contracts associated with the U.S. Department of State are denominated in Japanese yen. We mitigate exchange rate volatility, by purchasing local currencies pursuant to currency forward contracts. All gains and losses resulting from the change in fair value of the currency forward contracts are recorded in operations. As of March 31, 2007, we had no foreign currency forward contracts open.

Our international operations and transactions are subject to risks typical of international operations, including, but not limited to, differing economic conditions, changes in Political climate, differing tax structures, other regulations and restrictions and foreign currency exchange rate volatility. Accordingly, our future results could be materially impacted by changes in these or other factors.

ITEM 4 CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. We have established and maintain disclosure controls and procedures that are designed to ensure that material information relating to the Company and our subsidiaries required to be disclosed by us in our reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including the Company s Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure control and procedure, management recognized that any control and procedure, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

In connection with the preparation of this Quarterly Report on Form 10-Q, an evaluation under the supervision and with the participation of our management, including the CEO and CFO, 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) was performed as of December 31, 2006. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of March 31, 2007.

Changes in Internal Controls

We have designed our internal controls over financial reporting to provide reasonable assurance that controls will achieve their objectives. As of December 31, 2006 we concluded that our internal controls over financial reporting provided such reasonable assurance. We also note that any control system addressing internal control over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must be included as assessment of the costs and related risks associated with the control and the purpose for which it was intended. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues including instances of fraud and control breakdowns will not occur because of human error or mistakes. Additionally, controls can be circumvented by the individual acts of some person, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that a design will succeed in achieving its stated goals under all potential future conditions. Over time, our control systems, as we develop them, may become inadequate because of changes in conditions, or the degree of compliance with the policies of procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected and could be material and require a restatement of our financial statements.

During the quarter ended March 31, 2007, we began the planning for the documentation, operation and assessment of internal control over financial reporting for the entities that were excluded from our assessment in 2006, as well as remediating internal control deficiencies identified in 2006, none of which constituted a significant deficiency or material weakness. Except as described above, there have been no significant changes in our internal control over financial reporting.

The certifications of our principal executive officer and principal financial officer required in accordance with Rule 13a-14(a) under the Exchange Act are attached as exhibits to this Quarterly Report on Form 10-Q. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in our internal control over financial reporting, referred to in paragraph 4 of those certifications. Those certifications should be read in conjunction with this Item 4 for a more complete understanding of the matters covered by the certifications.

PART II - OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

In March and April 2005, eight putative class action lawsuits were filed in the United States District Court for the District of Massachusetts against L-1, Mr. Bernard C. Bailey, Mr. William K. Aulet (the Company s former Chief Financial Officer) and Mr. Denis K. Berube and other members of the Board of Directors of Viisage Technology, Inc. These lawsuits have been consolidated into one action under one case name: In re: Viisage Technology Securities Litigation, Civil Action No. 05-10438-MLW. The so-called Turnberry Group has been designated as lead plaintiff and its counsel has been designated as lead counsel. The amended consolidated complaint which was filed in February 2006 alleges violations of the federal securities laws by Viisage (now named L-1 Identity Solutions, Inc.) and certain officers and directors arising out of purported misstatements and omissions in Viisage s SEC filings related to certain litigation involving the Georgia drivers license contract and related to the Viisage s reported material weaknesses in internal controls over financial reporting, which allegedly artificially inflated the price of the Company s stock during the period May 12, 2004 through March 2, 2005. In April 2006, the Company filed a motion to dismiss this case. In February 2007 the judge dismissed all claims related to the Georgia drivers license contract and permitted the case to proceed on claims associated with purported internal control weaknesses over financial reporting. The Company believes that the allegations and claims made in this lawsuit are without merit and the Company intends to defend the action vigorously. The Company is not able to estimate the ultimate amount of the loss, if any, allegedly suffered by members of the putative class or the ultimate amount of legal costs and internal efforts associated with defending the Company and officers and directors. The Company s insurance carrier is currently paying the defense costs of the Company and the individual defendants. Based on all facts and circumstances, including available insurance policies, management believes that it is unlikely that the eventual resolution of the litigation will have a material adverse effect on the consolidated financial statements.

In April 2005, two purported shareholder derivative actions also were filed against directors, naming Viisage as a nominal defendant. The suits claim that these directors breached their fiduciary duties to its shareholders and to Viisage generally in connection with the same set of circumstances alleged in the class action lawsuit. The complaints are derivative in nature and do not seek relief from the Company. One of these actions was filed in Massachusetts Superior Court and the other was filed in the United States District Court for the District of Massachusetts. In July 2005, the state court action was dismissed with prejudice at the plaintiff s request. An amended complaint in the federal court derivative action was filed in July 2006 in which the plaintiff added allegations regarding disclosures by Viisage s representatives that generally appear to be intended to support her contention that she was excused from making a demand on the board of directors before filing a derivative complaint. Oral arguments have not yet been scheduled by the court. The Company has filed a motion to dismiss the federal court action. The Company believes that the allegations and claims made in the derivative lawsuit are without merit and intends to defend the action vigorously.

In January 2004, LG Electronics USA, Inc. and LG Electronics, Inc. (a Korean corporation.) (LG) filed a lawsuit against Iridian Technologies, Inc., a wholly owned subsidiary of the Company, in federal court in New Jersey seeking to cancel Iridian s federal trademark registration for its IrisAccess trademark, and alleging that Iridian had made false statements by announcing that it had discontinued its IrisAccess line of products. At the time LG filed this lawsuit, the parties had been engaged in an ongoing negotiation regarding Iridian s introduction of new standard pricing for its licenses. LG contended that Iridian was not entitled to impose its new standard per user pricing on LG pursuant to the terms of the parties 2000 Amended and Restated Development, Distribution and Supply agreement (the License Agreement). In August 2004, LG filed a demand for arbitration before the American Arbitration Association, seeking a finding that its fee for using Iridian s iris recognition technology remained at the original per unit pricing structure under the License Agreement. Shortly thereafter, Iridian terminated the License Agreement due to LG s failure to pay royalties as required under Iridian s new standard pricing. In response, LG filed another lawsuit in New Jersey federal court, asking the court to enter a finding that Iridian s termination of the License Agreement was improper and that LG s continued use of Iridian s technology did not infringe upon Iridian s patent rights. The issues in all three cases have since been consolidated into one action pending in New Jersey federal court, and are being litigated pursuant to a series of amended complaints filed by LG. Iridian vigorously denies all of LG s claims and is counterclaiming for LG s breach of contract, infringement of Iridian s patents and copyrights, and misappropriation of Iridian s trade secrets. LG has replied to Iridian s counterclaims and has asserted defenses that include, among other things, the alleged invalidity or unenforceability of Iridian s patents, copyrights and trade secrets. Late in 2006, the court (1) allowed LG to further amend its complaint to add additional allegations of antitrust violations by Iridian and (2) rejected LG s attempt to add L-1 and SecuriMetrics as defendants in the litigation. At this time, the parties are continuing extensive fact discovery. The court has not entered a formal scheduling order, but has set a conference for June 6, 2007 at which time the parties are expected to discuss scheduling and the possibility of further amending their claims and counter claims. Iridian believes that it has strong defenses to all of LG s claims and a strong basis to pursue all of Iridian s counterclaims, and intends to vigorously defend against LG s claims and pursue its own counterclaims. At this time, the parties have not completed discovery and accordingly, it is not possible to predict with certainty the outcome of this litigation. However, a material adverse ruling against Iridian respecting either the underlying contract claims or enforceability of Iridian s intellectual property rights could materially adversely impact the value of the Company s investment in Iridian and its iris recognition technology.

In July 2006, Identix received an ordinary course call from the Office of Export Enforcement (BIS) requesting copies of shipping documentation related to a prior shipment of Identix products. In the process of retrieving the documentation, Identix determined that its shipping department had incorrectly completed the relevant documentation, and Identix promptly informed BIS of the error. Identix promptly thereafter initiated an internal review of compliance with its own export compliance policies and export regulations. During the course of the internal review, additional shipping documentation discrepancies were identified. In September 2006, Identix voluntarily disclosed such discrepancies to BIS and retained an independent consultant to supplement Identix internal review of export compliance. In January 2007 Identix notified BIX of its final findings arising from the internal review. While monetary penalties arising out of Identix inadvertent discrepancies are a possible result of Identix findings and voluntary disclosures to BIS, based on information currently available, L-1 does not believe that liabilities or penalties arising out of these discrepancies will have a material adverse effect on the business, operations or financial results of L-1.

From time to time in the ordinary course of business, the Company is involved in disputes with third parties, including former employees of the Company. Identix Incorporated, a wholly owned subsidiary of the Company, was recently a defendant in one lawsuit filed by a former employee of Identix in the Fresno County Superior Court of California alleging, among other things, wrongful discharge. In a separate dispute, in June 2006 another former employee of Identix filed a lawsuit in the U.S. District Court for the Central District of California alleging, among other things, unlawful wage rate discrimination based on gender. Both of these cases were resolved by Identix in March 2007 without material cost or liability to the Company.

ITEM 1A RISK FACTORS

This Quarterly Report on Form 10-Q contains or incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate and management s beliefs and assumptions. Any statements contained herein (including without limitation statements to the effect that we or our management believe , expect , anticipate plan and similar expressions) that are not statements of historical fact should be considered forward-looking statements and should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements included in this report. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth below. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties, including those not presently known to us or that we currently deem immaterial, may also impair our business. We expressly disclaim any obligation to update any forward-looking statements, except as may be required by law.

Risks Related to Our Business

We have a history of operating losses.

We have a history of operating losses. Our business operations began in 1993 and, except for 1996 and 2000, have resulted in net losses in each year, including a net loss of $31.0 million in 2006 and a net loss of $8.8 million for the three months ended March 31, 2007. At March 31, 2007, we had an accumulated deficit of approximately $96.3 million. We will continue to invest in the development of our secure credential and biometric technologies, as well as related security consulting services. Although we were profitable in the fourth quarter of 2006, we cannot provide any assurance that we will achieve profitability on an annual basis in the future.

We derive over 90% of our revenue from government contracts, which are often non-standard, involve competitive bidding, may be subject to cancellation with or without penalty and may produce volatility in earnings and revenue.

More than 90% of our business involves providing solutions, and services under contracts with U.S. federal, state, local and foreign government agencies. Obtaining contracts from government agencies is challenging and government contracts often include provisions that are not standard in private commercial transactions. For example, government contracts may:

- include provisions that allow the government agency to terminate the contract without penalty under some circumstances;
- be subject to purchasing decisions of agencies that are subject to political influence;
- include bonding requirements;
- contain onerous procurement procedures; and
- be subject to cancellation or reduction if government funding becomes unavailable or is cut back.

Securing government contracts can be a protracted process involving competitive bidding. In many cases, unsuccessful bidders may challenge contract awards, which can lead to increased costs, delays and possible loss of the contract for the winning bidder. Protests, and similar delays, regarding any future government contracts of a material nature that may be awarded to us could result in materially adverse revenue volatility, making management of inventory levels, cash flows and profitability inherently difficult. Outright loss of any material government contract through the protest process or otherwise, could have a material adverse effect on our financial results and stock price.

Similar to federal government contracts, state and local government agency contracts may be contingent upon availability of matching funds from federal, state or local entities. State and local law enforcement and other government agencies are subject to political, budgetary, purchasing and delivery constraints which may result in quarterly and annual revenue and operating results that may be irregular and difficult to predict. Such revenue volatility makes management of inventory levels, cash flows and profitability inherently difficult. In addition, if we are successful in winning such procurements, there may be unevenness in shipping schedules, as well as potential delays and changes in the timing of deliveries and recognition of revenue, or cancellation of such procurements.

In addition, government contracts may specify performance criteria that must be satisfied before the customer accepts the products and services. Collection of accounts receivable may be dependent on meeting customer requirements, which may be unpredictable, subject to change by the customer, and not fully understood by us at the time of acceptance of the order, and may require the incurrence of unexpected costs. These costs are accounted for as required but may be uncompensated and could negatively affect profit margins and our liquidity.

We may not realize the full amount of revenues reflected in our backlog, which could harm our operations and significantly reduce our future revenues.

There can be no assurances that our backlog estimates will result in actual revenues in any particular fiscal period because our clients may modify or terminate projects and contracts and may decide not to exercise contract options. Our backlog represents sales value of firm orders for products and services not yet delivered and, for long term executed contractual arrangements (contracts, subcontracts, and customer commitments), the estimated future sales value of estimated product shipments, transactions processed and services to be provided over the term of the contractual arrangements, including renewal options expected to be exercised. For contracts with indefinite quantities backlog reflects estimated quantities based on current activity levels. Our backlog includes estimates of revenues the receipt of which require future government appropriation, option exercise by our clients and/or is subject to contract modification or termination. At December 31, 2006, our backlog approximated $523.0 million, $250.0 million of which is estimated to be realized in the following twelve months. These estimates are based on our experience under such contracts and similar contracts, and we believe such estimates to be reasonable. However, we believe that the receipt of revenues reflected in our backlog estimate for the following twelve months will generally be more certain than our backlog estimate for periods thereafter. If we do not realize a substantial amount of our backlog, our operations could be harmed and our future revenues could be significantly reduced.

We derive a significant portion of our revenue from federal government customers, the loss of which could have an adverse effect on our revenue.

For the three month period ended March 31, 2007, one Federal government agency accounted for 26% of our consolidated revenues. For the three month period March 31, 2006, the U.S. Department of State accounted for 15% of our consolidated revenues. As of March 31, 2007, we had an accounts receivable balance of approximately $13.4 million for one Federal government agency which was the only customer that had a balance of greater than 10% of consolidated accounts receivable. As of March 31, 2006, the U.S. Department of State was the only customer that had a balance of greater than 10% of consolidated accounts receivable, which was approximately $4.0 million. The loss of any of our significant customers would cause revenue to decline and could have a material adverse effect on our business.

We have been named as a defendant in a putative class action lawsuit, an adverse outcome in which could have a material adverse effect on our business, financial condition and results of operations by adversely affecting our cash position.

As described below in Item 1, Legal Proceedings, in March and April 2005, eight putative class action lawsuits were filed against Viisage in the United States District Court for the District of Massachusetts. These lawsuits have been consolidated into one action under one case name: In re: Viisage Technology Securities Litigation, Civil Action No. 05-10438-MLW. The amended consolidated complaint which was filed in February 2006 alleges violations of the federal securities laws by Viisage and certain of Viisage s then officers and directors arising out of purported misstatements and omissions in Viisage s SEC filings related to the litigation involving the Georgia drivers license contract and related to Viisage s reported material weaknesses in internal controls over financial reporting, which allegedly artificially inflated the price of Viisage s stock during the period May 12, 2004 through March 2, 2005. In February 2007 all claims related to the Georgia driver s license contract were dismissed. We are not able to estimate the ultimate amount of the loss allegedly suffered by members of the putative class or the ultimate amount of legal costs and internal efforts associated with defending ourselves and our officers and directors. If we are unsuccessful in defending ourselves in this litigation, this lawsuit could adversely affect our business, financial condition, results of operations and cash flows as a result of the damages that we would be required to pay. We cannot be certain that we will be successful in this litigation.

Biometric technologies have not achieved widespread commercial acceptance and our strategy of expanding our biometric business could adversely affect our business operations and financial condition.

Part of our strategy is to enhance our leadership in biometric technologies. Pursuing this strategy involves risks. For instance, to date, biometric technologies have not gained widespread commercial acceptance. Although there has been more recent activity, there is no assurance that this activity will continue. Some of the obstacles include a perceived loss of privacy and public perceptions as to the usefulness of biometric products. Whether the market for biometric technologies will expand will be dependent upon factors such as:

- national or international events which may affect the need for or interest in biometric products or services;
- the cost, performance and reliability of the products and services and those of our competitors;
- customers perception of the perceived benefit of biometric products and services and their satisfaction with the products and services;
- public perceptions of the intrusiveness of these biometric products and services and the manner in which firms are using the information collected;
- public perceptions regarding the confidentiality of private information;
- proposed or enacted legislation related to privacy of information; and
- marketing efforts and publicity regarding these products and services.

We do not know when, if ever, biometric products and services will gain widespread commercial acceptance. Certain groups have publicly objected to the use of biometric products and services for some applications on civil liberties grounds and legislation has been proposed to regulate the use of biometric security products. From time to time, biometric technologies have been the focus of organizations and individuals seeking to curtail or eliminate such technologies on the grounds that they may be used to diminish personal privacy rights. If such initiatives result in restrictive legislation, the market for biometric solutions may be adversely affected. Even if biometric technologies gain wide market acceptance, our biometric products and services may not adequately address the requirements of the market and may not gain widespread commercial acceptance.

We face intense competition, which could result in lower revenues and higher research and development expenditures and could adversely affect our results of operations.

The events of September 11, 2001 and subsequent regulatory and policy changes in the U.S. and abroad have heightened interest in the use of biometric security solutions, and we expect competition in this field, which is already substantial, to intensify. Competitors are developing and marketing semiconductor or optically based direct contact fingerprint image capture devices, or retinal blood vessel, iris pattern, hand geometry, voice or various types of facial structure solutions. Among these companies are Cognitec Systems Corporation, CrossMatch Technologies, Imageware Systems, Inc., SAGEM Morpho Inc., NEC Corporation and Cogent, Inc. Our products also compete with non-biometric technologies such as certificate authorities and traditional keys, cards, surveillance systems and passwords. Widespread adoption of one or more of these technologies or approaches in the markets we intend to target could significantly reduce the potential market for our systems and products. Many of our competitors have significantly more cash and resources than we have. Our competitors may introduce products that are more price competitive, have increased performance or functionality or incorporate technological advances that we have not yet developed or implemented. To remain competitive, we must continue to develop, market and sell new and enhanced systems and products at competitive prices, which will require significant research and development expenditures. If we do not develop new and enhanced products or if we are not able to invest adequately in their research and development activities, our business, financial condition and results of operations could be severely and negatively impacted.

Unless we keep pace with changing technologies, we could lose existing customers and fail to win new customers.

In order to compete effectively in the biometrics market, we must continually design, develop and market new and enhanced products. Our future success will depend, in part, upon our ability to address the changing and sophisticated needs of the marketplace. Frequently, technical development programs in the biometric industry require assessments to be made of the future directions of technology and technology markets generally, which are inherently risky and difficult to predict. We may not be able to accurately predict which technologies our customers will support. If we fail to choose correctly among technical directions, or we fail to offer innovative products and services at competitive prices in a timely manner, customers may forego purchases of our products and services and purchase those of our competitors.

Security breaches in systems that we sell or maintain could result in the disclosure of sensitive government information or private personal information that could result in the loss of customers and negative publicity.

Many of the systems we sell manage private personal information and protect information involved in sensitive government functions. The protective security measures that we use in these systems may not prevent security breaches, and failure to prevent security breaches may disrupt our business, damage our reputation, and expose us to litigation and liability. A party who is able to circumvent protective security measures used in these systems could misappropriate sensitive or proprietary information or cause interruptions or otherwise damage our products, services and reputation, and the property and privacy of our customers. If unintended parties obtain sensitive data and information, or create bugs or viruses or otherwise sabotage the functionality of our systems, we may receive negative publicity, incur liability to our customers or lose the confidence of our customers, any of which may cause the termination or modification of our contracts. Further, our insurance coverage may be insufficient to cover losses and liabilities that may result from such events.

In addition, we may be required to expend significant capital and other resources to protect ourselves against the threat of security breaches or to alleviate problems caused by the occurrence of any such breaches. However, protective or remedial measures may not be available at a reasonable price or at all, or may not be entirely effective if commenced.

Our reliance on external suppliers and contract manufacturers may result in disruption of our operations.

The lead-time for ordering certain of products and materials and for building many of our products can be many months. As a result, we must order products and materials based on forecasted demand. If demand for our products lags significantly behind our forecasts, we may purchase more products than we can sell, which can result in increased cash needs and write-downs of obsolete or excess inventory. In addition, if product purchases are delayed, we may lose customers and sales.

We rely on contract manufacturers to produce our hardware products under short term manufacturing arrangements. Although we believe we can find alternative sources of manufacturing our hardware, any disruption of contractual arrangements could result in delaying deliveries or in the loss our sales.

Loss of limited source suppliers may result in delays or additional expenses.

We obtain certain hardware and services, as well as software applications, from a limited group of suppliers. Our reliance on these suppliers involves significant risks, including reduced control over quality and delivery schedules. In particular, we are dependent on Toppan Printing Co. Ltd. for all of the printers and consumables for the U.S. Department of State passport contract and the U. S. Department of Defense common access card contract. Any financial instability of our suppliers could result in our having to find new suppliers. We may experience significant delays in manufacturing and deliveries of our products and services to customers if we lose our sources or if supplies and services delivered from these sources are delayed. As a result, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. It may take several months to locate alternative suppliers, if required, or to re-tool our products to accommodate components from different suppliers. We cannot predict if we will be able to obtain replacement components within the time frames we require at an affordable cost, or at all. Any delays resulting from suppliers failing to deliver components or obtain alternative service providers, products or services on a timely basis, in sufficient quantities and of sufficient quality or any significant increase in our costs of components from existing or alternative suppliers could have a severe negative impact on our business, financial condition and results of operations.

The market for our solutions is still developing and if the industry adopts standards or a platform different from our platform, then our competitive position would be negatively affected.

The market for identity solutions is still emerging. The evolution of this market is in a constant state of flux that may result in the development of different technologies and industry standards that are not compatible with our current products or technologies. In particular, the face recognition market lacks industry-wide standards. Several organizations, such as the International Civil Aviation Organization, which sets standards for travel documents that its member states then put into effect, and the National Institute for Standards and Testing, which is part of the U.S. Department of Commerce, have recently selected face recognition as the biometric to be used in identification documentation. It is possible, however, that these standards may change and that any standards eventually adopted could prove disadvantageous to or incompatible with our business model and product lines.

Our plan to pursue sales in international markets may be limited by risks related to conditions in such markets.

For the three months ended March 31, 2007 we derived approximately 12% of our total revenues from international sales. There is a risk that we may not be able to successfully market, sell and deliver our products in foreign countries.

Risks inherent in marketing, selling and delivering products in foreign and international markets, each of which could have a severe negative impact on our financial results and stock price, include those associated with:

- regional economic or political conditions;
- delays in or absolute prohibitions on exporting products resulting from export restrictions for certain products and technologies, including crime control products and encryption technology;
- loss of, or delays in importing products, services and intellectual property developed abroad, resulting from unstable or fluctuating social, political or governmental conditions;
- fluctuations in foreign currencies and the U.S. dollar;
- loss of revenue, property (including intellectual property) and equipment from expropriation, nationalization, war, insurrection, terrorism, criminal acts and other political and social risks;
- the overlap of different tax structures;
- seasonal reductions in business activity;
- risks of increases in taxes and other government fees; and

involuntary renegotiations of contracts with foreign governments.

We expect that we will have increased exposure to foreign currency fluctuations. As of March 31, 2007, our accumulated other comprehensive income includes foreign currency translation adjustments of $0.8 million. In addition, we have significant Japanese yen-denominated transactions with Japanese vendors supplying hardware and consumables for the delivery of certain large contracts. Fluctuations in foreign currencies, including our Japanese yen-denominated transactions could result in unexpected fluctuations to our results of operations, which could be material and adverse.

If we do not successfully expand our direct sales and services organizations and partnering arrangements, we may not be able to increase our sales or support our customers.

We sell substantially all of our services and license substantially all of our products through our direct sales organization. Our future success depends on substantially increasing the size and scope of our direct sales force and partnering arrangements, both domestically and internationally. We will face intense competition for personnel, and we cannot guarantee that we will be able to attract, assimilate or retain additional qualified sales personnel on a timely basis. Moreover, given the large-scale deployment required by some of our customers, we will need to hire and retain a number of highly trained customer service and support personnel. We cannot guarantee that we will be able to increase the size of our customer service and support organization on a timely basis to provide the high quality of support required by our customers. Failure to add additional sales and customer service representatives could result in our inability to increase sales and support our customers.

We rely in part upon original equipment manufacturers, or OEM, and distribution partners to sell our products, and we may be adversely affected if those parties do not actively promote their products or pursue installations that use their equipment.

A significant portion of our revenue comes from sales to partners including OEMs, systems integrators, distributors and resellers. Some of these relationships have not been formalized in a detailed contract, and may be subject to termination at any time. Even where these relationships are formalized in a detailed contract, the agreements can often be terminated with little or no notice and subject to periodic amendment. We cannot control the amount and timing of resources that our partners devote to activities on their behalf.

We intend to continue to seek strategic relationships to distribute, license and sell certain of our products. We, however, may not be able to negotiate acceptable relationships in the future and cannot predict whether current or future relationships will be successful.

For example, we are currently involved in a dispute with LG Electronics, Inc. and its subsidiary relating to the termination of such a relationship. As a result of this dispute, LG has alleged the invalidity of Iridian s patents, copyrights and trade secrets. A material adverse ruling against Iridian respecting either the underlying contract claims or enforceability of Iridian s intellectual property rights could materially adversely impact the value of the Company s investment in Iridian and its iris recognition technology. See Item 1. Legal Proceedings.

If our systems and products are not timely delivered or do not perform as promised, we could experience increased costs, lower margins, liquidated damage payment obligations and reputational harm.

We will be required to provide complex systems that will be required to operate on an as needed basis. This may in turn lead to delays or shortages in the availability of certain products, or, in some cases, the unavailability of certain products. The negative effects of any delay or failure to deliver our products could be exacerbated if the delay or failure occurs in products that provide personal security, secure sensitive computer data, authorize significant financial transactions or perform other functions where a security breach could have significant consequences. If a product launch is delayed or is the subject of an availability shortage because of problems with our ability to manufacture or assemble the product successfully on a timely basis, or if a product or service otherwise fails to meet performance criteria, we may lose revenue opportunities entirely and/or experience delays in revenue recognition associated with a product or service in addition to incurring higher operating expenses during the period required to correct the defects.

There is a risk that for unforeseen reasons we may be required to repair or replace a substantial number of products in use or to reimburse customers for products that fail to work or meet strict performance criteria. From time to time, in certain critical or complex sale or licensing transactions, we may be compelled to accept liability provisions that vary from our preferred contracting model. There is a risk that in certain contracts and circumstances we may not be successful in adequately minimizing our product and related liabilities or that the protections we negotiate will not ultimately be deemed enforceable. We carry product liability insurance, but existing coverage may not be adequate to cover potential claims. Although we will deploy back-up systems, the failure of our products to perform as promised could result in increased costs, lower margins, liquidated damage payment obligations and harm to our reputation. This could result in contract terminations and have a material adverse effect on our business and financial results.

Failure to maintain the proprietary nature of our technology, intellectual property and manufacturing processes could have a material adverse effect on our business and our ability to compete effectively.

We principally rely upon patent, trademark, copyright, trade secret and contract law to establish and protect our proprietary rights. There is a risk that claims allowed on any patents or trademarks we hold may not be broad enough to protect our technology. In addition, our patents or trademarks may be challenged, invalidated or circumvented and we cannot be certain that the rights granted there under will provide competitive advantages to us. Moreover, any current or future issued or licensed patents, or trademarks, or currently existing or future developed trade secrets or know-how may not afford sufficient protection against competitors with similar technologies or processes, and the possibility exists that certain of our already issued patents or trademarks may infringe upon third party patents or trademarks or be designed around by others. In addition, there is a risk that others may independently develop proprietary technologies and processes, which are the same as, substantially equivalent or superior to ours, or become available in the market at a lower price.

We may have to litigate to enforce our patents or trademarks or to determine the scope and validity of other parties proprietary rights. Litigation could be very costly and divert management s attention. An adverse outcome in any litigation may have a severe negative effect on our financial results and stock price. To determine the priority of inventions, we may have to participate in interference proceedings declared by the United States Patent and Trademark Office or oppositions in foreign patent and trademark offices, which could result in substantial cost and limitations on the scope or validity of our patents or trademarks.

In addition, foreign laws treat the protection of proprietary rights differently from laws in the United States and may not protect our proprietary rights to the same extent as U.S. laws. The failure of foreign laws or judicial systems to adequately protect our proprietary rights or intellectual property, including intellectual property developed on our behalf by foreign contractors or subcontractors may have a material adverse effect on our business, operations, financial results and stock price.

Legal claims regarding infringement by us or our suppliers of third party intellectual property rights could result in substantial costs, diversion of managerial resources and harm to our reputation.

Although we believe that our products and services do not infringe currently existing and validly issued intellectual property rights of others, we might not be able to defend successfully against a third-party infringement claim. A successful infringement claim against us, our customers or our suppliers could subject us to:

- liability for damages and litigation costs, including attorneys fees;
- lawsuits that prevent us from further use of the intellectual property;
- having to license the intellectual property from a third party, which could include significant licensing fees;
- having to develop a non-infringing alternative, which could be costly and delay projects;
- having to indemnify clients with respect to losses they incurred as a result of the alleged infringement; and
- having to establish alternative sources for products supplied to us by third parties, as discussed above in the risk factor regarding their dependence on limited source suppliers.

Our failure to prevail against any third party infringement claim could have a material adverse effect on our business and financial results. Even if we are not found liable in a claim for intellectual property infringement, such a claim could result in substantial costs, diversion of resources and management attention, termination of customer contracts and harm to our reputation.

We may be unable to obtain additional capital required to fund our operations and finance our growth.

The installation of our secure credentialing systems requires capital expenditures. Moreover, our strategy includes growth of our business through acquisitions. At March 31, 2007, we had cash and cash equivalents of $4.1 million and availability under our line of credit of $47.7 million. While we believe we have adequate capital resources to meet current working capital requirements and have been successful in the past in obtaining financing for working capital, capital expenditures, and acquisitions, we expect to have ongoing capital needs as we continue to expand our business. If we require additional financing, we may be unsuccessful in raising additional financing or we may not be able to do so on terms that are not excessively dilutive to existing stockholders or less costly than existing sources of financing. Failure to secure additional financing in a timely manner and on favorable terms could have a material adverse effect on our growth strategy, financial performance and stock price and could require us to delay or abandon our development and expansion plans or to implement certain cost reduction initiatives resulting in the curtailment of our operations.

We are dependent on a small number of individuals, and if we lose key personnel upon whom we are dependent, our business will be adversely affected.

Much of our future success depends on the continued service and availability of our senior management, including our Chairman of the Board, President and Chief Executive Officer, Robert V. LaPenta, and other members of our executive team. These individuals have acquired specialized knowledge and skills with regards to advanced technology identity solutions. The loss of any of these individuals could severely harm our business. Our business is also highly dependent on our ability to retain, hire and motivate talented highly skilled personnel. Experienced personnel in the advanced technology identity solutions industry are in high demand and competitions for their talents are intense. If we are unable to successfully attract, retain and motivate key personnel, our business may be severely harmed.

Certain of our stockholders have significant relationships with us, which could result in it taking actions that are not supported by unaffiliated stockholders.

In connection with the Aston investment, Aston became the largest stockholder of L-1, owning approximately 10.5% of our outstanding common stock. In addition, Lau Technologies, or (Lau), and Mr. Buddy Beck, beneficially own approximately 3% and 3%, respectively, of our outstanding common stock. As a result, Aston (together with its affiliate, L-1 Investment Partners LLC), Lau and Mr. Beck have an influence on matters requiring approval by our stockholders, including the election of directors and most corporate actions, such as mergers and acquisitions. In addition, we have significant relationships with each of L-1 Investment Partners LLC, Aston, Lau and Mr. Beck, including:

- Mr. Robert V. LaPenta, the founder and Chief Executive Officer of L-1 Investments Partners LLC, is Chairman of our board of directors and Chief Executive Officer and President;

Mr. James DePalma, Mr. Joseph Paresi and Ms. Doni Fordyce who are affiliates of L-1 Investment Partners LLC and Aston, serve as the Executive Vice President and Chief Financial Officer, Executive Vice President and Chief Marketing and Sales Officer, and Executive Vice President and of Corporate Communications, respectively;

we acquired intellectual property, contracts and distribution channels through a transaction with Lau in January 2002 under which we agreed to pay Lau a 3.1% royalty on certain of our face recognition revenues through June 30, 2014, up to a maximum of $27.5 million;

in connection with the above transaction with Lau, we entered into consulting agreements with Ms. Joanna Lau, the President of Lau, and her spouse Mr. Denis K. Berube, the Chief Operating Officer of Lau who also serves as a director on our board of directors, under which we will pay each of Ms. Lau and Mr. Berube $0.1 million per year through the earlier of January 10, 2012 or the commencement of the consultants full-time employment elsewhere. Mr. Berube and Ms. Lau own a majority of Lau s stock;

in connection with the acquisition of TDT in February 2004, Mr. Beck was elected a member of our board of directors and we entered into a consulting agreement with Mr. Beck under which we agreed to pay Mr. Beck $0.3 million per year for two years. The consulting agreement expired on April 14, 2006.

The concentration of large percentages of ownership in any single stockholder, or in any series of single stockholders, may delay or prevent change in control of the Company. Additionally, the sale of a significant number of our shares in the open market by single stockholders or otherwise could adversely affect our stock price.

Risks Related to Our Acquisition Strategy

Integration of Identix and other recently acquired businesses may be difficult to achieve and will consume significant financial and managerial resources, which may adversely affect operations.

We may encounter substantial difficulties, costs and delays in integrating our operations with Identix and other recently acquired companies, including SpecTal, SecuriMetrics, IBT, Iridian and ComnetiX, Inc. such as:

- exposure to unknown liabilities of acquired companies or assets;
- higher than anticipated acquisition costs and expenses;
- assumption of ongoing litigation matters that may be highly complex and involve significant time, cost and expense (such as the dispute with LG assumed with in connection with our acquisition of Iridian and described under Item 1. Legal Proceedings.)
- potential conflicts between business cultures;
- adverse changes in business focus perceived by third-party constituencies;
- disruption of our ongoing business;
- potential conflicts in distribution, marketing or other important relationships;
- potential constraints of management resources;
- failure to maximize our financial and strategic position by the successful incorporation of acquired technology;
- failure to realize the potential of acquired technologies, complete product development, or properly obtain or secure appropriate protection of intellectual property rights; and
- loss of key employees and/or the diversion of management s attention from other ongoing business concerns.

In addition, we have offices in many locations and have moved our corporate headquarters from the Viisage facilities in Billerica, Massachusetts, to Stamford, Connecticut. Identix is headquartered in Minnetonka, Minnesota and has employees in seven locations. SpecTal is headquartered in Reston, Virginia and SecuriMetrics and Iridian are located in Martinez, California. IBT is located in Nashville, Tennessee and Springfield, Illinois and ComnetiX is headquartered in Oakville, Ontario, Canada. The geographic distance between the companies and their respective offices and operations increases the risk that the integration will not be completed successfully or in a timely and cost-effective manner. We may not be successful in overcoming these risks or any other problems encountered in connection with the integration of the companies. The simultaneous integration of these acquisitions may place additional strain on our resources and increase the risk that our business may be adversely affected by the disruption caused by the acquisitions. Our strategy contemplates acquiring additional businesses, the integration of which may consume significant financial and managerial resources, and could have a severe negative impact on our business, financial condition and results of operations.

Our acquisitions could result in future impairment charges and other charges which could adversely affect our results of operations.

At March 31, 2007 goodwill and other intangible assets are $972.5 million and $168.0 million, respectively. Because goodwill represents a residual after the purchase price is allocated to the fair value of acquired assets and liabilities, it is difficult to quantify the factors that contribute to the recorded amounts. Nevertheless, management believes that the following factors have contributed to the amount recorded:

- technological development capabilities and intellectual capital;
- expected significant growth in revenues and profits from the expanding market in identity solutions; and
- expected synergies resulting from providing multi modal product offerings to existing customer base and to new customers of the combined company.

The recorded amounts at the purchase date for goodwill and other intangible assets are estimates at a point in time and are based on valuations and other analyses of fair value that require significant estimates and assumptions about future events, including but not limited to projections of revenues, market growth, demand, technological developments, political developments, government policies, among other factors, which are derived from information obtained from independent sources, as well as the management of the acquired businesses and our business plans for the acquired businesses or intellectual property. If estimates and assumptions used to initially record goodwill and intangible assets do not materialize, or unanticipated adverse developments or events occur, ongoing reviews of the carrying amounts of such goodwill and intangible assets may result in impairments which will require us to record a charge in the period in which such an impairment is identified, and could have a severe negative impact on its business and financial statements.

If we do not achieve the expected benefits of the acquisitions we have made, the price of our common stock could decline.

We expect that the acquisitions of Identix and Iridian in August 2006, SpecTal in October 2006, SecuriMetrics in February 2006 and ComnetiX in February 2007, as well as the acquisitions that we have made previously will enhance our leadership in the identity solutions industry through the combination of their respective technologies. However, the combination of such technologies might not meet the demands of the marketplace. If our technologies fail to meet such demand, customer acceptance of our biometric products could decline, which would have an adverse effect on our results of operations and financial condition. Further, we expect that the additions to our product portfolio will extend our reach into our current markets and provide a critical component to our comprehensive offering for new markets in need of identity solutions. However, there can be no assurance that our current customers or customers in new markets will be receptive to these additional offerings. Further, we might not be able to market successfully our products and services to the customers of the companies we acquired. If our product offerings and services fail to meet the demands of this marketplace, our results of operations and financial condition could be adversely affected. There is also a risk that we will not achieve the anticipated benefits of the acquisitions as rapidly as, or to the extent, anticipated by financial or industry analysts, or that such analysts will not perceive the same benefits to the acquisitions as they do. If these risks materialize, our stock price could be adversely affected.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 OTHER INFORMATION

None.

ITEM 6 EXHIBITS

The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this report.

L-1 IDENTITY SOLUTIONS, INC.

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.

Date: May 9, 2007	By:	/s/ ROBERT V. LAPENTA **Robert V. LaPenta** **Chairman of the Board, Chief Executive Officer and President** **(Principal Executive Officer)**
Date: May 9, 2007	By:	/s/ JAMES A. DEPALMA **James A. DePalma** **Executive Vice President, Chief Financial Officer and Treasurer** **(Principal Financial Officer)**

EXHIBIT INDEX

Exhibit No.	Note	Description
31.1	(a)	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	(a)	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	(a)	Certification of Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	(a)	Certification of Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Note	Description
(a)	Filed herewith.