PUBLICARD INC
Form 10-Q
August 08, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

OR

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

For the transition period from ___ to ___.

COMMISSION FILE NUMBER 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.)
620 FIFTH AVENUE, 7TH FLOOR, NEW YORK, NY	10020
(Address of principal executive offices)	(Zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

Number of shares of Common Stock outstanding as of August 7, 2003: 24,565,902

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS AS OF
JUNE 30, 2003 AND DECEMBER 31, 2002
(IN THOUSANDS EXCEPT SHARE DATA)

ASSETS

Current assets:
- Cash, including short-term investments of $1,835 and $1,138 in 2003 and 2002, respectively
- Trade receivables, less allowance for doubtful accounts of $94 and $103 in 2003 and 2002, respectively
- Inventories
- Prepaid insurance and other

Total current assets

Equipment and leasehold improvements, net
Goodwill and intangibles
Other assets

LIABILITIES AND SHAREHOLDERS' DEFICIT

Current liabilities:
- Trade accounts payable and overdraft
- Accrued liabilities

Total current liabilities

Other non-current liabilities

Total liabilities

Commitments and contingencies (Note 6)

Shareholders' deficit:
- Class A Preferred Stock, Second Series, no par value: 1,000 shares authorized; 665 and 765 issued and outstanding as of June 30, 2003 and December 31, 2002, respectively
- Common shares, $0.10 par value: 40,000,000 shares authorized; 24,440,902 and 24,190,902 shares issued and outstanding as of June 30, 2003 and December 31, 2002, respectively
- Additional paid-in capital
- Accumulated deficit
- Other comprehensive loss

Total shareholders' deficit

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

PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THREE AND SIX MONTHS ENDED JUNE 30, 2003 AND 2002
(IN THOUSANDS EXCEPT SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		
	2003	2002	2
Sales	$ 1,193	$ 1,016	$
Cost of sales	612	520	
Gross margin	581	496	
Operating expenses:			
General and administrative	687	761	
Sales and marketing	523	472	
Product development	156	128	
Amortization of intangibles	10	144	
	1,376	1,505	
Loss from operations	(795)	(1,009)	
Other income (expenses):			
Interest income	4	15	
Interest expense	(2)	(6)	
Cost of pensions - non-operating	(225)	(218)	
Gain on insurance recoveries	--	--	
Other income (expenses), net	89	(9)	
	(134)	(218)	
Net income (loss)	$ (929)	$ (1,227)	$
Basic and diluted earnings (loss) per common share	$ (.04)	$ (.05)	$
Weighted average common shares outstanding			
Basic	24,440,902	24,181,527	24,3
Diluted	26,103,402	24,181,527	26,1

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

PUBLICARD, INC.

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' DEFICIT
FOR THE SIX MONTHS ENDED JUNE 30, 2003
(IN THOUSANDS EXCEPT SHARE DATA)
(UNAUDITED)

	Class A Preferred Stock	Common Shares Shares Issued	Amount	Additional Paid-in Capital	Accumulate Deficit
Balance - January 1, 2003	$3,825	24,190,902	$2,419	$107,169	$(112,024)
Conversion of preferred stock	(500)	250,000	25	475	--
Comprehensive income:					
Net income	--	--	--	--	71
Foreign currency translation adjustment	--	--	--	--	--
Comprehensive income					
Balance - June 30, 2003	$3,325	24,440,902	$2,444	$107,644	$(111,953)

The accompanying notes to unaudited consolidated financial statements are an integral part of this statement.

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PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2003 AND 2002
(IN THOUSANDS)
(UNAUDITED)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 71	$(2,496)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Gain on insurance recoveries	(1,707)	--
Amortization of intangibles	20	288
Depreciation and amortization	83	111
Changes in assets and liabilities:		
Trade receivables	(170)	127
Inventories	264	(15)
Prepaid insurance and other current assets	131	442
Other assets	--	192
Trade accounts payable	(147)	(661)

Accrued liabilities	18	38
Other non-current liabilities	271	(60)
Net cash used in operating activities	(1,166)	(2,034)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(11)	(16)
Proceeds from insurance recoveries	1,707	--
Proceeds from discontinued operations	20	88
Net cash provided by investing activities	1,716	72
CASH FLOWS FROM FINANCING ACTIVITIES	--	--
Effect of exchange rate changes on cash and cash equivalents	1	3
Net increase (decrease) in cash	551	(1,959)
Cash - beginning of period	1,290	4,479
Cash - end of period	$ 1,841	$ 2,520
Cash paid for income taxes	$ --	$ --
Cash paid for interest	$ 5	$ 59

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

PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF THE BUSINESS

PubliCARD, Inc. ("PubliCARD" or the "Company") 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.

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.

At present, PubliCARD's sole operating activities are conducted through its Infineer Ltd. subsidiary ("Infineer"), 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 funding, as to which no assurance can be given.

LIQUIDITY AND GOING CONCERN CONSIDERATIONS

These unaudited 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 the years 2002, 2001 and 2000. 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 $1.8 million at June 30, 2003. The Company also had a working capital deficit of $89,000 and an accumulated deficit of $112.0 million at June 30, 2003.

If the distress termination of the Company's defined benefit pension plan for which the Company has applied is completed (see Note 5), for which no assurance can be given, the Company's 2003 funding requirements to the plan could be eliminated, in which case 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, 2003. However, additional capital will be necessary in order to operate beyond December 2003 and to fund the current business plan and other obligations. While the Company is actively 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 eliminate the 2003 funding requirements for the defined benefit pension plan or 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 may not be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which could have a material adverse effect on its business and results of operations and could lead the Company to seek bankruptcy protection.

These conditions raise substantial doubt about the Company's ability to continue as a going concern. The unaudited consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. The independent auditors' report on the Company's Consolidated Financial Statements for the year ended December 31, 2002 contained an emphasis paragraph concerning substantial doubt about the Company's ability to continue as a going concern.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of PubliCARD and its wholly-owned subsidiaries. All intercompany transactions are eliminated in consolidation.

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position of the Company and its subsidiary companies as of June 30, 2003 and the results of their operations and cash flows for the six months ended June 30, 2003. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, as amended.

EARNINGS (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is based on net income (loss) divided by the weighted average number of common shares outstanding during each period. Diluted net income (loss) per common share assumes issuance of the net incremental shares from stock options, warrants and convertible preferred stock at the later of the beginning of the year or date of issuance. For the three and six months ended June 30, 2002, diluted net income (loss) per share was the same as basic net income (loss) per share since the effect of stock options, warrants and convertible preferred stock were antidilutive.

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 recognized upon client acceptance or "go live" date. Revenue from maintenance and support fees is recognized ratably over the contract period. Provisions are recorded for estimated warranty repairs and returns at the time the products are shipped. Should 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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

inventory. Inventories as of June 30, 2003 and December 31, 2002 consisted of the following (in thousands):

	2003	2002
Raw materials and work-in-process	$ 217	$ 175
Finished goods	422	710
	$ 639	$ 885

STOCK-BASED COMPENSATION

The Company accounts for employee stock-based compensation cost using the intrinsic value method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation" ("SFAS No. 148").

At June 30, 2003, the Company had four fixed stock-based compensation plans. The exercise price of each option granted pursuant to these plans is equal to the market price of the Company's common stock on the date of grant. Accordingly, pursuant to APB No. 25, no compensation cost has been recognized for such grants. Had compensation cost been determined based on the fair value at the grant dates for such awards consistent with the method prescribed by SFAS No. 123, the Company's net income (loss) and earnings (loss) per share for the three and six months ended June 30, 2003 and 2002 would have been as follows (in thousands except per share data):

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS EN JUNE 30,	
	2003	2002	2003	2
Net income (loss), as reported	$ (929)	$(1,227)	$ 71	$(2
Deduct: Total stock-based compensation expense determined under fair value based method	(121)	(43)	(243)	
Pro forma loss	$(1,050)	$(1,270)	$(172)	$(2
Basic earnings (loss) per share:				
As reported	$ (.04)	$ (.05)	$ --	$
Pro forma	$ (.04)	$ (.05)	$(.01)	$

Diluted earnings (loss) per share:				
As reported	$ (.04)	$ (.05)	$ --	$
Pro forma	$ (.04)	$ (.05)	$(.01)	$

The weighted-average fair value of each stock option included in the preceding pro forma amounts was estimated using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options.

USE OF ESTIMATES

The preparation of these financial statements required the use of certain estimates by management in determining the Company's assets, liabilities, revenues and expenses. Certain of our 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, valuation of investments, goodwill and intangibles and pension

accounting to be critical policies due to the estimation processes involved. While all available information has been considered, actual amounts could differ from those reported.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2002, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 supersedes Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires that costs associated with an exit or disposal plan be recognized when incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The statement is effective beginning January 1, 2003, and did not have a material impact on the Company's Consolidated Financial Statements.

In December 2002, the FASB issued SFAS No. 148. SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock based employee compensation and the effect of the method used on reported results. The provisions of SFAS No. 148 are effective for fiscal years and interim periods ending after December 15, 2002. SFAS No. 148 did not require the Company to change to the fair value based method of accounting for stock-based compensation. The Company has elected to continue to apply APB No. 25 and related interpretations in accounting for stock options, and the disclosures required by SFAS Nos. 123 and 148 are included in Note 1 herein.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". The interpretation addresses the disclosures to be made by a guarantor in its financial statements about its obligations under guarantee. In addition, it also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure provisions became effective December 15, 2002 and did not have a material impact on the Company's Consolidated Financial Statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities". The interpretation requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the company that has controlling financial interest. It also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. This Interpretation is effective July 1, 2003, and is not expected to have a material impact on the Company's Consolidated Financial Statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149 clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 amends certain other existing pronouncements. SFAS No. 149 is effective on a prospective basis for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. This statement is not expected to have a material impact on the Company's Consolidated Financial Statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 establishes standards for

how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This statement will become effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement is not expected to have a material impact on the Company's Consolidated Financial Statements.

NOTE 2 - GOODWILL AND INTANGIBLES

Goodwill is the excess of the purchase price and related costs over the value assigned to the net tangible and intangible assets relating to the

November 1999 acquisition of Infineer. Through December 31, 2001, goodwill had been amortized over a five year life. Effective January 1, 2002, the Company adopted FASB Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("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 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.

The Company performed its annual goodwill impairment test in the fourth quarter of 2002 and determined that goodwill had been impaired. The Company determined the fair value 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 an entity 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. Based on comparing the values derived from the two techniques 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. On an ongoing basis, the Company expects to perform its annual impairment test during the fourth quarter absent any interim impairment indicators. The carrying value of goodwill as of June 30, 2003 and December 31, 2002 was $782,000.

Intangible assets consist of completed technology identified as of the Infineer acquisition date and are amortized over a five year life. 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. 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 attributed 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The gross carrying amount and accumulated amortization of intangible assets at June 30, 2003 and December 31, 2002 was as the following (in thousands):

	2003	2002
Gross carrying amount	$ 1,881	$ 1,881
Accumulated amortization	(1,821)	(1,801)
	$ 60	$ 80

Amortization of intangibles for the six months ended June 30, 2003 and 2002 was $20,000 and $288,000, respectively. The estimated annual amortization expense for intangibles is $40,000 for each of the years 2003 and 2004.

NOTE 3 - INVESTMENTS

In December 2000, the Company acquired an ownership interest in TecSec, Incorporated, a Virginia corporation ("TecSec"), for $5.1 million. TecSec 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. The TecSec investment, amounting to a 5% ownership interest on a fully diluted basis, has been accounted for at cost. The Company has certain anti-dilutive rights whereby its ownership interest may be increased following contributions of additional third-party capital. The Company believed that the investment in TecSec had been impaired and a charge of $2.1 million was recorded in the third quarter of 2002. The Company attributed the impairment to a general decline in valuations of technology entities, the difficulties in raising capital and TecSec's recurring operating losses. TecSec is currently evaluating alternative sources of financing to meet ongoing capital and operating needs. If TecSec is not successful in executing its business plan or in obtaining sufficient capital on acceptable terms or at all, the Company's investment in TecSec could be further impaired and subject to an additional significant write-down.

NOTE 4 - SEGMENT DATA

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. Sales by geographical areas for the six months ended June 30, 2003 and 2002 are as follows (in thousands):

	2003	2002
United States	$ 554	$ 420
Europe	1,853	1,748
Rest of world	199	47
	$2,606	$2,215

The Company has operations in the United States and United Kingdom. Identifiable assets by country as of June 30, 2003 and December 31, 2002 are as follows (in thousands):

	2003	2002
United States	$ 5,372	$ 4,842
United Kingdom	2,004	2,235
	$ 7,376	$ 7,077

NOTE 5 - UNDERFUNDED PENSION PLAN

The Company sponsors a defined benefit pension plan (the "Plan") that was frozen in 1993. As of December 31, 2002, the actuarial present value of accrued liabilities exceeded the plan assets by approximately $6.1 million (determined on an ongoing basis). The assets of the Plan are managed by an outside trustee and invested primarily in equity and fixed income securities. PubliCARD common stock represented less than 1% of plan assets as of December 31, 2002. For 2003, the minimum required contributions are expected to be approximately $1.5 million.

In January 2003, the Company filed a notice with the Pension Benefit Guaranty Corporation ("PBGC") seeking a "distress termination" of the Plan. If the PBGC determines that the Company meets one of the tests for such a termination, the Plan will terminate and the PBGC will become responsible for meeting future retirement obligations of participants (within certain limitations). The Company would be liable to the PBGC for the amount of the unfunded guaranteed benefit obligation. The Company believes that on a termination basis, the Plan's liabilities could exceed the value of its assets by in excess of $7.0 million. In addition, the Company did not make the required contributions that were due on January 15, 2003, April 15, 2003 and July 15, 2003 which aggregate approximately $900,000. The Company has initiated discussions with the PBGC concerning the termination of the Plan and its obligation to the PBGC if the Plan is terminated (including the timing of its repayment obligation). It is not possible to predict the outcome of such discussions.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

LEGAL

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.

Notice of the commencement of this action has been given to the Company's directors and officers liability insurance carriers. 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 to dismiss, without leave to amend, six of the eleven purported causes of action in the amended complaint. The lawsuit is in the early stages. There has been no discovery 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 2003.

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 businesses. Certain claims are covered by liability insurance. The Company believes that the resolution of those claims to the extent not covered by insurance will not, individually or in the aggregate, have a material adverse effect on the financial position or results of operations of the Company.

INSURANCE RECOVERIES

In February and March 2003, the Company entered into two binding settlements with various historical insurers that resolve 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 and offsetting adjustments, the Company received net proceeds of approximately $1.0 million in February 2003 and an additional $682,000 in April 2003. The Company recognized a non-recurring gain from these settlements of $1.7 million in the first quarter of 2003.

The Company is also in discussions with other insurance markets regarding the status of certain policies of insurance. It cannot be determined whether any additional amounts may be recovered from these other insurers nor can the timing of any such additional recoveries be determined.

NOTE 7 - COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for the Company includes foreign currency translation adjustments as well as net income (loss) reported in the Company's Consolidated Statements of Operations. Comprehensive income (loss) for the three and six months ended June 30, 2003 and 2002 was as follows (in thousands):

	THREE MONTHS ENDED JUNE 30, 2003	THREE MONTHS ENDED JUNE 30, 2002	SIX MONTHS ENDED JUNE 30, 2003	SIX MONTHS ENDED JUNE 30, 2002
Net income (loss)	$ (929)	$(1,227)	$ 71	$(2,496)
Foreign currency translation adjustments	9	80	8	54
Comprehensive income (loss)	$ (920)	$(1,147)	$ 79	$(2,442)

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this Form 10-Q contains forward-looking statements, including (without limitation) statements concerning possible or assumed future results of operations of PubliCARD preceded by, followed by or that include the words "believes," "expects," "anticipates," "estimates," "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 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.

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, 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.

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.

At present, PubliCARD's sole operating activities are conducted through its Infineer subsidiary, which designs smart card platform 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 financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the Unaudited Consolidated Financial Statements, the Company has incurred operating losses, has a working capital deficiency and requires additional capital to meet its obligations and accomplish the Company's business plan, which raises substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the Company's failure to obtain funding or inability to continue as a going concern.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2003 COMPARED TO THREE MONTHS ENDED JUNE 30, 2002

SALES. Revenues are generated from product sales, technology and software license fees, installation and maintenance contracts. Consolidated net sales increased to $1.2 million in 2003 compared to $1.0 million for 2002. The increase in sales was due to principally to an improvement in shipments to distributors in the United States.

GROSS MARGIN. Cost of sales consists primarily of material, personnel costs and overhead. Gross margin, as a percentage of net sales, was 49% in both 2003 and 2002.

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 $523,000 in 2003 compared to $472,000 in 2002. The increase is mainly due to higher personnel costs.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses include costs associated with the development of new products and enhancements to existing products. Product development expenses consist primarily of personnel and travel costs and contract engineering services. Product development expenses amounted to $156,000 in 2003 compared to $128,000 in 2002.

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 were $687,000 in 2003 compared to $761,000 in 2002. The decrease is mainly due to a slight overall reduction in salaries and benefit expenses.

AMORTIZATION OF INTANGIBLES. In accordance with SFAS No. 142, effective January 1, 2002, 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 of intangibles relates to the continuing amortization of definite life intangibles. Amortization expense decreased from $144,000 in 2002 to $10,000 in 2003 as a result of an impairment loss of $1.0 million recognized in the fourth quarter of 2002.

OTHER INCOME AND EXPENSE. 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.

SIX MONTHS ENDED JUNE 30, 2003 COMPARED TO SIX MONTHS ENDED JUNE 30, 2002

SALES. Consolidated net sales increased to $2.6 million in 2003 compared to $2.2 million for 2002. Sales in 2003 benefited from several one-time custom development projects and an increase in sales outside of the United Kingdom.

GROSS MARGIN. Gross margin, as a percentage of net sales, was 53% in 2003 compared to 48% in 2002. The gross margin improvement resulted from higher margins generated by the revenues from the custom development projects and license fees in the first quarter of 2003.

SALES AND MARKETING EXPENSES. Sales and marketing expenses were $1.0 million in 2003 compared to $899,000 in 2002. The increase is mainly due to higher personnel costs.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses amounted to $245,000 in 2003 compared to $247,000 in 2002.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the six months ended June 30, 2003 decreased to $1.4 million from $1.7 million for 2002. The decrease is mainly due to

corporate cost containment initiatives and headcount reductions.

AMORTIZATION OF GOODWILL AND INTANGIBLES. Amortization expense decreased from $288,000 in 2002 to $20,000 in 2003 as a result of an impairment loss of $1.0 million recognized in the fourth quarter of 2002.

OTHER INCOME AND EXPENSE. 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.

In February and March 2003, the Company entered into two binding settlements with various historical insurers that resolve 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 and offsetting adjustments, the Company received net proceeds of approximately $1.0 million in February 2003 and an additional $682,000 in April 2003. The Company recognized a non-recurring gain from these settlements of $1.7 million in the first quarter of 2003.

LIQUIDITY

The Company has financed its operations over the last three years primarily through the sale of capital stock, the sale of non-core businesses and insurance recoveries. During the six months ended June 30, 2003, cash, including short-term investments, increased by $551,000 to $1.8 million as of June 30, 2003.

Operating activities utilized cash of $1.2 million in 2003 and principally consisted of the net income of $71,000 plus depreciation and amortization of $103,000 and a reduction in assets and liabilities of $367,000 offset by a gain on insurance recoveries of $1.7 million.

Investing activities provided cash of $1.7 million in 2003 and consisted principally of $1.7 million of proceeds received from insurance recoveries.

The Company has experienced negative cash flow from operating activities in the past and expects to experience negative cash flow in 2003 and beyond. In addition to funding operating and capital requirements and corporate overhead, future uses of cash include the following:

- The Company sponsors a defined benefit pension plan, which was frozen in 1993. As of December 31, 2002, the actuarial present value of accrued liabilities exceeded the plan assets by approximately $6.1 million (determined on an ongoing basis). The required contribution to the plan is expected to be approximately $1.5 million in 2003. Absent some action by the Company, the annual contribution requirements beyond 2003 would continue to be significant. In view of its financial condition, in January 2003, the Company filed a notice with the PBGC seeking a "distress termination" of the Plan. If the PBGC determines that the Company meets one of the tests for such a termination, the Plan will terminate and the PBGC will become responsible for meeting future retirement obligations to participants (within certain limitations). The Company would be liable to the PBGC for the amount of the unfunded guaranteed benefit obligation. The Company believes that on a termination basis, the Plan's liabilities could exceed the value of its assets by in excess of $7.0 million. In addition, the Company did not make the required contributions that were due on January 15, 2003, April 15, 2003 and July 15, 2003 which aggregate approximately $900,000. The Company has initiated discussions with the PBGC concerning the termination of the Plan and its repayment obligation to the PBGC if the Plan is terminated (including the timing of its repayment obligation). It is not possible to predict the outcome of such discussions.

- The Company and certain current and former officers are defendants in a lawsuit alleging, among other things, misrepresentation and securities fraud. The Company believes that it has meritorious defenses to the allegations and intends to defend itself vigorously. The cost of defending against

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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.

- The Company leases certain office space, vehicles and office equipment under operating leases that expire over the next six years. Minimum payments for operating leases having initial or remaining non-cancelable terms in excess of one year are $176,000 for the remainder of 2003, $217,000 in 2004, $77,000 in 2005, $56,000 in 2006, $55,000 in 2007 and $40,000 thereafter.

The Company will need to raise additional capital that may not be available to it. If the distress termination of the Company's defined benefit pension plan for which the Company has applied is completed (see Note 5 to the Notes to Unaudited Consolidated Financial Statements), the Company's 2003 funding requirements to the plan could be eliminated, in which case 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, 2003. However, additional capital will be necessary in order to operate beyond December 2003 and to fund the current business plan and other obligations. While the Company is actively considering various funding alternatives, it has not secured or entered into any arrangements to obtain additional capital. There can be no assurance that the Company will be able to eliminate the 2003 funding requirements for the defined benefit pension plan or 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 may not be able to meet its obligations, take advantage of future acquisition opportunities or further develop or enhance its product offering, any of which could 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 ("National Market"), the Company transferred the listing of its common stock to the Nasdaq SmallCap Market ("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 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 could seek bankruptcy protection. Such an event may result in the Company's common and preferred stock being negatively affected or becoming worthless. The auditors' report on the Company's Consolidated Financial Statements for the year ended December 31, 2002 contains an emphasis paragraph concerning substantial doubt about the Company's ability to continue as a going concern.

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are more fully described in the Notes to the Company's Unaudited 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, valuation of investments and goodwill and intangibles and pension accounting 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 recognized upon client acceptance or "go live" date. Revenue from maintenance and support fees is recognized ratably over the contract period. Provisions are recorded for estimated warranty repairs and returns at the time the products are shipped. Should 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.

VALUATION OF INVESTMENTS. The Company periodically assesses the carrying value of its minority-owned investments for impairment. This assessment is based upon a review of operations and indications of continued viability, such as subsequent rounds of financing. As discussed in Note 3 to the Unaudited Consolidated Financial Statements, during 2002 the Company made a determination that its minority-owned investments in TecSec was impaired. While management believes that the adjusted carrying value of its investment in TecSec is fairly stated, future circumstances could affect the valuation.

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 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.

The Company performed its annual goodwill impairment test in the fourth quarter of 2002 and determined that goodwill had been impaired. The Company determined the fair value 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 an entity 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. Based on comparing the values derived from the two techniques 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. On an ongoing basis, the Company expects to perform its annual impairment test during the fourth quarter absent any interim impairment indicators.

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. 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 attributed 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.

PENSION OBLIGATIONS. The determination of obligations and expense for pension benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. These assumptions include, among others, the discount rate and the expected rate of return on plan assets. Actual results that differ from assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While management believes that the assumptions are appropriate, differences in actual experience or significant changes in assumptions may materially affect the pension obligation and future expense.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 supersedes Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires that costs associated with an exit or disposal plan be recognized when incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The statement is effective beginning January 1, 2003, and did not have a material impact on the Company's Consolidated Financial Statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for

Stock-Based Compensation". SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock based employee compensation and the effect of the method used on reported results. The provisions of SFAS No. 148 are effective for fiscal years and interim periods ending after December 15, 2002. SFAS No. 148 did not require the Company to change to the fair value based method of accounting for stock-based compensation. The Company has elected to continue to apply APB No. 25 and related interpretations in accounting for stock options, and the disclosures required by SFAS Nos. 123 and 148 are included in Note 1 to the Unaudited Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". The interpretation

addresses the disclosures to be made by a guarantor in its financial statements about its obligations under guarantee. In addition, it also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure provisions became effective December 15, 2002 and did not have a material impact on the Company's Consolidated Financial Statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities". The interpretation requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the company that has controlling financial interest. It also provides the framework for determining whether a variable interest entity should be consolidated based on voting interest or significant financial support provided to it. This Interpretation is effective July 1, 2003, and is not expected to have a material impact on the Company's Consolidated Financial Statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 amends certain other existing pronouncements. SFAS No. 149 is effective on a prospective basis for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. This statement is not expected to have a material impact on the Company's Consolidated Financial Statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This statement will become effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after

June 15, 2003. The adoption of this statement is not expected to have a material impact on the Company's Consolidated Financial Statements.

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 2000, 2001 and 2002 of approximately $19.7 million, $17.2 million and $8.3 million, respectively. In addition, we experienced negative cash flow from continuing operating activities of $18.7 million, $12.2 million, $5.1 million and $1.2 million in 2000, 2001, 2002 and the six months ended June 30, 2003, respectively, and have a working capital deficit of $89,000 as of June 30, 2003.

We sponsor a defined benefit pension plan which was frozen in 1993. As of December 31, 2002, the present value of the accrued liabilities of our plan exceeded its' assets by approximately $6.1 million. (determined on an ongoing basis) The required contribution to the Plan is expected to be approximately $1.5 million for 2003 and if the Plan is continued, we will be obligated to make continued contributions in future years which, absent some action by us, we expect that the annual contribution requirements beyond 2003 will continue to be significant. Future contribution levels depend in large measure on the mortality rate of plan participants, the discount rate required, and the expected return on the plan assets. In April 2002, we failed to make the required quarterly contribution to the Plan due April 15, 2002, in the amount of $253,000. We made this contribution on June 11, 2002 and quarterly contributions of $253,000 were made

on a timely basis in July 2002 and October 2002. In view of our financial condition, in January 2003, we filed a notice with the PBGC seeking a "distress termination" of the Plan and did not make the contributions due on January 15, 2003, April 15, 2003 and July 15, 2003 which aggregate approximately $900,000. If the PBGC determines that we meet one of the tests for such termination, the Plan will terminate and the PBGC will become responsible for meeting future retirement obligations to participants (within certain limitations). We would be liable to the PBGC for the amount of the unfunded benefit obligation. We believe that, on a termination basis, the Plan's liabilities could exceed the value of its assets by in excess of $7.0 million. We have initiated discussions with the PBGC concerning the termination of the Plan and our repayment obligation to the PBGC if the Plan is terminated (including the timing of our repayment obligation). It is not possible to predict the outcome of such discussions.

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 we are not successful in defending ourself, we may be required to pay the plaintiff's damages, which could have a material adverse effect on our 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 $620,000.

We will need to raise additional capital that may not be available to us. If the distress termination of the Plan for which we have applied is completed, our 2003 funding requirements discussed above could be eliminated, in which case, we believe that existing cash and short-term investments may be sufficient to meet our operating and capital requirements at the currently anticipated level through December 31, 2003. However, additional capital will be necessary in order to operate beyond December 2003 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 eliminate the 2003 funding requirements for the Plan or 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 our Consolidated Financial Statements for the years ended December 31, 2001 and 2002 contained an emphasis paragraph concerning substantial doubt about our 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.

OUR STOCK HAS BEEN DELISTED FROM THE NASDAQ SYSTEM. On February 14, 2002, we received a notice from The Nasdaq Stock Market ("Nasdaq") that our common stock had failed to maintain a minimum closing bid price of $1.00 over the last 30 consecutive trading days as required by National Market rules. We received a second notice on February 27, 2002, that our common stock also failed to maintain a market value of public float of $5 million.

In accordance with the Nasdaq rules, we were required to regain compliance with the National Market minimum bid price requirement and with the market value of public float requirement by May 2002. Since our common stock continued to trade significantly below $1.00, in April 2002, we filed an application to transfer the listing of our common stock to the SmallCap Market. The application was approved and our common stock listing was transferred to the SmallCap Market effective May 2, 2002. The SmallCap Market also has a minimum bid price requirement of $1.00. We qualified for an extended grace period to comply with the SmallCap Market's $1.00 minimum bid price requirement, which extended the delisting

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determination by Nasdaq until February 10, 2003.

On March 19, 2003, we received a Nasdaq Staff Determination letter indicating that we failed to comply with the minimum bid price requirement for continued listing on the SmallCap Market and that our common stock was therefore subject to delisting. Our Board decided not to appeal the delisting determination. Effective March 28, 2003, our common stock no longer traded on the SmallCap Market. On March 28, 2003, our common stock began trading on the OTC Bulletin Board.

As a result of the delisting, the liquidity of our common stock may be materially adversely affected. This could impair our ability to raise capital in the future. 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.

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.

Notice of the commencement of this action has been given to our directors and officers liability insurance carriers. We believe we have meritorious defenses to the allegations and we intend to defend ourselves 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 plaintiff had the right to replead and subsequently filed an amended complaint in February 2003. We and individual defendants filed a second demurrer in March 2003. In June 2003, the court ruled in favor of the demurrer to dismiss, without leave to amend, six of the eleven purported causes of action in the amended complaint. The lawsuit is in the early stages. There has been no discovery 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. The Company incurred approximately $200,000 in defense costs in 2002. No additional costs have been incurred in 2003.

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

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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.

OUR TECSEC INVESTMENT MAY BE IMPAIRED OR SUBJECT TO A SIGNIFICANT WRITE-DOWN IN THE FUTURE. As of June 30, 2003, after recording an impairment charge of $2.1 million in the third quarter of 2002, the carrying value of our investment in TecSec, a privately held company, was $3.0 million. This investment has been accounted for at cost and could be subject to write-down in future periods if it is determined that the investment is permanently impaired and not recoverable. TecSec is currently evaluating alternative sources of financing to meet ongoing capital and operating needs. If TecSec is not successful in executing its business plan or in obtaining sufficient capital on acceptable terms or at all, our investment in TecSec could be further impaired and subject to an additional significant write-down.

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 six months ended June 30, 2003, no one customer represented more than 10% of our sales. Amounts due from three customers represented approximately 17%, 13% and 11%, respectively, of the accounts receivable balance as of June 30, 2003. For the year ended December 31, 2002, one customer represented approximately 10% of our sales. Amounts due from this customer represented approximately 12% of the accounts receivable balance as of December 31, 2002.

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 Girovend, MARS, Cunninghams, Uniware, Diebold and Schlumberger.

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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, 2002, we had federal net operating loss carryforwards, subject to review by the Internal Revenue Service, totaling approximately $64.0 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 patent, 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. We have reached an agreement in principle with this third party, subject to negotiation of definitive documentation, and believe this particular challenge should be 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 RISK ASSOCIATED WITH OPERATING IN FOREIGN MARKETS, INCLUDING FLUCTUATIONS IN CURRENCY EXCHANGE RATES, WHICH COULD ADVERSELY AFFECT OUR OPERATIONS AND FINANCIAL CONDITION. Sales outside the U.S. represented approximately 78% and 79% of total sales for the year ended December 31, 2002 and six months ended June 30, 2003, 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;
- 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.

OUR ARTICLES OF INCORPORATION AND BY-LAWS, CERTAIN CHANGE OF CONTROL AGREEMENTS, OUR RIGHTS PLAN AND PROVISIONS OF PENNSYLVANIA LAW COULD DETER TAKEOVER ATTEMPTS.

Blank check preferred stock. Our board of directors has the authority to issue preferred stock and to fix the rights, preferences, privileges and restrictions, including voting rights, of these shares without any further vote or action by the holders of our common stock. The rights of the holders of any preferred stock that may be issued in the future may adversely affect the rights of the holders of our common stock. The issuance of preferred stock could make it more difficult for a third party to acquire a majority of our outstanding voting stock, thereby delaying, deferring or preventing a change of control. Such preferred stock may have other rights, including economic rights, senior to our common stock, and as a result, the issuance of the preferred stock could limit the price that investors might be willing to pay in the future for shares of our common stock and could have a material adverse effect on the market value of our common stock.

Rights plan. Our rights plan entitles the registered holders of rights to purchase shares of our class A preferred stock upon the occurrence of certain events, and may have the effect of delaying, deferring or preventing a change of control.

Change of control agreements. We are a party to change of control agreements, which provide for payments to certain of our directors and executive officers under certain circumstances following a change of control. Since the change of control agreements require large cash payments to be made by any person effecting a change of control, these agreements may discourage takeover attempts.

The change of control agreements provide that, if the services of any person party to a change of control agreement are terminated within three years following a change of control, that individual will be entitled to receive, in a lump sum within 10 days of the termination date, a payment equal to 2.99 times that individual's average annual compensation for the shorter of the five years preceding the change of control and the period the individual received compensation from us for personal services. Assuming a change of control were to occur at the present time, payments in the following amounts would be required: Mr. Harry I. Freund of $842,000 and Mr. Jay S. Goldsmith of $842,000. If any such payment, either alone or together with others made in connection with the individual's termination, is considered to be an excess parachute payment under the Internal Revenue Code, the individual will be entitled to receive an additional payment in an amount which, when added to the initial payment, would result in a net benefit to the individual, after giving effect to excise taxes imposed by Section 4999 of the Internal Revenue Code and income taxes on such additional payment, equal to the initial payment before such additional payment and we would not be able to deduct these initial or additional payments for income tax purposes.

Pennsylvania law. We are a Pennsylvania corporation. Anti-takeover provisions of Pennsylvania law could make it difficult for a third party to acquire control of us, even if such change of control would be beneficial to our shareholders.

OUR STOCK PRICE IS EXTREMELY VOLATILE. The stock market has recently experienced significant price and volume fluctuations unrelated to the operating performance of particular companies. The market price of our common stock has been highly volatile and is likely to continue to be volatile. The future trading price for our common stock will depend on a number of factors, including:

- delisting of our common stock from the Nasdaq SmallCap Market effective March 28, 2003 (see "Our stock has been delisted from the Nasdaq System" above);

- the volume of activity for our common stock is minimal and therefore a large number of shares placed for sale or purchase could increase its volatility;

- our ability to effectively manage our business, including our ability to raise capital;

- variations in our annual or quarterly financial results or those of our competitors;

- general economic conditions, in particular, the technology service sector;

- expected or announced relationships with other companies;

- announcements of technological advances innovations or new products by us or our competitors;

- patents or other proprietary rights or patent litigation; and

- product liability or warranty litigation.

We cannot be certain that the market price of our common stock will not experience significant fluctuations in the future, including fluctuations that are adverse and unrelated to our performance.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign currency exchange rate risk

We conduct operations in the United Kingdom and sell products in several different countries. Therefore, our operating results may be impacted by the fluctuating exchange rates of foreign currencies, especially the British pound, in relation to the U.S. dollar. We do not currently engage in hedging activities with respect to our foreign currency exposure. We continually monitor our exposure to currency fluctuations and may use financial hedging techniques when appropriate to minimize the effect of these fluctuations. Even so, exchange rate fluctuations may still have a material adverse effect on our business and operating results.

Market Risk

We are exposed to market risk primarily through short-term investments and an overdraft facility. Our investment policy calls for investment in short-term, low risk instruments. As of June 30, 2003, short-term investments (principally U.S. Treasury bills and money-market accounts) were $1.8 million and borrowing under the overdraft facility amounted to $299,000. Due to the nature of the short-term investments and the amount of the overdraft facility, any change in rates would not have a material impact on our financial condition or results of operations.

Investment Risk

As of June 30, 2003, the carrying value of our investment in TecSec, a privately held company, was $3.0 million after recording an impairment change of $2.1 million in the third quarter of 2002. This investment has been accounted for at cost and could be subject to write-downs in future periods if it is determined that the investment is permanently impaired and is not recoverable. TecSec is currently evaluating alternative sources of financing to meet ongoing capital and operating needs. If TecSec is not successful in executing its business plan or in obtaining sufficient capital on acceptable terms or at all, our investment could be further impaired and subject to a significant additional write-down.

ITEM 4. CONTROLS AND PROCEDURES

With the participation of management, the Company's chief executive officer and chief financial officer has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon this evaluation, the chief executive officer and chief financial officer has concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

There has not been any change in the Company's internal controls over financial reporting during the fiscal quarter to which this report relates that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. 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 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.

Notice of the commencement of this action has been given to the Company's directors and officers liability insurance carriers. 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 to dismiss, without leave to amend, six of the eleven purported causes of action in the amended complaint. The lawsuit is in the early stages. There has been no discovery 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 2003.

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 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification of the Chief Executive Officer and Chief Financial Officer filed herewith pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer and Chief Financial Officer filed herewith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Report on Form 8-K

Form 8-K dated May 15, 2003, reporting of the Registrant's results of operations for the first quarter of 2003.

SIGNATURES

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

PUBLICARD, INC.
(Registrant)

Date: August 8, 2003

/s/ Antonio L. DeLise
Antonio L. DeLise, President,
Chief Executive Officer, Chief Financial Officer