PUBLICARD INC
Form 10-K
March 30, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004 OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____ TO ____.

COMMISSION FILE NUMBER 0-29794

PUBLICARD, INC.
(Exact Name of Registrant as Specified in Its Charter)

PENNSYLVANIA	23-0991870
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

ONE ROCKEFELLER PLAZA, 14TH FLOOR, NEW YORK, NY	10020
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (212) 651-3102

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
NONE	NONE

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK ($.10 PAR VALUE)
(Title of Class)

RIGHTS TO PURCHASE CLASS A PREFERRED STOCK, FIRST SERIES
(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [_] No [X]

As of June 30, 2004, the aggregate market value of the voting Common Stock held by non-affiliates of the registrant was approximately $1,025,000.

Number of shares of Common Stock outstanding as of March 24, 2005: 24,690,902

DOCUMENTS INCORPORATED BY REFERENCE
None

PART I

This Form 10-K contains forward-looking statements, including (without limitation) statements concerning possible or assumed future results of operations of PubliCARD, Inc. and subsidiaries, ("PubliCARD," the "Company," "we," "us" and "our," as the context requires) preceded by, followed by or that include forward-looking words or phrases, including "believes," "expects," "anticipates," "estimates," "may," "should," "would," "could," "intends," "plans" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions. You should understand that the possible consequences of events described under such statements made under "Factors That May Affect Future Results" and elsewhere in this document could affect our future results and could cause those results to differ materially from those expressed in such forward-looking statements.

ITEM 1. BUSINESS

PubliCARD was originally incorporated in 1913 in the Commonwealth of Pennsylvania. PubliCARD's sole operating activities are conducted through its Infineer Ltd. ("Infineer") subsidiary. Infineer is a smart card technology company, which designs and develops smart card software and hardware solutions for campus environments. This market includes institutions such as corporate campuses, secondary schools and universities. The Company's ChipNet solution focuses on delivering a multi-functional platform to control access to and payment for a wide variety of applications using a single smart card. The solution has been designed to accommodate integration with a range of third party technologies. The Company believes that the educational, government and corporate sectors all continue to move toward the more functional and broader applications that a smart card solution can provide over traditional methods. The Company sells its transaction solutions to value-added resellers and distributors, and directly to end-users.

The Company's future plans revolve around a potential acquisition strategy that would focus on businesses in areas outside the high technology sector while continuing to support the expansion of the Infineer business. However, the Company will not be able to implement such plans unless it is successful in obtaining funding, as to which no assurance can be given.

The consolidated financial statements included in this Form 10-K contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred operating losses, a substantial decline in working capital and negative cash flow from operations for a number of years. The Company has also experienced a substantial reduction in its cash and short term investments, which declined from $17.0 million at December 31, 2000 to $1.9 million at December 31, 2004. The Company also had a shareholders' deficiency of $118.5 million at December 31, 2004.

The Company sponsored a defined benefit pension plan (the "Plan") that was frozen in 1993. In January 2003, the Company filed a notice with the Pension Benefit Guaranty Corporation (the "PBGC") seeking a "distress termination" of

the Plan. In September 2004, the PBGC proceeded to terminate the Plan and was appointed as the Plan's trustee. See Note 5 to the Notes to Consolidated Financial Statements for further information regarding the Plan termination. As a result of the Plan termination, the Company's 2003 and 2004 funding requirements due to the Plan amounting to $3.4 million through September 15, 2004 were eliminated. As such, management believes that existing cash and short term investments may be sufficient to meet the Company's operating and capital requirements at the currently anticipated levels through December 31, 2005. However, additional capital will be necessary in order to operate beyond December 31, 2005 and to fund the current business plan and other obligations. While the Company is considering various funding alternatives, the Company has not secured or entered into any arrangements to obtain additional funds. There can be no assurance that the Company will be able to obtain additional funding on acceptable terms or at all. If the Company cannot raise additional capital to continue its present level of operations it is not likely to be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which would have a material adverse effect on its business and results of operations and is likely to lead the Company to seek bankruptcy protection. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. The independent auditors' reports on the Company's Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002 contain emphasis paragraphs concerning substantial doubt about the Company's ability to continue as a going concern.

INDUSTRY

Security and privacy are primary concerns of the ever-growing information economy. The expected level of growth in secure business-to-business and consumer-to-business transactions will only occur if consumers, businesses, governments and other organizations are confident that their network and Internet exchanges and transactions are secure from unauthorized intrusion, usage, sabotage and theft. To effectively address the growing need for greater enterprise and on-line security, individuals and organizations are turning to smart card technology. Through its central processing and memory capabilities, smart card technology enables cryptographic communications, authentication and other applications that permit secure data access, information exchange and electronic transactions within network and Internet environments.

A smart card is similar in appearance to a traditional credit card, but unlike a traditional credit card, stores information on an integrated circuit chip embedded within the card, rather than on a magnetic stripe on the surface. While a typical magnetic stripe card can store information such as a user's name, account and personal identification number, a smart card has the capacity to store detailed account information, health care records, merchant coupons, still or video images and cash. Additionally, the integrated circuit within a smart card serves as a central processing unit which, combined with its memory capacity, facilitates the use of encryption applications, which secure data and value exchanges within networks and the Internet. Smart cards also permit bi-directional authentication in which the smart card can authenticate the validity of the intended party or device prior to exchanging information or value.

The rollout of smart card technology started in the telecommunication sector, specifically to facilitate the use of public payphones (replacing coins) and mobile phones (Subscriber Identification Modules). The deployment of smart card technology in this sector demonstrates the security and adaptability of the

technology and evidences the uniqueness of smart cards as a medium for storing, transporting and processing personal information, access keys and other information.

Smart card technology is now being widely deployed in other market sectors, including the security and transaction management sectors. In the security sector, smart card technology is being used to authenticate and secure access to physical premises, PCs, networks, virtual private networks, and the Internet, and through cryptography, facilitate secure email, electronic document and information exchanges, e-commerce transactions/payments and other Internet and broadband applications. In the transaction management sector, smart card technology is being used within a variety of closed system environments. For example, smart card technology is being used in the banking sector to secure payment transactions in physical and virtual worlds and in the transportation sector to replace "tickets," thereby speeding up the ticketing process and making it more efficient. Other closed environments such as corporate or educational campuses are using smart card technology to resolve a mix of both security and transaction needs including purchase and payment transactions, identification, authentication and access.

Demand for smart card solutions is being further driven by governments and financial institutions. The U.S. Department of Defense began deployment of smart cards to armed forces personnel under the Common Access Card personal identity program in 2000. The European Commission ("EC") is also supporting the adoption of smart card technology in their continuing efforts to create a more efficient and competitive economy within the European community. Through the eEurope program, the EC is sponsoring programs to standardize smart card infrastructure devices and harmonize system platforms. Finally, smart card technology is rapidly becoming a key facilitator of financial transactions. The financial and banking community in Asia and Europe is using smart card technology to support credit, debit and e-purse cards (cards that store cash values), multi-application services and services dealing with coupons and/or tickets. Several large U.S. financial institutions, including American Express, MasterCard and Visa International, have introduced smart cards as part of their financial card systems.

The use of smart card technology is especially well suited for managing transactions in closed environment solutions that restrict access and manage payments. In closed environments, smart cards are used to control access to physical premises, process payments and provide portable network security. The Company believes that the educational, government and corporate sectors all continue to provide growth opportunities as these institutions move toward the more functional and broader applications that a smart card solution can provide over other traditional methods. Smart card solutions offer a greater level of flexibility and permit development of customer specific applications that cannot be offered by traditional methods of providing closed environment security and transaction management such as the magnetic stripe.

With the increased use and acceptance of smart cards and related technologies worldwide, there are numerous applications to use smart card technology in a variety of infrastructure platforms. PubliCARD has developed a client-server based software solution for closed campus proprietary card users, which is focused on delivering multi-functionality around a single card supporting a wide range of third party technologies.

STRATEGY

HISTORY OF THE COMPANY'S SMART CARD INITIATIVE

PubliCARD established its presence within the smart card industry through a series of acquisitions:

- In February 1998, PubliCARD acquired, through a joint venture arrangement in Greenwald Intellicard, Inc. ("Greenwald Intellicard"), the assets and intellectual property of Intellicard Systems, Ltd. Greenwald Intellicard provided smart cards, smart card readers, value transfer stations, card management software and machine interface boards for the commercial laundry appliance industry. PubliCARD initially owned 50% of Greenwald Intellicard, and acquired the remaining 50% in February 1999 and February 2000.

- In November 1998, PubliCARD acquired Tritheim Technologies, Inc. ("Tritheim"), which developed conditional access and security products for the software industry, computers and the electronic information and the digital video broadcast industry. In May 2000, the Company changed the name of its Tritheim subsidiary to Infineer, Inc. as part of a re-branding effort.

- In February 1999, PubliCARD acquired Amazing! Smart Card Technologies, Inc. ("Amazing"), a developer of consumer smart card solutions and a manufacturer of customized smart cards.

- In February 1999, PubliCARD acquired Greystone Peripherals, Inc. ("Greystone"), a developer of hard disk duplicators.

- In November 1999, PubliCARD acquired Absec Limited ("Absec"), a designer of closed environment solutions, including small value electronic cash systems and database management solutions. In May of 2000, the Company changed the name of its Absec subsidiary to Infineer Ltd. as part of a re-branding effort.

While PubliCARD developed a number of successful products and solutions, its operations were fragmented throughout a variety of markets. PubliCARD's Board of Directors, together with its management team, determined to integrate its operations and focus on a single market in which:

- high growth potential existed;
- PubliCARD had established relationships;
- PubliCARD had already deployed products and gained credibility; and
- PubliCARD possessed core technologies and competencies.

PubliCARD believed that it could leverage its existing smart card technology for deployment in the rapidly growing enterprise and on-line security and transaction management market sectors, which PubliCARD had already penetrated and which it believed exhibited each of the characteristics identified above. To effect this new business strategy, in March 2000, the Company's Board of Directors adopted a plan to dispose of the operations of the Company's Greenwald Industries Inc. ("Greenwald"), Greenwald Intellicard, Greystone and Amazing subsidiaries. These subsidiaries designed, manufactured and distributed mechanical and smart card laundry solutions, hard disk duplicators and smart cards.

On June 29, 2000, the Company completed the sale of substantially all of the assets of Greenwald and Greenwald Intellicard to The Eastern Company ("Eastern") for $22.5 million in cash, less $1.75 million held in escrow to secure the payment of certain indemnification obligations. As part of the transaction, Eastern assumed certain liabilities of Greenwald and Greenwald Intellicard, including certain contractual liabilities, accounts payable and accrued liabilities. The Company completed the wind-down of the operations of

Amazing and Greystone including the sale of certain assets and the licensing of certain intellectual property during 2000 and 2001.

In December 2000, the Company acquired a 3.5% ownership interest in TecSec Incorporated ("TecSec") for $5.1 million. TecSec, a Virginia company, develops and markets encryption products and solutions, which are designed to enable the next generation information security for the enterprise, multi-enterprise e-business and other markets.

In July 2001, after evaluating the timing of potential future revenues, PubliCARD's Board decided to shift the Company's strategic focus. While the Board remained confident in the long-term prospects of the smart card business, the timing of public sector and corporate initiatives in wide-scale, broadband environments utilizing the Company's smart card reader and chip products had become more uncertain. Given the lengthened time horizon, the Board did not believe it would be prudent to continue to invest the Company's current resources in the ongoing development and marketing of these technologies. Accordingly, the Board determined that shareholders' interests would be best served by pursuing strategic alliances with one or more companies that have the resources to capitalize more fully on the Company's smart card reader and chip-related technologies. In connection with this shift in the Company's strategic focus, workforce reductions and other measures were implemented to achieve cost savings.

CURRENT STRATEGY

At present, PubliCARD's sole operating activities are conducted through its Infineer subsidiary, which designs smart card solutions for educational and corporate sites. The Company's future plans revolve around a potential acquisition strategy focused on businesses in areas outside the high technology sector while continuing to support the expansion of the Infineer business. However, the Company will not be able to implement such plans unless it is successful in obtaining funding, as to which no assurance can be given. Key elements of our strategy include the following:

- GENERATE CAPITAL. Management believes that existing cash and short term investments may be sufficient to meet the Company's operating and capital requirements at the currently anticipated levels through December 31, 2005. However, additional capital will be necessary in order to operate beyond December 31, 2005 and to fund the current business plan and other obligations. While the Company is considering various funding alternatives, the Company has not secured or entered into any arrangements to obtain additional funds. There can be no assurance that the Company will be able to obtain additional funding on acceptable terms or at all. If the Company cannot raise additional capital to continue its present level of operations it is not likely to be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which would have a material adverse effect on its business and results of operations and is likely to lead the Company to seek bankruptcy protection. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

- GROW PUBLICARD BUSINESS THROUGH ACQUISITIONS. An important element of the Company's strategic plan involves the acquisition of businesses in areas outside the technology sectors in which the Company is engaged, so as to diversify its asset base. The Company made a series of successful acquisitions in the 1980s and early 1990s and will endeavor to replicate

this success by seeking out businesses meeting a targeted profile. Implementation of this plan will require the Company to obtain funding. However, there can be no assurance that the Company will be able to obtain funding on acceptable terms or at all.

- EXPAND INFINEER MARKET REACH. Management believes that Infineer can expand the market reach of its smart card solutions by forming strategic marketing and distribution relationships with a number of key industry players both in the United Kingdom and elsewhere. Infineer has a strong market position in the United Kingdom educational sector, and to a lesser extent in the corporate market, and intends to leverage this market position to select markets outside of the United Kingdom. Implementation of this initiative will require the Company to obtain funding. However, there can be no assurance that the Company will be able to obtain funding on acceptable terms or at all.

- EXPAND INFINEER PRODUCT OFFERING. Management believes that Infineer can expand its total product offering, technologies and market position by partnering with companies engaged in complementary businesses or by acquiring or licensing complementary technologies and products. Infineer intends to form relationships, which will provide a "complete" solution to the educational and corporate campus market places. Implementation of this initiative will require the Company to obtain funding. However, there can be no assurance that the Company will be able to obtain funding on acceptable terms or at all.

PUBLICARD PRODUCTS AND SOLUTIONS

PubliCARD, through its Infineer subsidiary, designs smart card solutions for campus environments. Infineer's solutions facilitate card-based payment for a wide variety of services typically found on both corporate and education sites. Infineer's card-based solutions are currently installed in over 700 sites, primarily in educational and corporate sites in the United Kingdom and Ireland. Infineer's products and solutions include the following:

- CHIPNET3. Using a single smart card, ChipNet3 users gain access to, and tender payment for, a wide variety of services typically found on both corporate and educational sites. ChipNet3 delivers applications such as photo identification, payment for cafeteria, vending machine, photocopy

and printing purchases, and access control on a single card platform. Each time a transaction takes place, all details are recorded, such as the date and time, user and item purchased. The transaction details are then processed by a back office software package, utilizing a tracking tool that delivers accurate management information regarding sales and card activity.

ChipNet3 has the ability to accept a range of both contact and contactless smart cards. The solution is scalable and can run in a networked or non-networked environment. The ChipNet3 solution has been structured to allow integration with existing third party applications such as payroll, stock control, physical access control, PC log-on and time and attendance reporting.

ChipNet3 solution is comprised of smart cards, application software and hardware. Each user has a personalized smart card which may feature photo identification, a bar code, magnetic stripe or signature panel, if

required. The chip on the card carries the cardholder's personal permission file and may be loaded and reloaded with a cash value which is used for purchasing needs. Hardware includes point-of-sale terminals and mini-tills, vending station card readers and add-value or card reload stations.

Infineer recently introduced ChipNetID which allows corporate sites the ability to extend the use of their existing identification cards to include payment at cafeteria and vending stations. ChipNetID can operate with a range of contactless smart cards issued by Mifare and HID. Corporate sites can benefit from deploying cashless payments in a facility without the need to replace existing in-use identification and access control cards.

- EASYSMART. EasySmart is designed to deliver a first experience with smart cards for locations that do not want to pay or do not need a multi-application card system, and has been developed to fill a gap in the market for an entry-level smart card solution providing an administration-free payment system. EasySmart is a stand-alone solution operating with a low cost smart card and is useful for a wide range of locations including colleges, cafeterias and libraries. EasySmart offers card acceptance for PC log-on, cafeteria point-of-sale, self-service centers, networked printing, photocopying and encoding stations. Although EasySmart offers the capacity to run without being networked, it also contains a built-in upgrade path to ChipNet3.

- EASYCARD. The EasyCard product line delivers a flexible magnetic stripe based solution across a range of applications, including copying, printing, point-of-sale, vending and Internet access. Operating with either disposable or rechargeable thin magnetic stripe cards, EasyCard is a simple to use solution, useful for schools, colleges, libraries and copy shops as well as corporate and government facilities and business parks. Users carry cards, featuring either a cash or unit value, and the appropriate amount is deducted each time a service is used. For those customers not paying in advance for services, account cards can be used, recording the use of a range of services against an individual or department. A full range of support products offer card acceptance at self-service card centers and encoding stations.

- PCOUNTER. Pcounter is a scalable network server-based print management and accounting solution that provides a range of cost control and cost recovery capabilities. Pcounter aims to eliminate waste and misuse and help rationalize and reallocate print resources by providing usage accountability. Pcounter is marketed to schools, colleges, professional services firms, the public sector and corporations.

SALES AND MARKETING

Infineer sells and distributes its products directly to end-users in the United Kingdom through its direct sales force. Infineer has approximately 16 employees directly engaged in the sale, distribution and support of its products in the United Kingdom. Outside of the United Kingdom, Infineer is represented by over 30 independent distributors and value-added resellers. Key markets include, among others, the United States, the Netherlands, France and Australia.

In support of its sales strategies, Infineer also makes use of direct mail campaigns to its customers, advertising in targeted trade media and at trade shows and conferences. Infineer intends to continue seeking to form strategic relationships with key industry players to provide it with access to leading edge technology, marketing and sales leverage, and access to key customers and accounts.

RESEARCH AND DEVELOPMENT

Research and development is a key element to the Company's future success and competitive position. Infineer develops an annual technology development plan as an integral part of its business planning process. This plan identifies new areas requiring development in support of identified business opportunities, as well as a program of maintenance and enhancement for existing solutions. Development expenses were $716,000, $584,000 and $605,000 in 2004, 2003 and 2002, respectively.

Infineer's product development is organized to quickly bring products from concept to product introduction. The Company's future success will depend upon its ability to enhance existing products and to develop and to introduce new products on a timely basis that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of its customers. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results -- Our future success depends on our ability to keep pace with technological changes and introduce new products in a timely manner."

COMPETITION

Competition in the markets in which Infineer operates is intense and is characterized by rapidly changing technologies, evolving industry standards, frequent new product introductions and rapid changes in customer requirements. To maintain and improve its competitive position, Infineer must continue to develop and introduce, on a timely and cost-effective basis, new products and product features that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of its customers. The principal competitive factors affecting the market for Infineer's technology products are the product's technical characteristics and price, customer service and competitor reputation, as well as positioning and resources. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results -- The highly competitive markets in which we operate could have a material adverse effect on our business and operating results." Infineer will be required to continue to respond promptly and effectively to the challenges of technological changes and its competitors' innovations.

The market for smart card technology solutions is new, intensely competitive and rapidly evolving. The Company expects competition to continue to increase both from existing competitors and new market entrants. Infineer's primary competition currently comes from or is anticipated to come from companies offering campus environment solutions, including small value electronic cash systems and database management solutions, such as Moneybox (Girovend), Counter Solutions, Uniware, Cunninghams, Plastic Card Services, MARS, Diebold and Schlumberger.

Many of Infineer's current and potential competitors have longer operating histories and significantly greater financial, technical, sales, customer support, marketing and other resources, as well as greater name recognition and a larger installed base of their products and technologies than Infineer. Many of these companies have broader customer relationships that could be leveraged, including relationships with many of Infineer's customers. These companies also have more established customer support and professional services organizations than Infineer does. In addition, a number of companies with significantly greater resources than Infineer could attempt to increase their presence in the

marketplace by acquiring or forming strategic alliances with competitors of Infineer, resulting in increased competition.

INTELLECTUAL PROPERTY

PubliCARD's success depends significantly upon Infineer's proprietary technology. Infineer relies on a combination of copyright and trademark laws, trade secrets, confidentiality agreements and contractual provisions to protect its proprietary rights. Infineer seeks to protect its software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. Infineer generally enters into confidentiality and non-disclosure agreements with its employees and with key vendors and suppliers. Despite Infineer's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of Infineer's products or to obtain and use information that Infineer regards as proprietary. Moreover, effective copyright and trade secret protection may be unavailable or limited in certain foreign countries, making the possibility of misappropriation of Infineer's proprietary technology more likely. The steps taken by Infineer to protect its proprietary technology might not prevent misappropriation of such technology, and such protections may not preclude competitors from developing products with functionality or features similar to Infineer's products.

PubliCARD currently has several trademarks and trademark applications registered and pending in the United States. PubliCARD and Infineer will continue to evaluate the registration of additional trademarks as it deems appropriate. There can be no assurance that Infineer will develop proprietary products or technologies that are patentable, that any issued patent will provide Infineer with any competitive advantages or will not be challenged by third parties or that the patents of others will not have a material adverse effect on Infineer's business and operating results.

In the event that Infineer's technology or products are determined to infringe upon the rights of others, Infineer could be required to cease using such technology and stop selling such products, if Infineer is unable to obtain licenses to utilize such technology. There can be no assurance that Infineer would be able to obtain such licenses in a timely manner on acceptable terms and conditions, and the failure to do so could have a material adverse effect on PubliCARD's and Infineer's financial condition and results of operations. If

Infineer is unable to obtain such licenses, it could encounter significant delays in product market introductions while it attempted to design around the infringed-upon patents or rights, or could find the development, manufacture or sale of products requiring such license to be foreclosed. In addition, patent disputes are common in the smart card and computer industries and there can be no assurance that PubliCARD and Infineer will have the financial resources to enforce or defend a patent infringement or proprietary rights action.

PubliCARD expects that software product developers will be increasingly subject to infringement claims as the number of products and competitors in the smart card market grows. Any such claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause product shipment delays or require Infineer to develop non-infringing technology or enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable or at all. In the event of a successful claim of product infringement against Infineer and failure or inability to develop non-infringing technology or license the infringed or similar technology, PubliCARD's and Infineer's

business, financial condition and results of operations could be materially adversely affected. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Factors That May Affect Future Results -- Our proprietary technology is difficult to protect and may infringe on the intellectual proprietary rights of third parties."

EMPLOYEES

As of March 24, 2005, the Company had approximately 38 employees, of which 36 are employed by Infineer. At Infineer, there are 16 employees involved in sales, marketing and customer support, 9 employees in product development, 7 employees in manufacturing and 4 employees in administration. The Company considers its employee relations to be good.

SEGMENT INFORMATION

The Company's sole operating activities involve the deployment of smart card solutions for educational and corporate sites. As such, the Company reports as a single segment. Revenues by geographical areas for the years ended December 31, 2004, 2003 and 2002 are as follows (in thousands):

	2004	2003	2002
United States	$ 540	$ 869	$1,029
Europe	3,631	3,467	3,445
Rest of world	224	445	131
	$4,395	$4,781	$4,605

The Company has operations in the United States and United Kingdom. Identifiable tangible assets by country as of December 31, 2004 and 2003 are as follows (in thousands):

	2004	2003
United States	$2,770	$4,542
United Kingdom	1,521	2,035
	$4,291	$6,577

See also the Company's Financial Statements beginning on page F-1.

AVAILABLE INFORMATION

The SEC maintains an Internet site that contains reports, proxy and information statements, and other Company related information at http://www.sec.gov.

ITEM 1A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information about the only executive officer of the Company as of March 24, 2005. The business address of the executive officer is the address of the Company, One Rockefeller Plaza, New York, New York 10020.

Name	Age	Office and Position

Antonio L. DeLise	43	Director, President, Chief Executive Officer, Chief Financial Officer and Secretary

Officers are elected to serve for a term ending with the next annual meeting of shareholders.

Mr. DeLise joined the Company in April 1995 as Vice President, Chief Financial Officer and Secretary. He was appointed to the Board of Directors in July 2001 and was elected to the additional posts of President in February 2002 and Chief Executive Officer in August 2002.

Effective January 1, 2005, Harry I. Freund and Jay S. Goldsmith resigned their officer positions as Chairman and Vice Chairman, respectively. Mr. Freund and Mr. Goldsmith remain Chairman and Vice Chairman of the Board of Directors, respectively.

ITEM 2. PROPERTIES

The Company leases the following facilities, which are believed to be adequate for its present needs.

PREMISES	PURPOSE	YEAR OF LEASE EXPIRATION	SQUARE FOOTAGE
New York, NY	Executive offices for PubliCARD	2007	3,600
Bangor, Northern Ireland	Office and manufacturing	2008	12,000

Balfour Investors Inc. ("Balfour") occupies a portion of the office space leased by the Company in New York City. The Chairman and Vice Chairman of the Company's Board of Directors are the only shareholders of Balfour. Balfour pays to the Company 50% of the rent and occupancy costs paid by the Company under its lease, including base rent, electricity, water, real estate tax escalations and operation and maintenance escalations. The base rent payable by Balfour is approximately $9,500 per month.

ITEM 3. LEGAL PROCEEDINGS

On May 28, 2002, a lawsuit was filed against the Company in the Superior Court of the State of California, in the County of Los Angeles by Leonard M. Ross and affiliated entities alleging, among other things, misrepresentation and securities fraud. The lawsuit names the Company and four of its current and former executive officers and directors as the defendants. The plaintiffs seek monetary and punitive damages for alleged actions made by the defendants in order to induce the plaintiffs to purchase, hold or refrain from selling PubliCARD common stock. The plaintiffs allege that the defendants made a series of material misrepresentations, misleading statements, omissions and concealments, specifically and directly to the plaintiffs concerning the nature, existence and status of contracts with certain purchasers, the nature and existence of investments in the Company by third parties, the nature and existence of business relationships and investments by the Company. The Company believes it has meritorious defenses to the allegations and intends to defend vigorously.

In November 2002, the Company and the individual defendants served with the action filed a demurrer seeking the dismissal of six of the plaintiffs' nine purported causes of action. In January 2003, the court ruled in favor of the demurrer and dismissed the entire complaint. The plaintiffs were granted the right to replead and subsequently filed an amended complaint in February 2003.

The Company and individual defendants filed a second demurrer in March 2003. In June 2003, the court ruled in favor of the demurrer and dismissed, without leave to amend, six of the eleven purported causes of action in the amended complaint. Discovery has commenced and no trial date has been set. Consequently, at this time it is not reasonably possible to estimate the damages, or range of damages, if any, that the Company might incur in connection with this action. However, if the outcome of this lawsuit is unfavorable to the Company, it could have a material adverse effect on the Company's operations, cash flow and financial position.

The Company incurred approximately $200,000 in defense costs in 2002. No additional costs have been incurred in 2004 and 2003. Notice of the commencement of this action has been given to the Company's directors and officers liability insurance carriers. The Company's directors and officers liability insurance carriers are funding the additional costs of defending this action, subject to the carriers' reservation of rights.

Various other legal proceedings are pending against the Company. The Company considers all such other proceedings to be ordinary litigation incident to the character of its business. Certain claims are covered by liability insurance. The Company believes that the resolution of these claims to the extent not covered by insurance will not, individually or in the aggregate, have a material adverse effect on the consolidated financial position or consolidated results of operations of the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) PubliCARD's common stock was listed on the Nasdaq National Market from December 22, 1998 to May 1, 2002. Effective May 2, 2002, the listing of PubliCARD common stock was transferred to the Nasdaq SmallCap Market. On March 19, 2003, the Company received a Nasdaq Staff Determination letter indicating that the Company failed to comply with the minimum bid price requirement for continued listing on the Nasdaq SmallCap Market and that the Company's common stock was therefore subject to delisting. The board of directors of the Company decided not to appeal the delisting determination. Effective March 28, 2003, the Company's common stock began trading on the OTC Bulletin Board. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results - Our stock was delisted from the Nasdaq System." The following table sets forth the high and low closing sale prices of PubliCARD's common stock for the calendar periods indicated (in dollars):

	2004		2003	
	HIGH	LOW	HIGH	LOW

First Quarter	.09	.05	.16	.06
Second Quarter	.10	.05	.09	.042
Third Quarter	.06	.03	.09	.045
Fourth Quarter	.06	.02	.12	.04

(b) There were approximately 2,300 registered holders of record of common stock of the Company as of March 24, 2005.

(c) The Company did not pay dividends on its common stock during the prior five fiscal years and does not anticipate paying dividends in the foreseeable future.

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ITEM 6. SELECTED FINANCIAL DATA

The selected financial data of the Company presented below for the five year period ended December 31, 2004 have been derived from the consolidated financial statements of the Company. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's Consolidated Financial Statements and the Notes thereto included elsewhere in this Form 10-K.

	YEAR ENDED DECEMBER 31			
	2004	2003	2002	2001
	(in thousands, except per share a			
STATEMENT OF OPERATIONS DATA:				
Revenues	$ 4,395	$ 4,781	$ 4,605	$ 5,65
Cost of revenues	2,010	2,316	2,455	2,87
Inventory adjustment	--	--	--	1,66
Gross margin	2,385	2,465	2,150	1,11
Operating expenses:				
General and administrative	2,330	2,708	3,235	4,62
Sales and marketing	1,671	1,844	1,877	3,41
Product development	716	584	605	2,44
Stock compensation expense	--	--	--	8
Amortization of goodwill and intangibles	40	40	576	1,82
Impairment of goodwill and intangibles	--	--	1,365	-
Repositioning and other special charges	--	--	--	5,65
	4,757	5,176	7,658	18,04
Loss from operations	(2,372)	(2,711)	(5,508)	(16,93
Other income (expenses):				
Interest income	27	15	71	47
Interest expense	(22)	(12)	(39)	(6
Cost of retirement benefits - non-operating	(405)	(903)	(795)	(78
Loss on pension settlement	(2,739)	--	--	-
Write-down of minority investment	--	(3,000)	(2,068)	-

Gain on insurance recoveries	647	4,590	--	-
Other income	5	428	80	13
	(2,487)	1,118	(2,751)	(24
Loss from continuing operations	(4,859)	(1,593)	(8,259)	(17,17
Gain on disposition of discontinued operations	--	--	1,066	2,35
Net loss	$ (4,859)	$ (1,593)	$ (7,193)	$(14,82
Basic and diluted earnings (loss) per common share:				
Continuing operations	$ (.20)	$ (.07)	$ (.34)	$ (.7
Discontinued operations	--	--	.04	.1
	$ (.20)	$ (.07)	$ (.30)	$ (.6

	AS OF DECEMBER DECEMBER 3			
	2004	2003	2002	2001
BALANCE SHEET DATA:				
Working capital (deficiency)	$ 1,405	$ (987)	$ (548)	$ 2,63
Total assets	5,073	7,399	7,939	17,39
Other non-current liabilities	7,869	3,552	4,990	5,32
Shareholders' equity (deficiency)	(5,159)	(2,928)	(1,002)	7,48

No dividends on common shares have been declared or paid during the last five years.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

PubliCARD was incorporated in the Commonwealth of Pennsylvania in 1913. PubliCARD entered the smart card industry in early 1998, and began to develop solutions for the conditional access, security, payment system and data storage needs of industries utilizing smart card technology. In 1998 and 1999, the Company made a series of acquisitions to enhance its position in the smart card industry. In March 2000, PubliCARD's Board of Directors (the "Board"), together with its management team, determined to integrate its operations and focus on deploying smart card solutions, which facilitate secure access and transactions. To effect this new business strategy, in March 2000, the Board adopted a plan of disposition pursuant to which the Company divested its non-core operations. See Note 9 to the Consolidated Financial Statements for a discussion on the disposition plan.

In July 2001, after evaluating the timing of potential future revenues, PubliCARD's Board decided to shift the Company's strategic focus. While the Board remained confident in the long-term prospects of the smart card business, the timing of public sector and corporate initiatives in wide-scale, broadband

environments utilizing the Company's smart card reader and chip products had become more uncertain. Given the lengthened time horizon, the Board did not believe it would be prudent to continue to invest the Company's current resources in the ongoing development and marketing of these technologies. Accordingly, the Board determined that shareholders' interests will be best served by pursuing strategic alliances with one or more companies that have the resources to capitalize more fully on the Company's smart card reader and chip-related technologies. In connection with this shift in the Company's strategic focus, workforce reductions and other measures were implemented to achieve cost savings.

At present, PubliCARD's sole operating activities are conducted through its Infineer subsidiary, which designs smart card solutions for educational and corporate sites. The Company's future plans revolve around a potential acquisition strategy that would focus on businesses in areas outside the high technology sector while continuing to support the expansion of the Infineer business. However, the Company will not be able to implement such plans unless it is successful in obtaining additional funding, as to which no assurance can be given.

PubliCARD's consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred operating losses, a substantial decline in working capital and negative cash flow from operations for a number of years. The Company has also experienced a substantial reduction in its cash and short term investments, which declined from $17.0 million at December 31, 2000 to $1.9 million at December 31, 2004. The Company also had a shareholders' deficit of $5.2 million at December 31, 2004.

The Company's defined benefit pension plan was frozen in 1993. In January 2003, the Company filed a notice with the PBGC seeking a "distress termination" of the Plan. In September 2004, the PBGC proceeded to terminate the Plan and was appointed as the Plan's trustee. See Note 5 to the Notes to Consolidated Financial Statements for further information on the Plan termination. As a result of the Plan termination, the Company's 2003 and 2004 funding requirements due to the Plan amounting to $3.4 million through September 15, 2004 were eliminated. As such, management believes that existing cash and short term investments may be sufficient to meet the Company's operating and capital requirements at the currently anticipated levels through December 31, 2005. However, additional capital will be necessary in order to operate beyond December 31, 2005 and to fund the current business plan and other obligations. While the Company is considering various funding alternatives, the Company has not secured or entered into any arrangements to obtain additional funds. There can be no assurance that the Company will be able to obtain additional funding on acceptable terms or at all. If the Company cannot raise additional capital to continue its present level of operations it is not likely to be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which would have a material adverse effect on its business and results of operations and is likely to lead the Company to seek bankruptcy protection. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. The independent auditors' reports on the Company's Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002 contain emphasis paragraphs concerning substantial doubt about the Company's ability to continue as a going concern.

RESULTS OF OPERATIONS

The following table is derived from the Consolidated Financial Statements and sets forth the Company's consolidated results of operations for the years ended December 31, 2004, 2003 and 2002 (in thousands).

	2004	2003	2002
Revenues	$ 4,395	$ 4,781	$ 4,605
Cost of revenues	2,010	2,316	2,455
Gross margin	2,385	2,465	2,150
Gross margin percentage	54%	52%	47%
Operating expenses:			
General and administrative	2,330	2,708	3,235
Sales and marketing	1,671	1,844	1,877
Product development	716	584	605
Amortization of intangibles	40	40	576
Impairment of goodwill and intangibles	--	--	1,365
	4,757	5,176	7,658
Loss from operations	(2,372)	(2,711)	(5,508)
Other income (expenses):			
Interest income	27	15	71
Interest expense	(22)	(12)	(39)
Cost of retirement benefits - non-operating	(405)	(903)	(795)
Loss on pension settlement	(2,739)	--	--
Write-down of minority investment	--	(3,000)	(2,068)
Gain on insurance recoveries	647	4,590	--
Other income	5	428	80
	(2,487)	1,118	(2,751)
Loss from continuing operations	(4,859)	(1,593)	(8,259)
Income from discontinued operations	--	--	1,066
Net loss	$(4,859)	$(1,593)	$(7,193)

YEAR ENDED DECEMBER 31, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003

REVENUES. Revenues are generated from product sales, technology and software license fees, installation and maintenance contracts. Consolidated revenues decreased to $4.4 million in 2004 compared to $4.8 million for 2003. Foreign currency changes had the effect of increasing revenues by a 10%. Excluding the impact of foreign currency changes, revenues in 2004 decreased by 18% driven principally by a decline in shipments to distribution partners located in the United States and elsewhere outside of Europe.

GROSS MARGIN. Cost of revenues consists primarily of material, personnel costs and overhead. Gross margin as a percentage of sales increased to 54% in 2004 from 52% in 2003. The gross margin improvement resulted from a higher percentage of revenues derived from direct sales in the United Kingdom.

SALES AND MARKETING EXPENSES. Sales and marketing expenses consist

primarily of personnel and travel costs, public relations, trade shows and marketing materials. Sales and marketing expenses were $1.7 million in 2004 compared to $1.8 million in 2003. The decrease is primarily attributable to a reduction in employee business expense and employee termination expense resulting from headcount reductions in 2003. Also, the 2004 expenses reflect a reimbursement of $47,000 of marketing costs under a grant with a government agency in Northern Ireland.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses consist primarily of personnel, independent consultants and contract engineering services. Product development expenses include expenses associated with the development of new products and enhancements to existing products. Product development expenses amounted to $716,000 in 2004 compared to $584,000 in 2003. The 2003 expenses included a $75,000 reimbursement of certain development costs under a grant with a government agency in Northern Ireland. This reimbursement, coupled with a $73,000 increase in wages and third party engineering costs, primarily accounted for the increase in product development expense.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of personnel and related costs for general corporate functions, including finance and accounting, human resources, risk management and legal. General and administrative expenses for the year ended December 31, 2004 decreased to $2.3 million from $2.7 million for 2003. The decrease in expenses is mainly attributable to a $196,000 decline in corporate legal, public reporting costs and other corporate costs as well as a $43,000 favorable bad debt allowance adjustment.

AMORTIZATION OF INTANGIBLES. In accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), goodwill is no longer amortized. Goodwill and other intangibles will be subject to an annual review for impairment or earlier if circumstances or events indicate that impairment has occurred. This may result in future write-downs or the write-off of such assets. Amortization expense in 2004 and 2003 relates to the continuing amortization of definite lived intangibles. Amortization expense was $40,000 in both 2004 and 2003.

COST OF PENSIONS - NON-OPERATING. Cost of pensions, which represents amounts related to discontinued product lines and related plant closings in prior years, principally relates to pension expense associated with the Company's frozen defined benefit pension plan. As a result of the pension settlement (see below), cost of pensions - non-operating will be zero prospectively. Cost of pensions declined from $903,000 in 2003 to $405,000 in 2004.

LOSS ON PENSION SETTLEMENT. The Company sponsored a defined benefit pension plan that was frozen in 1993. In January 2003, the Company filed a notice with the PBGC seeking a "distress termination" of the Plan. Pursuant to the Agreement for Appointment of Trustee and Termination of Plan between the PBGC and the Company effective September 30, 2004, the PBGC proceeded to terminate the Plan and was appointed as the Plan's trustee. As a result, the PBGC has assumed responsibility for paying the obligations to Plan participants. Under the terms of the Settlement Agreement, the Company was liable to the PBGC for the unfunded guaranteed benefit payable by the PBGC to Plan participants in the amount of $7.5 million. The Company satisfied this liability by issuing a non-interest bearing note payable to the PBGC with a face amount of $7.5 million (the "Note"). A loss on the termination of the Plan of $2.7 million was recorded

in the third quarter of 2004.

Pursuant to the Security Agreement and Pledge Agreement, both dated September 23, 2004, between the Company and the PBGC (the "Security Agreement" and the "Pledge Agreement") the Note is secured by (a) all presently owned or hereafter acquired real or personal property and rights to property of the Company and (b) the common and preferred stock of Infineer and TecSec owned by the Company. Infineer is a wholly-owned subsidiary of the Company. The Company has an approximately 5% ownership interest in TecSec, on a fully diluted basis.

The Note matures on September 23, 2011. The first payment will be equal to $1.0 million and will become due 30 days after the Company has received a total of $4.0 million in Net Recoveries (as defined below). Thereafter, on each anniversary of the first payment, the Company is required to pay the PBGC an amount equal to 25% of the Net Recoveries in excess of $4.0 million (less the sum of all prior payments made in accordance with this sentence in prior years). "Net Recoveries", as defined in the Settlement Agreement, is the net cash proceeds received by the Company with respect to transactions consummated after March 31, 2003 from (a) the sale of the Company's interest in Infineer and TecSec, real property in Louisiana and any other real or personal property assets and (b) any recoveries from the Company's historic insurance program. As of December 31, 2004, Net Recoveries was approximately $3.4 million.

In the event of default by the Company under the Settlement Agreement, the PBGC may declare the outstanding amount of the Note to be immediately due and payable, proceed with foreclosure of the liens granted in favor of the PBGC and exercise any other rights available under applicable law.

GAIN ON INSURANCE RECOVERIES. In February 2004, the Company entered into a binding agreement to assign to a third party certain insurance claims against a group of historic insurers. In July 2004, the assignment was supplemented to include several additional insurers. The claims involve several historic general liability policies of insurance issued to the Company. As a result of the assignment, after allowance for associated expenses and offsetting adjustments, the Company received net proceeds of approximately $477,000 in May 2004 and an additional $170,000 in October 2004. The Company recognized a gain of $477,000 in the first quarter of 2004 and an additional gain of $170,000 in the third quarter of 2004.

INTEREST INCOME AND EXPENSE. Interest income increased to $27,000 from $15,000 in the prior year principally due to higher investment balances. Interest expense increased from $12,000 to $22,000 due to higher average borrowings under the overdraft facility.

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YEAR ENDED DECEMBER 31, 2003 COMPARED TO YEAR ENDED DECEMBER 31, 2002

REVENUES. Consolidated revenues increased to $4.8 million in 2003 compared to $4.6 million for 2002 driven by a 6% increase from foreign currency changes. Excluding the impact of foreign currency changes, revenues in 2003 decreased by 2%.

GROSS MARGIN. Gross margin as a percentage of sales increased to 52% in 2003 from 47% in 2002. The gross margin improvement resulted from higher margins generated from certain custom development projects and increased service revenue in the United Kingdom.

SALES AND MARKETING EXPENSES. Sales and marketing expenses were $1.8

million in 2003 compared to $1.9 million in 2002.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses amounted to $584,000 in 2003 compared to $605,000 in 2002.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the year ended December 31, 2003 decreased to $2.7 million from $3.2 million for 2002. The decrease in expense is mainly due to a $400,000 decline in salary costs due to a headcount reduction of three employees.

IMPAIRMENT OF GOODWILL AND INTANGIBLES. The Company performed an initial review for impairment of goodwill as of January 1, 2002 and determined that no impairment existed at that date. The Company determined the fair value of its sole reporting unit primarily using two approaches: a market approach technique and a discounted cash flow valuation technique. The market approach relied primarily on the implied fair value using a multiple of revenues for several entities with comparable operations and economic characteristics. Significant assumptions used in the discounted cash valuation included estimates of future cash flows, future short-term and long-term growth rates and estimated cost of capital for purposes of arriving at a discount factor.

In performing its annual goodwill impairment test at the end of the fourth quarter of 2002, the Company determined that goodwill had been impaired. Based on comparing the values derived from the two techniques described above to the carrying value of the reporting unit, the Company recorded a goodwill impairment loss of $364,000 in the fourth quarter of 2002. The Company attributed the impairment loss to the value of a comparable entity that was sold in a transaction in late 2002, the significant 2002 operating loss for the reporting unit and lower forecasted revenue growth due to a continued overall decline in technology spending and a shortage of capital available to invest in the reporting unit.

In the fourth quarter of 2002, the Company determined that its intangible assets had been impaired and recorded an impairment loss of $1.0 million. The Company attributes the impairment loss to the significant 2002 operating loss for the reporting unit and lower forecasted revenue growth due to a continued overall decline in technology spending and a shortage of capital available to invest in the reporting unit.

AMORTIZATION OF INTANGIBLES. Amortization expense decreased from $576,000 in 2002 to $40,000 in 2003 as a result of an impairment charge recorded in 2002, which significantly reduced the carrying value of intangibles.

COST OF PENSIONS - NON-OPERATING. Cost of pensions increased from $795,000 in 2002 to $903,000 in 2003. The net periodic pension cost increased by $112,000 principally as a result of amortization of unrecognized net losses.

GAIN ON INSURANCE RECOVERIES. During 2003, the Company entered into three binding settlements with various historical insurers that resolved certain claims (including certain future claims) under policies of insurance issued to the Company by those insurers. As a result of the settlements, after allowance for associated expenses, offsetting adjustments and amounts held in escrow, the Company received net proceeds of approximately $4.1 million in 2003. Pursuant to one of the settlements, an additional net amount of approximately $470,000 was placed in escrow to secure the payment of certain indemnification obligations. Absent any indemnity claims, amounts will be released from escrow beginning September 30, 2004 and ending June 30, 2006. The Company recognized a gain from these settlements of approximately $4.6 million in 2003.

WRITE-DOWN OF MINORITY INVESTMENT. In 2003 and 2002, other expense includes charges for an impairment of the Company's minority investment in TecSec of $3.0 million and $2.1 million, respectively.

OTHER INCOME AND EXPENSE. In 2002, other expense includes a $200,000 charge in connection with the defense of a shareholder lawsuit.

INTEREST INCOME AND EXPENSE. Interest income decreased to $15,000 from $71,000 in the prior year principally due to lower interest rates and investment balances.

LIQUIDITY

The Company has financed its operations over the last several years primarily through funds received from the sale of a non-core businesses in 2000 and insurance recoveries in 2003 and 2004. During the year ended December 31, 2004, cash, including short-term investments, decreased by $1.6 million to $1.9 million as of December 31, 2004.

Operating activities utilized cash of $2.3 million in 2004 and principally consisted of the net loss of $4.9 million plus a gain on insurance recoveries of $647,000 offset by a loss on the pension settlement of $2.7 million, depreciation and amortization of $156,000 and a reduction in assets and liabilities of $286,000.

Investing activities provided cash of $686,000 in 2004 and principally consisted of cash received from insurance recoveries of $727,000 offset by capital expenditures of $48,000.

The Company has experienced negative cash flow from operating activities in the past and expects to experience negative cash flow in 2005 and beyond. In addition to funding operating and capital requirements and corporate overhead, future uses of cash include the following:

- The Company sponsored a defined benefit pension plan, which was frozen in 1993. In January 2003, the Company filed a notice with the PBGC seeking a "distress termination" of the Plan. Pursuant to the Agreement for Appointment of Trustee and Termination of Plan between the PBGC and the Company effective September 30, 2004, the PBGC proceeded to terminate the Plan and was appointed as the Plan's trustee. As a result, the PBGC has assumed responsibility for paying the obligations to Plan participants. Under the terms of the Settlement Agreement effective September 23, 2004 between the PBGC and the Company, the Company was liable to the PBGC for the unfunded guaranteed benefit payable by the PBGC to Plan participants in the amount of $7.5 million. The Company satisfied this liability by issuing the Note dated September 23, 2004 payable to the PBGC with a face amount of $7.5 million.

  Pursuant to the Security Agreement and Pledge Agreement, both dated September 23, 2004, the Note is secured by (a) all presently owned or hereafter acquired real or personal property and rights to property of the Company and (b) the common and preferred stock of Infineer and TecSec owned by the Company. Infineer is a wholly-owned subsidiary of the Company. The Company has an approximately 5% ownership interest in TecSec, on a fully diluted basis.

  The Note matures on September 23, 2011. The first payment will be equal to $1.0 million and will become due 30 days after the Company has received a total of $4.0 million in Net Recoveries. Thereafter,

on each anniversary of the first payment, the Company is required to pay the PBGC an amount equal to 25% of the Net Recoveries in excess of $4.0 million (less the sum of all prior payments made in accordance with this sentence in prior years). As of December 31, 2004, Net Recoveries was approximately $3.4 million.

In the event of default by the Company under the Settlement Agreement, the PBGC may declare the outstanding amount of the Note to be immediately due and payable, proceed with foreclosure of the liens granted in favor of the PBGC and exercise any other rights available under applicable law.

- On May 28, 2002, a lawsuit was filed against the Company in the Superior Court of the State of California, in the County of Los Angeles by Leonard M. Ross and affiliated entities alleging, among other things, misrepresentation and securities fraud. The lawsuit names the Company and four of its current and former executive officers and directors as the defendants. The plaintiffs seek monetary and punitive damages for alleged actions made by the defendants in order to induce the plaintiff to purchase, hold or refrain from selling PubliCARD common stock. The plaintiffs allege that the defendants made a series of material misrepresentations, misleading statements, omissions and concealments, specifically and directly to the plaintiffs concerning the nature, existence and status of contracts with certain purchasers, the nature and existence of investments in the Company by third parties, the nature and existence of business relationships and investments by the Company. The Company believes it has meritorious defenses to the allegations and intends to defend vigorously.

In November 2002, the Company and the individual defendants served with the action filed a demurrer seeking the dismissal of six of the plaintiffs' nine purported causes of action. In January 2003, the court ruled in favor of the demurrer and dismissed the entire complaint. The plaintiffs were granted the right to replead and subsequently filed an amended complaint in February 2003. The Company and individual defendants filed a second demurrer in March 2003. In June 2003, the court ruled in favor of the demurrer and dismissed, without leave to amend, six of the eleven purported causes of action in the amended complaint. Discovery has commenced and no trial date has been set. Consequently, at this time it is not reasonably possible to estimate the damages, or range of damages, if any, that the Company might incur in connection with this action. However, if the outcome of this lawsuit is unfavorable to the Company, it could have a material adverse effect on the Company's operations, cash flow and financial position.

- The Company leases certain office space, vehicles and office equipment under operating leases that expire over the next four years. Minimum future payments for operating leases having initial or remaining non-cancelable terms in excess of one year aggregates approximately $861,000.

The Company will need to raise additional capital that may not be available to it. As a result of the Plan termination discussed above, the Company's 2003 and 2004 funding requirements due to the Plan amounting to $3.4 million through September 15, 2004 were eliminated. As such, management believes

that existing cash and short term investments may be sufficient to meet the Company's operating and capital requirements at the currently anticipated levels through December 31, 2005. However, additional capital will be necessary in order to operate beyond December 31, 2005 and to fund the current business plan and other obligations. While the Company is considering various funding alternatives, the Company has not secured or entered into any arrangements to obtain additional funds. There can be no assurance that the Company will be able to obtain additional funding on acceptable terms or at all. If the Company cannot raise additional capital to continue its present level of operations it is not likely to be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which would have a material adverse effect on its business and results of operations.

The Company currently has no capacity for commercial debt financing. Should such capacity become available it may be adversely affected in the future by factors such as higher interest rates, inability to borrow without collateral, and continued operating losses. Borrowings may also involve covenants limiting or restricting its operations or future opportunities.

As a result of a failure to meet certain continuing listing requirements of the Nasdaq National Market, the Company transferred the listing of its common stock to the Nasdaq SmallCap Market effective May 2, 2002. On March 19, 2003, the Company received a Nasdaq Staff Determination letter indicating that the Company failed to comply with the minimum bid price requirement for continued listing on the Nasdaq SmallCap Market and that the Company's common stock was therefore subject to delisting. The Board of the Company decided not to appeal the delisting determination. Effective March 28, 2003, the Company's common stock no longer traded on the Nasdaq SmallCap Market. On March 28, 2003 the Company's common stock began trading on the OTC Bulletin Board. As a result of the delisting, the liquidity of the common stock may be adversely affected. This could impair the Company's ability to raise capital in the future. If additional capital is raised through the issuance of equity securities, the Company's stockholders' percentage ownership of the common stock will be reduced and stockholders may experience dilution in net book value per share, or the new equity securities may have rights, preferences or privileges senior to those of its common stockholders.

If the Company's liquidity does not improve, it may be unable to continue as a going concern and is likely to seek bankruptcy protection. Such an event may result in the Company's common and preferred stock being negatively affected or becoming worthless. The auditors' reports on the Company's Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002 contained an emphasis paragraph concerning substantial doubt about the Company's ability to continue as a going concern.

CONTRACTUAL OBLIGATIONS

The following is a summary of the Company's commitments as of December 31, 2004 (in thousands):

	PAYMENTS DUE BY PERIOD				
	TOTAL	LESS THAN 1 1 YEAR	1 TO 3 YEARS	3 TO 5 YEARS	MORE THAN 5 YEARS
Operating lease obligations	$ 861	$ 350	$ 463	$ 48	$ --

Other long-term liabilities:					
Note payable to PBGC	7,501	--	--	--	7,501
Other long-term obligations	368	20	273	40	35
Total	$8,730	$ 370	$ 736	$ 88	$7,536

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are more fully described in the Notes to the Company's Consolidated Financial Statements. Certain accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. The Company considers certain accounting policies related to revenue recognition, estimates of reserves for receivables and inventories, and valuation of goodwill to be critical policies due to the estimation processes involved.

REVENUE RECOGNITION AND ACCOUNTS RECEIVABLE. Revenue from product sales and technology and software license fees is recorded upon shipment if a signed contract exists, the fee is fixed and determinable, the collection of the resulting receivable is probable and the Company has no obligation to install the product or solution. If the Company is responsible for installation, revenue from product sales and license fees is deferred and recognized upon client acceptance or "go live" date. Maintenance and support fees are deferred and recognized as revenue ratably over the contract period. Provisions are recorded for estimated warranty repairs and returns at the time the products are shipped. In the event changes in conditions cause management to determine that revenue recognition criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's credit worthiness. The Company continually monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that it has identified. While such credit losses have historically been within management's expectations and the provisions established, there is no assurance that the Company will continue to experience the same credit loss rates as in the past.

INVENTORIES. Inventories are stated at lower of cost (first-in, first-out method) or market. The Company periodically evaluates the need to record adjustments for impairment of inventory. Inventory in excess of the Company's estimated usage requirements is written down to its estimated net realizable value. Inherent in the estimates of net realizable value are management's estimates related to the Company's production schedules, customer demand, possible alternative uses and the ultimate realization of potentially excess inventory. A decrease in future demand for current products could result in an increase in the amount of excess inventories on hand.

IMPAIRMENT OF GOODWILL AND INTANGIBLES. Effective January 1, 2002, the Company adopted SFAS No. 142. In accordance with the guidelines of this statement, goodwill and indefinite lived intangible assets are no longer amortized but will be assessed for impairment on at least an annual basis. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives and reviewed for impairment. The Company determines the fair value of its sole reporting unit primarily using two approaches: a market approach technique and a discounted cash flow valuation technique. The market approach relies primarily on the implied fair value using a multiple of revenues for several entities with comparable operations and economic characteristics. Significant assumptions used

in the discounted cash valuation include estimates of future cash flows, future short-term and long-term growth rates and estimated cost of capital for purposes of arriving at a discount factor.

Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of any impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the net realizable of the asset.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123R (revised 2004), "Share-Based Payment". This statement requires compensation costs related to share-based payment transactions to be recognized in financial statements. Generally, compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the requisite service period, generally as the award vests. The Company will adopt SFAS No. 123R in the third quarter of 2005. SFAS No. 123R applies to all awards granted after June 30, 2005 and to previously-granted awards unvested as of the adoption date. The adoption of the statement is not expected to have a material impact on Company's consolidated financial positions, results of operations and cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Cost, an amendment of ARB No. 43, Chapter 4." This statement amends Accounting Research Bulletin No. 43 to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). The provision of the statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of the statement is not expected to have a material effect on the Company's consolidated financial positions, results of operations and cash flows.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." This statement amends APB No. 29, "Accounting for Nonmonetary Transactions," to eliminate the exception for nonmonetary exchanges of similar productive assets under APB No. 29 and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement is effective for financial statements for fiscal years beginning after June 15, 2005. The adoption of the statement is not expected to have a material effect on the Company's consolidated financial positions, results of operations and cash flows.

FACTORS THAT MAY AFFECT FUTURE RESULTS

WE HAVE A HISTORY OF OPERATING LOSSES AND NEGATIVE CASH FLOW, WE HAVE ONGOING FUNDING OBLIGATIONS AND WE NEED TO RAISE ADDITIONAL CAPITAL THAT MAY NOT BE AVAILABLE TO US, ALL OF WHICH COULD LEAD US TO SEEK BANKRUPTCY PROTECTION. We have incurred losses and experienced negative cash flow from operating activities in the past, and we expect to incur losses and experience negative cash flow from operating activities in the foreseeable future. We incurred losses from continuing operations in 2002, 2003 and 2004 of approximately $8.3 million, $1.6 million and $4.9 million, respectively. In addition, we experienced negative cash flow from operating activities of $5.1 million, $2.2

million and $2.3 million in 2002, 2003 and 2004 respectively, and have a shareholders' deficiency of $5.2 million as of December 31, 2004.

We sponsor a defined benefit pension plan which was frozen in 1993. In January 2003, we filed a notice with the PBGC seeking a "distress termination" of the Plan. Pursuant to the Agreement for Appointment of Trustee and Termination of Plan between the PBGC and us effective September 30, 2004, the PBGC proceeded to terminate the Plan and was appointed as the Plan's trustee. As a result, the PBGC has assumed responsibility for paying the obligations to Plan participants. Under the terms of the Settlement Agreement effective September 23, 2004 between the PBGC and us, we were liable to the PBGC for the unfunded guaranteed benefit payable by the PBGC to Plan participants in the amount of $7.5 million. We satisfied this liability by issuing the Note dated September 23, 2004 payable to the PBGC with a face amount of $7.5 million.

Pursuant to the Security Agreement and Pledge Agreement, both dated September 23, 2004, the Note is secured by (a) all of our presently owned or hereafter acquired real or personal property and rights to property and (b) the common and preferred stock of Infineer and TecSec we own. Infineer is a wholly-owned subsidiary of ours. We have an approximately 5% ownership interest in TecSec, on a fully diluted basis.

The Note matures on September 23, 2011. The first payment will be equal to $1.0 million and will become due 30 days after we have received a total of $4.0 million in Net Recoveries. Thereafter, on each anniversary of the first payment, we are required to pay the PBGC an amount equal to 25% of the Net Recoveries in excess of $4.0 million (less the sum of all prior payments made in accordance with this sentence in prior years). As of December 31, 2004, Net Recoveries was approximately $3.4 million.

In the event of our default under the Settlement Agreement, the PBGC may declare the outstanding amount of the Note to be immediately due and payable, proceed with foreclosure of the liens granted in favor of the PBGC and exercise any other rights available under applicable law.

We and certain current and former officers are defendants in a lawsuit alleging, among other things, misrepresentation and securities fraud. We believe that we have meritorious defenses to the allegations and intend to defend ourselves vigorously. The cost of defending against this action could be significant, and if the Company is not successful in defending itself, the Company may be required to pay the plaintiff's damages, which could have a material adverse effect on the Company's business and operations. See "We are unable to predict the extent to which the resolution of lawsuits pending against us could adversely affect our business". In addition, we have future non-cancelable operating lease obligations for office space, vehicles and office equipment aggregating $861,000.

We will need to raise additional capital that may not be available to us. As a result of the Plan termination discussed above, our 2003 and 2004 funding requirements due to the Plan amounting to $3.4 million through September 15, 2004 were eliminated. As such, we believe that existing cash and short term investments may be sufficient to meet our operating and capital requirements at the currently anticipated levels through December 31, 2005. However, additional capital will be necessary in order to operate beyond December 31, 2005 and to fund the current business plan and other obligations. While we are actively considering various funding alternatives, no arrangement to obtain additional funding has been secured or entered into. There can be no assurance that we will

be able to obtain additional funding, on acceptable terms or at all. If we cannot raise additional capital to continue at our present level of operations we may not be able to meet our obligations, take advantage of future acquisition opportunities or further develop or enhance our product offering, any of which could have a material adverse effect on our business and results of operations and could lead us to seek bankruptcy protection. The auditors' reports on the Company's Consolidated Financial Statements for the years ended December 31, 2002, 2003 and 2004 contained an emphasis paragraph concerning substantial doubt about the Company's ability to continue as a going concern.

We currently have no capacity for commercial debt financing. Should such capacity become available to us, we may be adversely affected in the future by factors such as higher interest rates, inability to borrow without collateral, and continued operating losses. Borrowings may also involve covenants limiting or restricting our operations or future opportunities.

WE CANNOT ASSURE YOU THAT INFINEER WILL BE ABLE TO CONTINUE TO OPERATE. During 2002, 2003 and 2004, PubliCARD contributed additional capital to Infineer of $44,000, $70,000 and $225,000, respectively. Without such contributions, Infineer may not have been able to fund its operations. We cannot assure you that additional capital contributions will not be required in the future, or, if required, that PubliCARD will be in a position to make any additional capital contributions.

WE ARE UNABLE TO PREDICT THE EXTENT TO WHICH THE RESOLUTION OF LAWSUITS PENDING AGAINST US COULD ADVERSELY AFFECT OUR BUSINESS. On May 28, 2002, a lawsuit was filed against us in the Superior Court of the State of California, in the County of Los Angeles by Leonard M. Ross and affiliated entities alleging, among other things misrepresentation and securities fraud. The lawsuit names four of our current and former executive officers and directors and us as the defendants. The plaintiffs seek monetary and punitive damages for alleged actions made by the defendants in order to induce the plaintiff to purchase, hold or refrain from selling our common stock. The plaintiffs allege that the defendants made a series of material misrepresentations, misleading statements, omissions and concealments, specifically and directly to the plaintiffs concerning the nature, existence and status of contracts with certain purchasers, the nature and existence of investments in us by third parties, the nature and existence of business relationships and investments by us. We believe we have meritorious defenses to the allegations and intend to defend vigorously.

In November 2002, we and the individual defendants served with the action filed a demurrer seeking the dismissal of six of the plaintiffs' nine purported causes of action. In January 2003, the court ruled in favor of the demurrer and dismissed the entire complaint. The plaintiffs were granted the right to replead and subsequently filed an amended complaint in February 2003. We and the individual defendants filed a second demurrer in March 2003. In June 2003, the court ruled in favor of the demurrer and dismissed, without leave to amend, six of the eleven purported causes of action in the amended complaint. Discovery has commenced and no trial date has been set. Consequently, at this time it is not reasonably possible to estimate the damages, or range of damages, if any, that we might incur in connection with this action. However, if the outcome of this lawsuit is unfavorable to us, it could have a material adverse effect on our operations, cash flow and financial position.

We incurred approximately $200,000 in defense costs in 2002. No additional costs have been incurred in 2004 and 2003. Notice of the commencement of this action has been given to our directors and officers liability insurance carriers. Our directors and officers liability insurance carriers are funding the additional costs of defending this action, subject to the carriers' reservation of rights.

WE FACE RISKS ASSOCIATED WITH ACQUISITIONS. An important element of our

strategic plan involves the acquisition of businesses in areas outside the technology sectors in which we have recently been engaged, so as to diversify our asset base. However, we will only be able to engage in future acquisitions if we are successful in obtaining additional funding, as to which no assurance

can be given. Acquisitions would require us to invest financial resources and may have a dilutive effect on our earnings or book value per share of common stock. We cannot assure you that we will consummate any acquisitions in the future, that any financing required for such acquisitions will be available on acceptable terms or at all, or that any past or future acquisitions will not materially adversely affect our results of operations and financial condition.

Our acquisition strategy generally presents a number of significant risks and uncertainties, including the risks that:

- we will not be able to retain the employees or business relationships of the acquired company;
- we will fail to realize any synergies or other cost reduction objectives expected from the acquisition;
- we will not be able to integrate the operations, products, personnel and facilities of acquired companies;
- management's attention will be diverted to pursuing acquisition opportunities and integrating acquired products, technologies or companies and will be distracted from performing its regular responsibilities;
- we will incur or assume liabilities, including liabilities that are unknown or not fully known to us at the time of the acquisition; and
- we will enter markets in which we have no direct prior experience.

We cannot assure you that any of the foregoing will not materialize, which could have an adverse effect on our results of operations and financial condition.

THE MARKET'S ACCEPTANCE OF OUR PRODUCTS IS UNCERTAIN. Demand for, and market acceptance of, our software solutions and products are subject to a high level of uncertainty due to rapidly changing technology, new product introductions and changes in customer requirements and preferences. The success of our products or any future products depends upon our ability to enhance our existing products and to develop and introduce new products and technologies to meet customer requirements. We face the risk that our current and future products will not achieve market acceptance.

Our future revenues and earnings depend in large part on the success of these products, and if the benefits are not perceived sufficient or if alternative technologies are more widely accepted, the demand for our solutions may not grow and our business and operating results would be materially and adversely affected.

WE DEPEND ON A RELATIVELY SMALL NUMBER OF CUSTOMERS FOR A MAJORITY OF OUR REVENUES. We rely on a limited number of customers in our business. We expect to continue to depend upon a relatively small number of customers for a majority of the revenues in our business. For the years ended December 31, 2003 and 2004, no one customer accounted for more than 10% of our revenues. Amounts due from two customers represented approximately 21% and 13%, respectively, of the accounts receivable balance as of December 31, 2004.

We generally do not enter into long-term supply commitments with our customers. Instead, we bid on a project basis. Significant reductions in sales

to any of our largest customers would have a material adverse effect on our business. In addition, we generate significant accounts receivable and inventory balances in connection with providing products to our customers. A customer's inability to pay for our products could have a material adverse effect on our results of operations.

OUR FUTURE SUCCESS DEPENDS ON OUR ABILITY TO KEEP PACE WITH TECHNOLOGICAL CHANGES AND INTRODUCE NEW PRODUCTS IN A TIMELY MANNER. The rate of technological change currently affecting the smart card market is particularly rapid compared to other industries. Our ability to anticipate these trends and adapt to new technologies is critical to our success. Because new product development commitments must be made well in advance of actual sales, new product decisions must anticipate future demand as well as the speed and direction of technological change. Our ability to remain competitive will depend upon our ability to develop in a timely and cost effective manner new and enhanced products at competitive prices. New product introductions or enhancements by our competitors could cause a decline in sales or loss of market acceptance of our existing products and lower profit margins.

Our success in developing, introducing and selling new and enhanced products depends upon a variety of factors, including:

- product selections;
- timely and efficient completion of product design and development;
- timely and efficient implementation of manufacturing processes;
- effective sales, service and marketing;
- price; and
- product performance in the field.

Our ability to develop new products also depends upon the success of our research and development efforts. We may need to devote additional resources to our research and development efforts in the future. We cannot assure you that funds will be available for these expenditures or that these funds will lead to the development of viable products.

THE HIGHLY COMPETITIVE MARKETS IN WHICH WE OPERATE COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS AND OPERATING RESULTS. The markets in which we operate are intensely competitive and characterized by rapidly changing technology. We compete against numerous companies, many of which have greater resources than we do, and we believe that competition is likely to intensify.

We believe that the principal competitive factors affecting us are:

- the extent to which products support industry standards and are capable of being operated or integrated with other products;
- technical features and level of security;
- strength of distribution channels;
- price;
- product reputation, reliability, quality, performance and customer support;
- product features such as adaptability, functionality and ease of use; and
- competitor reputation, positioning and resources.

We cannot assure you that competitive pressures will not have a material adverse effect on our business and operating results. Many of our current and potential competitors have longer operating histories and significantly greater financial, technical, sales, customer support, marketing and other resources, as

well as greater name recognition and a larger installed base of their products and technologies than our company. Additionally, there can be no assurance that new competitors will not enter our markets. Increased competition would likely result in price reductions, reduced margins and loss of market share, any of which could have a material adverse effect on our business and operating results.

Our primary competition currently comes from companies offering closed environment solutions, including small value electronic cash systems and database management solutions, such as Moneybox (Girovend), Counter Solutions, Uniware, Cunninghams, Plastic Card Services, MARS, Diebold and Schlumberger.

Many of our current and potential competitors have broader customer relationships that could be leveraged, including relationships with many of our customers. These companies also have more established customer support and professional services organizations than we do. In addition, a number of companies with significantly greater resources than we have could attempt to increase their presence by acquiring or forming strategic alliances with our competitors, resulting in increased competition.

OUR LONG PRODUCT SALES CYCLES SUBJECT US TO RISK. Our products fall into two categories; those that are standardized and ready to install and use and those that require significant development efforts to implement within the purchasers' own systems. Those products requiring significant development efforts tend to be newly developed technologies and software applications that can represent major investments for customers. We are subject to potential customers' internal review processes and systems requirements. The implementation of some of our products involves deliveries of small quantities for pilot programs and significant testing by the customers before firm orders are received, or lengthy beta testing of software solutions. For these more complex products, the sales process may take one year or longer, during which time we may expend significant financial, technical and management resources, without any certainty of a sale.

WE MAY BE LIMITED IN OUR USE OF OUR FEDERAL NET OPERATING LOSS CARRYFORWARDS. As of December 31, 2004, we had federal net operating loss carryforwards, subject to review by the Internal Revenue Service, totaling approximately $67.6 million for federal income tax purposes. The federal net operating loss carryforwards begin to expire in 2005. We do not expect to earn any significant taxable income in the next several years, and may not do so until much later, if ever. A federal net operating loss can generally be carried back two, three or five years and then forward fifteen or twenty years (depending on the year in which the loss was incurred), and used to offset taxable income earned by a company (and thus reduce its income tax liability).

Section 382 of the Internal Revenue Code provides that when a company undergoes an "ownership change," that company's use of its net operating losses is limited in each subsequent year. An "ownership change" occurs when, as of any testing date, the sum of the increases in ownership of each shareholder that owns five percent or more of the value of a company's stock as compared to that shareholder's lowest percentage ownership during the preceding three-year period exceeds fifty percentage points. For purposes of this rule, certain shareholders who own less than five percent of a company's stock are aggregated and treated

as a single five-percent shareholder. We may issue a substantial number of shares of our stock in connection with public and private offerings, acquisitions and other transactions in the future, although no assurance can be

given that any such offering, acquisition or other transaction will be effected. In addition, the exercise of outstanding options to purchase shares of our common stock may require us to issue additional shares of our common stock. The issuance of a significant number of shares of stock could result in an "ownership change." If we were to experience such an "ownership change," we estimate that virtually all of our available federal net operating loss carryforwards would be effectively unavailable to reduce our taxable income.

The extent of the actual future use of our federal net operating loss carryforwards is subject to inherent uncertainty because it depends on the amount of otherwise taxable income we may earn. We cannot give any assurance that we will have sufficient taxable income in future years to use any of our federal net operating loss carryforwards before they would otherwise expire.

OUR PROPRIETARY TECHNOLOGY IS DIFFICULT TO PROTECT AND MAY INFRINGE ON THE INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES. Our success depends significantly upon our proprietary technology. We rely on a combination of copyright and trademark laws, trade secrets, confidentiality agreements and contractual provisions to protect our proprietary rights. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. We cannot assure you that any of our applications will be approved, that any new patents will be issued, that we will develop proprietary products or technologies that are patentable, that any issued patent will provide us with any competitive advantages or will not be challenged by third parties. Furthermore, we cannot assure you that the patents of others will not have a material adverse effect on our business and operating results.

If our technology or products is determined to infringe upon the rights of others, and we were unable to obtain licenses to use the technology, we could be required to cease using the technology and stop selling the products. We may not be able to obtain a license in a timely manner on acceptable terms or at all. Any of these events would have a material adverse effect on our financial condition and results of operations.

Patent disputes are common in technology related industries. We cannot assure you that we will have the financial resources to enforce or defend a patent infringement or proprietary rights action. As the number of products and competitors in the smart card market grows, the likelihood of infringement claims also increases. Any claim or litigation may be time consuming and costly, cause product shipment delays or require us to redesign our products or enter into royalty or licensing agreements. Any of these events would have a material adverse effect on our business and operating results. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to use our proprietary information and software. In addition, the laws of some foreign countries do not protect proprietary and intellectual property rights as effectively as do the laws of the United States. Our means of protecting our proprietary and intellectual property rights may not be adequate. There is a risk that our competitors will independently develop similar technology, duplicate our products or design around patents or other intellectual property rights.

We believe that establishing, maintaining and enhancing the Infineer brand name is essential to our business. We filed an application for a United States trademark registration and an application for service mark registration of our name and logo. We are aware of third parties that use marks or names that contain similar sounding words or variations of the "infi" prefix. In July 2002, we received a claim from a third party challenging the use of the Infineer name. Upon reaching an agreement with this third party in 2004 to amend our trademark application, we believe that this claim has been resolved. As a result of this claim and other challenges which may occur in the future, we may incur significant expenses, pay substantial damages and be prevented from using the

Infineer name. Use of a similar name by third parties may also cause confusion to our clients and confusion in the market, which could decrease the value of our brand and harm our reputation. We cannot assure you that our business would not be adversely affected if we are required to change our name or if confusion in the market did occur.

THE NATURE OF OUR PRODUCTS SUBJECTS US TO PRODUCT LIABILITY RISKS. Our customers may rely on certain of our current products and products in development to prevent unauthorized access to digital content for financial transactions, computer networks, and real property. A malfunction of or design defect in certain of our products could result in tort or warranty claims. Although we attempt to reduce the risk of exposure from such claims through warranty disclaimers and liability limitation clauses in our sales agreements and by maintaining product liability insurance, we cannot assure you that these measures will be effective in limiting our liability for any damages. Any liability for damages resulting from security breaches could be substantial and could have a material adverse effect on our business and operating results. In addition, a well-publicized actual or perceived security breach involving our conditional access or security products could adversely affect the market's perception of our products in general, regardless of whether any breach is attributable to our products. This could result in a decline in demand for our products, which could have a material adverse effect on our business and operating results.

WE MAY HAVE DIFFICULTY RETAINING OR RECRUITING PROFESSIONALS FOR OUR BUSINESS. Our future success and performance is dependent on the continued services and performance of our senior management and other key personnel. If we fail to meet our operating and financial objectives this may make it more difficult to retain and reward our senior management and key personnel. The loss of the services of any of our executive officers or other key employees could materially adversely affect our business.

Our business requires experienced software and hardware engineers, and our success depends on identifying, hiring, training and retaining such experienced, knowledgeable professionals. If a significant number of our current employees or any of our senior technical personnel resign, or for other reasons are no longer employed by us, we may be unable to complete or retain existing projects or bid for new projects of similar scope and revenues. In addition, former employees may compete with us in the future.

Even if we retain our current employees, our management must continually recruit talented professionals in order for our business to grow. Furthermore, there is significant competition for employees with the skills required to perform the services we offer. We cannot assure you that we will be able to attract a sufficient number of qualified employees in the future to sustain and grow our business, or that we will be successful in motivating and retaining the employees we are able to attract. If we cannot attract, motivate and retain qualified professionals, our business, financial condition and results of operations will suffer.

OUR INTERNATIONAL OPERATIONS SUBJECT US TO RISKS ASSOCIATED WITH OPERATING IN FOREIGN MARKETS, INCLUDING FLUCTUATIONS IN CURRENCY EXCHANGE RATES, WHICH COULD ADVERSELY AFFECT OUR OPERATIONS AND FINANCIAL CONDITION. Our operations are located in the United Kingdom and sales to customers outside the U.S. represented approximately 82% and 88% of total sales for the years ended December 31, 2003 and 2004, respectively. Because we derive a substantial portion of our business outside the United States, we are subject to certain

risks associated with operating in foreign markets including the following:

- tariffs and other trade barriers;
- difficulties in staffing and managing foreign operations;
- currency exchange risks;
- export controls related to encryption technology;
- unexpected changes in regulatory requirements;
- changes in economic and political conditions;
- seasonal reductions in business activities in the countries where our customers are located;
- longer payment cycles and greater difficulty in accounts receivable collection;
- potentially adverse tax consequences; and
- burdens of complying with a variety of foreign laws.

Any of the foregoing could adversely impact the success of our operations. We cannot assure you that such factors will not have a material adverse effect on our future sales and, consequently, on our business, operating results and financial condition. In addition, fluctuations in exchange rates could have a material adverse effect on our business, operating results and financial condition. To date, we have not engaged in currency hedging.

CHANGES WE MAY NEED OR BE REQUIRED TO MAKE IN OUR INSURANCE COVERAGE MAY EXPOSE US TO INCREASED LIABILITIES AND MAY INTERFERE WITH OUR ABILITY TO RETAIN OR ATTRACT QUALIFIED OFFICERS AND DIRECTORS. We renew or replace various insurance policies on an annual basis, including those that cover directors and officers liability. Given the current climate of rapidly increasing insurance premiums and erosions of coverage, we may need or be required to reduce our coverage and increase our deductibles in order to afford the premiums. To the extent we reduce our coverage and increase our deductibles, our exposure and the exposure of our directors and officers for liabilities that either become excluded from coverage or underinsured will increase. As a result, we may lose or may experience difficulty in attracting qualified directors and officers.

WE ARE SUBJECT TO GOVERNMENT REGULATION. Federal, state and local regulations impose various environmental controls on the discharge of chemicals and gases, which have been used in our past assembly processes and may be used in future processes. Moreover, changes in such environmental rules and regulations may require us to invest in capital equipment and implement compliance programs in the future. Any failure by us to comply with environmental rules and regulations, including the discharge of hazardous substances, could subject us to liabilities and could materially adversely affect our operations.

RECENTLY ENACTED AND PROPOSED REGULATORY CHANGES WILL CAUSE US TO INCUR INCREASED COSTS. Recently enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002, will increase our expenses as we evaluate the implications of new rules and devote resources to respond to the new requirements. In particular, we expect to incur significant additional administrative expense as we implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our independent registered public accounting firm to attest to, our internal controls. The compliance of these new rules could also result in continued diversion of management's time and attention, which could prove to be disruptive to business operations. Further, we may lose or may experience difficulty in attracting qualified directors and officers.

There can be no assurance that we will timely comple