PUBLICARD INC
Form 10-Q
November 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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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 SEPTEMBER 30, 2001

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 Identificat |
| 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 .

Number of shares of Common Stock outstanding as of November 1, 2001: 24,153,402

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS AS OF
SEPTEMBER 30, 2001 AND DECEMBER 31, 2000
(IN THOUSANDS EXCEPT SHARE DATA)

ASSETS

Current assets:
Cash, including short-term investments of $5,969 in 2001 and $16,820 in 2000
Trade receivables, less allowance for doubtful accounts (2001 - $148, 2000 - $89)
Inventories
Other

Total current assets

Equipment and leasehold improvements, net
Goodwill
Other assets

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:
Trade accounts payable
Accrued liabilities

Total current liabilities

Other non-current liabilities

Total liabilities

Shareholders' equity:
Class A Preferred Stock, Second Series, no par value: 1,000 shares authorized; 780 and 790 issued and outstanding as of September 30, 2001 and December 31, 2000, respectively
Common shares, $0.10 par value: 40,000,000 shares authorized; 24,153,402 and 24,237,402 shares issued as of September 30, 2001 and December 31, 2000, respectively
Additional paid-in capital
Accumulated deficit
Other comprehensive loss
Unearned compensation

Total shareholders' equity

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



PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME (LOSS)
FOR THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000
(IN THOUSANDS EXCEPT SHARE DATA)
(UNAUDITED)

| | THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS SEPTEMBER |
|---|---|---|---|
| | 2001 | 2000 | 2001 |
| Net sales | $ 1,575 | $ 1,573 | $ 4,434 |
| Cost of sales | 721 | 770 | 2,214 |
| Gross margin | 854 | 803 | 2,220 |
| Operating expenses: | | | |
| General and administrative | 1,177 | 1,531 | 3,703 |
| Sales and marketing | 496 | 2,197 | 2,996 |
| Product development | 389 | 1,296 | 2,229 |
| Stock compensation | 28 | 422 | 86 |
| Goodwill amortization | 252 | 658 | 1,572 |
| Repositioning charge | 1,232 | -- | 7,317 |
| | 3,574 | 6,104 | 17,903 |
| Loss from operations | (2,720) | (5,301) | (15,683) |
| Other income (expenses): | | | |
| Interest income | 128 | 333 | 445 |
| Interest expense | (11) | (22) | (51) |
| Cost of pensions - non-operating | (207) | (210) | (588) |
| Other income | 11 | 28 | 59 |
| | (79) | 129 | (135) |
| Net loss from continuing operations | (2,799) | (5,172) | (15,818) |
| Discontinued operations | -- | 4,275 | 2,350 |

| | | | | |
|---|---|---|---|---|
| Net loss | $ (2,799) | $ (897) | $ (13,468) | $ |
| Basic loss per common share: | | | | |
| Continuing operations | $ (.12) | $ (.22) | $ (.66) | $ |
| Discontinued operations | -- | .18 | .10 | |
| | $ (.12) | $ (.04) | $ (.56) | $ |
| Weighted average shares outstanding | 24,140,902 | 23,479,903 | 24,198,802 | |

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

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PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001
(IN THOUSANDS EXCEPT SHARE DATA)
(UNAUDITED)

| | Class A Preferred Stock | Common Shares: Shares Issued | Common Shares: Amount | Additional Paid-in Capital |
|---|---|---|---|---|
| Balance -- December 31, 2000 | $ 3,950 | 24,237,402 | $ 2,424 | $ 107,30 |
| Repurchase of Common Shares | | (109,000) | (11) | (20 |
| Conversion of Preferred Stock | (50) | 25,000 | 2 | 4 |
| Private placement costs | -- | -- | -- | (4 |
| Amortization of unearned compensation | -- | -- | -- | - |
| Comprehensive Income: | | | | |
| Net loss | -- | -- | -- | - |
| Foreign currency translation adjustment | -- | -- | -- | - |
| Balance -- September 30, 2001 | $ 3,900 | 24,153,402 | $ 2,415 | $ 107,09 |

| Unearned Compensa-tion | Share-holders' Equity | Comprehen-sive loss |
|---|---|---|

| | | | |
|---|---|---|---|
| Balance -- December 31, 2000 | $ (86) | $ 23,578 | $ -- |
| Repurchase of Common Shares | -- | (218) | -- |
| Conversion of Preferred Stock | -- | -- | -- |
| Private placement costs | -- | (43) | -- |
| Amortization of unearned compensation | 86 | 86 | -- |
| Comprehensive Income: | | | |
| Net loss | -- | (13,468) | (13,468) |
| Foreign currency translation adjustment | -- | (178) | (178) |
| Balance -- September 30, 2001 | $ -- | $ 9,757 | $ (13,646) |

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



PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000
(IN THOUSANDS)
(UNAUDITED)

| | 2001 | |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Loss from continuing operations | $(15,818) | $ |
| Adjustments to reconcile loss to net cash used in continuing operations: | | |
| Goodwill amortization | 1,572 | |
| Stock compensation expense | 86 | |
| Depreciation | 274 | |
| Non-cash repositioning charge | 6,458 | |
| Changes in operating assets and liabilities | (3,349) | |
| Net cash used in continuing operations | (10,777) | |
| Income from discontinued operations | 2,350 | |
| Adjustments to reconcile income to net cash used in discontinued operations: | | |
| Non-cash gain for discontinued operations | (2,350) | |
| Change in net assets of discontinued operations | (332) | |
| Net cash used in discontinued operations | (332) | |
| Net cash used in operating activities | (11,109) | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (64) | |
| Other | (6) | |
| Net cash used in continuing operations | (70) | |

| | |
|---|---|
| Proceeds from discontinued operations | 222 |
| Capital expenditures of discontinued operations | -- |
| Net cash provided by discontinued operations | 222 |
| Net cash provided by operating activities | 152 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Issuance of common shares pursuant to stock option exercises | -- |
| Costs incurred from private placement of Class A Preferred Stock | (43) |
| Repayment of notes payable from discontinued operations | -- |
| Net cash (used in) provided by financing activities | (43) |
| Effect of exchange rate changes on cash and cash equivalents | (2) |
| Net (decrease) increase in cash | (11,002) |
| Cash - beginning of period | 17,049 |
| Cash - end of period | $ 6,047 |

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



PUBLICARD, INC.
AND SUBSIDIARY COMPANIES

NOTES TO 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. See Note 6 for a discussion on the disposition plan.

At present, PubliCARD, through its Infineer Ltd. subsidiary ("Infineer"), designs smart card platform solutions for educational and corporate sites. The Company also licenses industry compliant smart card reader solutions and application specific integrated circuits to an affiliated company.

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 remains 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 has become more uncertain. Given the lengthened time horizon, the Board did not believe it would be prudent to continue to invest the Company's current resources in the ongoing development and marketing of these technologies. Accordingly, the Board determined that shareholders' interests will be best served by pursuing strategic alliances with one or more companies that have the resources to capitalize more fully on the Company's smart card reader and chip-related technologies. In connection with this shift in the Company's strategic focus, workforce reductions and other measures were implemented to achieve cost savings. See Note 2 for a discussion on the repositioning charge associated with this action.

In September 2001, the Company announced the formation of a new minority-owned affiliate, MAKO Technologies LLC ("Mako"), a Delaware limited liability company, to market its smart card reader and chip technologies. This decision substantially eliminates the cash funding requirements of the Company while retaining an upside potential in the form of royalties to be paid over the next two years for the use of certain intellectual property rights of Infineer and a 46% ownership interest in Mako.

The Company's future plans revolve around an acquisition strategy focused on businesses in areas outside the high technology sector while continuing to support the expansion of the Infineer business.

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 September 30, 2001 and the results of their operations and cash flows for the three and nine months ended September 30, 2001 and 2000. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2000, as amended.





EARNINGS (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is based on net income 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. Diluted net income (loss) per share was not computed for 2001 and 2000 as the effect of stock options, warrants and convertible preferred stock were antidilutive.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations"

("SFAS No. 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142").

SFAS No. 141 addresses financial accounting and reporting for business combinations. This new statement requires that all business combinations be accounted for using one method (the purchase method), intangible assets be recognized apart from goodwill if they meet certain criteria and disclosure of the primary reasons for a business combination and the allocation of the purchase price paid to the assets acquired and liabilities assumed by major balance sheet caption. The provisions of this statement apply to all business combinations initiated after June 30, 2001.

SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. Under this new statement, goodwill and intangible assets that have indefinite useful lives will not be amortized, but rather will be tested at least annually for impairment based on the specific guidance of this statement. In addition, this statement requires disclosure of information about goodwill and other intangible assets in the years subsequent to their acquisition that was not previously required. The provisions of this statement are required to be applied starting with fiscal years beginning after December 15, 2001. However, goodwill and intangible assets acquired after June 30, 2001 will be subject immediately to the non-amortization and amortization provisions of this statement. The Company will adopt this statement on January 1, 2002. The Company is in the process of determining the impact of this pronouncement, if any, on the Company's financial position and results of operations.

INVENTORIES

Inventories are stated at lower of cost (first-in, first-out method) or market. The Company evaluates the need to record adjustments for impairment of inventory on a quarterly basis. 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. Inventories as of September 30, 2001 and December 31, 2000 consisted of the following (in thousands):

| | 2001 | 2000 |
|---|---|---|
| Raw materials and supplies | $ 532 | $ 750 |
| Finished goods | 277 | 867 |
| | $ 809 | $1,617 |

NOTE 2 - REPOSITIONING CHARGE

As discussed in Note 1, in July 2001, after evaluating the timing of potential future revenues, PubliCARD's Board decided to shift the Company's strategic focus. The Board authorized management to pursue strategic alliances with one or more companies that have the resources to capitalize more fully on PubliCARD's smart card reader and chip-related technologies. Accordingly, the Company recorded a charge aggregating $7.3 million in the second and third quarters of 2001. The charge consisted of write-offs of goodwill of $4.1 million and fixed assets of $554,000, an inventory realizability

PUBLICARD, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

adjustment of $1.7 million as a result of the business closure, and severance and other costs of $1.0 million principally related to the termination of 36 employees. As of September 30, 2001, the remaining repositioning reserve was $601,000. Management expects the repositioning activities to be completed by March 2002.

NOTE 3 - INVESTMENTS

In September 2001, the Company formed a new minority-owned affiliate, Mako, to market its smart card reader and related integrated circuit technologies. The move is consistent with the Company's previously announced decision to explore strategic transactions that would enable the Company to reduce or eliminate its ongoing cash funding requirements for its smart card reader and chip business while retaining an interest in the upside potential for these technologies. The Company contributed certain inventories and equipment valued at $104,000 and is committed to make an additional contribution of $152,000 in the form of inventory or cash by March 24, 2002, in exchange for an initial 46% ownership interest in Mako. The remaining 54% ownership interest, invested in cash, is held by the owners of Asian Identification Systems, Ltd. and a sister company, which were the Company's smart card reader contract manufacturing and distribution partners in the Asia-Pacific and Latin America regions. In addition, Mako's employees have been granted the right to receive, in the aggregate, a 27 percent equity stake after two years. The Company will account for its investment in Mako on the equity basis.

The Company has also granted a perpetual license of its reader and chip technology to Mako in exchange for royalties based on sales over the next two years. Mako will continue to sell the existing Infineer lines of smart card readers and chips for keyboard and set-top box readers. It will also provide support services for Infineer products and continue its product development activities.

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 and could be subject to write-down in future periods if it is determined that the investment is impaired and not recoverable.

NOTE 4 - STOCK MATTERS

In February 2001, the Company concluded a stock option re-pricing program whereby a total of approximately 3.3 million stock options were cancelled. Pursuant to the program, employees and directors voluntarily elected to cancel stock options held with an exercise price that exceeded $4.81 per share. In return, the Company granted a total of approximately 3.1 million replacement stock options on August 20, 2001. The replacement stock options generally contain the same terms and conditions of the cancelled stock options and have an exercise price of $.39 per share, the closing price of the Company's common

stock on August 20, 2001.

In August 2001, 10 shares of Class A Preferred Stock were converted into 25,000 shares of PubliCARD's common stock.

NOTE 5 - SEGMENT DATA

As a result of the disposition of certain operations (See Note 6) and because the Company predominantly operates in one industry, that being the deployment of smart card solutions which facilitate secure access and transactions, the Company reports as a single segment. Sales by geographical areas for the nine months ended September 30, 2001 and 2000 are as follows (in thousands):





| | 2001 | 2000 |
|---|---|---|
| United States | $1,510 | $ 696 |
| Europe | 2,686 | 3,238 |
| Rest of world | 238 | 281 |
| | $4,434 | $4,215 |

The Company has operations in the United States and United Kingdom. Identifiable assets by country as of September 30, 2001 and December 31, 2000 are as follows (in thousands):

| | 2001 | 2000 |
|---|---|---|
| United States | $14,061 | $25,547 |
| United Kingdom | 2,797 | 2,866 |
| | $16,858 | $28,413 |

NOTE 6 - DISCONTINUED OPERATIONS

In March 2000, the Company's Board adopted a plan to dispose of the operations of the Company's Greenwald Industries Inc. ("Greenwald"), Greenwald Intellicard, Inc. ("Greenwald Intellicard"), Greystone Peripherals, Inc. ("Greystone") and Amazing! Smart Card Technologies, Inc. ("Amazing") subsidiaries. These subsidiaries designed, manufactured and distributed mechanical and smart card laundry solutions, hard disk duplicators and smart cards. In the fourth quarter of 1999, the Company recorded a loss of $2.0 million related to the disposition plan, net of the expected gain on the

disposition of these businesses. The loss provision was based on estimates of the proceeds expected to be realized on the dispositions and the results of operations through the disposition or wind-down dates.

On June 29, 2000, the Company completed the sale of substantially all of the assets of Greenwald and Greenwald Intellicard to The Eastern Company ("Eastern") for $22.5 million in cash less $1.75 million held in escrow to secure the payment of certain indemnification obligations. As part of the transaction, Eastern assumed certain liabilities of Greenwald and Greenwald Intellicard, including certain contractual liabilities, accounts payable and accrued liabilities. In the third quarter of 2000, the Company recognized a gain of $4.3 million principally related to the sale of Greenwald and Greenwald Intellicard.

In the second quarter of 2001, the Company revised its estimates of proceeds and expenses associated with the wind-down of Amazing and Greystone, which has been substantially completed, and recognized a gain of $2.4 million, which had been previously deferred pending resolution of certain contingencies. The amounts the Company will ultimately realize from its discontinued operations could differ from the amounts estimated and could therefore result in additional charges or gains in future periods.

The results of the operations of Greenwald, Greenwald Intellicard, Amazing and Greystone have been reflected as discontinued operations. Summarized balance sheet information with respect to the discontinued operations as of September 30, 2001 is as follows (in thousands):

| | |
|---|---|
| Current assets (primarily cash held in escrow) | $ 2,253 |
| Current liabilities and disposition reserves | (1,458) |
| Net assets of discontinued operations | $ 795 |



PUBLICARD, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 - SUPPLEMENTAL CASH FLOW INFORMATION

Changes in operating assets and liabilities reflected in the Consolidated Statements of Cash Flows are net of acquisitions and disposals of businesses and consisted of the following for the nine months ended September 30, 2001 and 2000 (in thousands):

| | 2001 | 2000 |
|---|---|---|
| Trade receivables | $ (59) | $ (201) |
| Inventories | (918) | (801) |
| Other current assets | 86 | (53) |
| Other assets | (491) | (48) |

| | | |
|---|---|---|
| Trade accounts payable | (516) | (685) |
| Accrued liabilities | 531 | (555) |
| Other non-current liabilities | (1,982) | (792) |
| | $(3,349) | $(3,135) |

Cash paid for interest for the nine months ended September 30, 2001 and 2000 was $102,000 and $135,000, respectively. No income taxes were paid in 2001 and 2000. Non-cash investing activities include the acquisition of the remaining interest in Greenwald Intellicard for shares of common stock and options valued at $696,000 in 2000.

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

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

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 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

At present, PubliCARD, through its Infineer subsidiary, designs smart card platform solutions for educational and corporate sites. The Company also licenses industry compliant smart card reader solutions and application specific integrated circuits to an affiliated company.

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 remains 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 has become more uncertain. Given the lengthened time horizon, the Board did not believe it would be prudent to continue to invest the Company's current resources in the ongoing development and marketing of these technologies. Accordingly, the Board determined that shareholders' interests will be best served by pursuing strategic alliances with one or more companies that have the resources to capitalize more fully on the Company's smart card reader and chip-related technologies. In connection with this shift in the Company's strategic focus, workforce reductions and other measures were implemented to achieve cost savings. See Note 2 to the financial statements for a discussion on the repositioning charge associated with this action.

In September 2001, the Company announced the formation of a new minority-owned affiliate, Mako, to market its smart card reader and chip

technologies. This decision substantially eliminates the cash funding requirements of the Company while retaining an upside potential in the form of royalties to be paid over the next two years for the use of certain intellectual property rights of Infineer and a 46% ownership interest in Mako.

The Company's future plans revolve around an acquisition strategy focused on businesses in areas outside the high technology sector while continuing to support the expansion of the Infineer business, which represented 77% of consolidated revenues for the first nine months of 2001.

ACQUISITION AND DIVESTITURES--1998-2000

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

- In February 1998, PubliCARD acquired, through a joint venture arrangement in Greenwald Intellicard, the assets and intellectual property of Intellicard Systems, Ltd. Greenwald Intellicard



provided smart cards, smart card readers, value transfer stations, card management software and machine interface boards for the commercial laundry appliance industry. PubliCARD initially owned 50% of Greenwald Intellicard, and acquired the remaining 50% in February 1999 and February 2000.

- In November 1998, PubliCARD acquired Tritheim Technologies, Inc. ("Tritheim"), which develops conditional access and security products for the software industry, computers and the electronic information and digital video broadcast, also known as DVB, industry.

- In February 1999, PubliCARD acquired Amazing a developer of consumer smart card solutions and a manufacturer of customized smart cards.

- In February 1999, PubliCARD acquired Greystone a developer of hard disk duplicators.

- In November 1999, PubliCARD acquired Absec Ltd. ("Absec"), a designer of closed environment solutions, including small value electronic cash systems and database management solutions. Through Absec (now known as Infineer Ltd.), PubliCARD provides systems for closed populations to allow individual user access, unique rights and monitoring.

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

- high growth potential exists;

- PubliCARD has established relationships;

- PubliCARD has already deployed products and gained credibility; and

- PubliCARD possesses core technologies and competencies.

PubliCARD determined that it could leverage its existing smart card technology for deployment in the rapidly growing enterprise security and transaction management market sectors, which PubliCARD had already penetrated

and which it believed exhibited each of the characteristics identified above. To effect this new business strategy, in March 2000, the Company's Board adopted a plan to dispose of the operations of the Company's Greenwald, Greenwald Intellicard, Greystone and Amazing subsidiaries. These subsidiaries designed, manufactured and distributed mechanical and smart card laundry solutions, hard disk duplicators and smart cards.

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

In December 2000, the Company acquired an ownership interest in 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.



Sales

Revenues are generated from infrastructure product sales, licenses of software products, maintenance contracts and software development services. Revenue from product sales is recorded upon shipment of the product. Provisions are recorded for estimated warranty repairs, returns and bad debts at the time the product is shipped. Software license fees are recognized upon shipment if a signed contract exists, the fee is fixed and determinable and the collection of the resulting receivable is probable. Revenue from maintenance and support fees is recognized ratably over the contract period.

Cost of sales and operating expenses

Cost of sales consists primarily of material, personnel costs, overhead and third-party contract manufacturing costs.

Sales and marketing expenses consist primarily of personnel and travel costs, public relations, trade shows and marketing materials.

Product development expenses consist primarily of personnel and travel costs, independent consultants and contract engineering services and include expenses associated with the development of new products and enhancements to existing products. The Company believes that a significant level of development expenditures are required to enable it to quickly introduce new solutions that incorporate the latest technological advances and to develop and maintain close relationships with key suppliers of components and technologies. The Company's future success will depend upon its ability to develop and to introduce new solutions on a timely basis that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of its customers.

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.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2000

SALES. Consolidated net sales of $1.6 million for 2001 were flat compared to 2000. Increased smart card solution sales to the education and corporate market were offset by lower shipments of smart card readers and integrated circuits in the United States.

GROSS MARGIN. Gross margin as a percentage of net sales increased slightly to 54% in 2001 from 51% in 2000. The increase is attributed to higher margins on Infineer's smart card solution sales to educational and corporate sites.

SALES AND MARKETING EXPENSES. Sales and marketing expenses were $496,000 in 2001 compared to $2.2 million in 2000. The decrease in expense is primarily attributed to the workforce reductions and other cost containment measures associated with the Company's July 2001 strategic repositioning action.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses were $389,000 in 2001 compared to $1.3 million in 2000. The decrease in expense is primarily attributed to the repositioning action.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the quarter ended September 30, 2001 decreased to $1.2 million from $1.5 million for 2000. The decrease in expense is primarily attributed to the repositioning action.

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STOCK COMPENSATION EXPENSE. Stock-based compensation recorded in 2000 and 2001 principally relates to the issuance of stock awards and below market stock option grants to two executives hired in 2000 and 1999.

GOODWILL AMORTIZATION. Amortization of goodwill amounted to $252,000 in 2001 compared to $658,000 in 2000. The decrease is attributed to the write off of goodwill associated with the Tritheim acquisition in the second quarter of 2001.

REPOSITIONING CHARGE. As discussed in Note 1, in July 2001, after evaluating the timing of potential future revenues, PubliCARD's Board decided to shift the Company's strategic focus. The Board authorized management to pursue strategic alliances with one or more companies that have the resources to capitalize more fully on PubliCARD's smart card reader and chip-related technologies. Accordingly, the Company recorded a charge aggregating $7.3 million in the second and third quarters of 2001. The charge consisted of write-offs of goodwill of $4.1 million and fixed assets of $554,000, an inventory realizability adjustment of $1.7 million as a result of the business closure, and severance and other costs of $1.0 million principally related to the termination of 36 employees. As of September 30, 2001, the repositioning reserve was $601,000. Management expects the remaining repositioning activities to be completed by March 2002.

OTHER INCOME AND EXPENSE. Interest income decreased to $128,000 for 2001 from $333,000 for 2000 due to lower interest rates and investment balances. Interest expense, which principally relates to interest on the remaining environmental obligation (see below), decreased to $11,000 in 2001 compared to $22,000 in 2000.

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30,

2000

SALES. Consolidated net sales for the nine months ended September 30, 2001 increased to $4.4 million compared to $4.2 million for 2000. The increase is primarily attributed to sales of smart card readers for security applications.

GROSS MARGIN. Gross margin as a percentage of net sales increased slightly in 2001 to 50% from 49% in 2000. The increase is principally due to improved margins on smart card reader sales.

SALES AND MARKETING EXPENSES. Sales and marketing expenses were $3.0 million in 2001 compared to $6.0 million in 2000. The decrease is attributed to the July 2001 repositioning actions, additional headcount reductions throughout 2000 and early 2001 and lower consulting expenses for market research and corporate branding.

PRODUCT DEVELOPMENT EXPENSES. Product development expenses amounted to $2.2 million in 2001 compared to $3.5 million in 2000. The decrease in expense is attributed to the July 2001 repositioning action, headcount reductions throughout 2000 and early 2001 and lower contract engineering services costs.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses decreased to $3.7 million for 2001 from $5.0 million for 2000. The decrease in expense is attributed to the July 2001 repositioning action and lower corporate expenditures, which consisted primarily of legal, consulting and professional fees.

STOCK COMPENSATION EXPENSE. Stock-based compensation recorded in 2000 and 2001 principally relates to the issuance of stock awards and below market stock option grants to two executives hired in 2000 and 1999.

GOODWILL AMORTIZATION. Goodwill and other intangibles are associated with the Tritheim and Absec



acquisitions. Amortization decreased to $1.6 million in 2001 from $2.0 million in 2000 due to the write-off of goodwill associated with the Tritheim acquisition in the second quarter of 2001.

OTHER INCOME AND EXPENSE. Interest income decreased to $445,000 for 2001 from $632,000 for 2000 due to a lower interest rates and investment balances. Interest expense, which principally relates to interest on the remaining environmental obligation (see below), decreased to $51,000 in 2001 compared to $79,000 in 2000.

LIQUIDITY

The Company has financed its operations over the last two years primarily through the sale of its common and preferred stock and the sale of its non-core businesses. Cash, including short-term investments, decreased by $11.0 million during the nine months ended September 30, 2001, to $6.0 million.

Operating activities from continuing operations utilized cash of $10.8 million for the nine months ended September 30, 2001 and principally consisted of the loss from continuing operations of $15.8 million and an increase in net operating assets and liabilities of $3.4 million offset by non-cash charges of $8.4 million for the repositioning charge, goodwill amortization, stock compensation expense and depreciation. Operating activities from discontinued operations utilized $332,000 of cash.

Investing activities provided cash of $152,000 in 2001 and consisted principally of proceeds from the sale of discontinued operations offset in part by capital expenditures.

Financing activities utilized cash of $43,000 in 2001 and consisted of closing costs in connection with the Company's December 2000 private placement of common and preferred stock. The effect of exchange rate changes on cash and cash equivalents reduced cash by $2,000.

During the first nine months of 2001, the Company's capital expenditures from continuing operations totaled $64,000. The Company has not entered into any material commitments for acquisitions or capital expenditures and has the ability to increase or decrease capital expenditure levels as required.

The Company has experienced negative cash flow from operating activities in the past and expects to experience negative cash flow for the remainder of 2001 and 2002. The Company believes that its current cash balance and expected cash flows will satisfy working capital, and product development, sales and marketing activities, and capital expenditures at their currently reduced levels, for the next 12 months. The Company will need to obtain additional sources of liquidity to finance its working capital needs, and to maintain its product development, sales and marketing activities, and capital expenditure requirements beyond the next 12 months. Future uses of cash include the following:

- In April 1996, a consent decree (the "Consent Decree") among the Company, the United States Environmental Protection Agency and the Pennsylvania Department of Environmental Protection ("PADEP") was entered by the court which resolved all of the United States' and PADEP's claims against the Company for recovery of costs incurred in responding to releases of hazardous substances at a facility previously owned and operated by the Company. Pursuant to the Consent Decree, the Company will pay a total of $14.4 million plus interest to the United States and Commonwealth of Pennsylvania. Through September 30, 2001, the Company has made principal payments aggregating $13.6 million. A final payment of $823,000, including interest, is scheduled to be made to the United States Environmental Protection Agency in April 2002.

- The Company sponsors a defined benefit pension plan, which was frozen in 1993. As of December 31, 2000, the actuarial present value of accrued liabilities exceeded the plan assets by approximately $5.4 million. The annual contribution to the plan is expected to be approximately $1.6 million in 2002.



The success of our repositioning strategy significantly depends on our ability to raise additional financing to fund acquisitions. We cannot assure you that any financing required for such acquisitions will be available on acceptable terms or at all, or that any future acquisitions will not materially adversely affect our results of operations and financial condition.

As of September 30, 2001, the value of the Company's investment in TecSec, a privately held company, was $5.1 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. 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 permanently impaired and subject to a significant write-down.

As of December 31, 2000, approximately $84 million of U.S. tax loss carryforwards (subject to review by the Internal Revenue Service), expiring from

2001 through 2020, were available to offset future taxable income. Due to the "change of ownership" provisions of the Internal Revenue Code of 1986, the availability of net operating loss carryforwards to offset federal taxable income in future periods could be subject to an annual limitation if a change in ownership for income tax purposes occurs.

FACTORS THAT MAY AFFECT FUTURE RESULTS

WE HAVE A HISTORY OF OPERATING LOSSES AND NEGATIVE CASH FLOW, AND WE HAVE ONGOING FUNDING OBLIGATIONS. 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 1998, 1999, 2000 and for the nine months ended September 30, 2001, of approximately $8.4 million, $16.7 million, $19.7 million and $15.8 million, respectively. In addition, we experienced negative cash flow from continuing operating activities of $5.6 million, $8.5 million, $18.7 million and $10.8 million in 1998, 1999, 2000 and for the nine months ended September 30, 2001, respectively.

We also have continuing obligations to fund payments due under the Consent Decree and an underfunded pension plan. We are scheduled to make a final payment of $823,000 in April 2002 in connection with the Consent Decree. Consistent with the general practices of environmental enforcement agencies, the Consent Decree does not eliminate our potential liability for remediation of contamination that had not been known at the time of the settlement. We sponsor a defined benefit pension plan, which was frozen in 1993. As of December 31, 2000, the present value of the accrued benefit liabilities of our pension plan exceeded the plan's assets by approximately $5.4 million. In addition to the $1.6 million we expect to contribute to the plan in 2002, we are obligated to make continued contributions to the plan in accordance with the rules and regulations prescribed by the Employee Retirement Income Security Act of 1974. Future contribution levels depend in large measure on the mortality rate of plan participants and the investment return on the plan assets.

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

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



- we will not be able to retain the employees or business relationships of the acquired company;

- we will fail to realize any synergies or other cost reduction objectives expected from the acquisition;

- we will not be able to integrate the operations, products, personnel and facilities of acquired companies;

- management's attention will be diverted to pursuing acquisition opportunities and integrating acquired products, technologies or

companies and will be distracted from performing its regular responsibilities;

- we will incur or assume liabilities, including liabilities that are unknown or not fully known to us at the time of the acquisition; and

- we will enter markets in which we have no direct prior experience.

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

THE MARKET'S ACCEPTANCE OF OUR PRODUCTS IS UNCERTAIN. Demand for, and market acceptance of, our smart card reader and software solutions 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 nine months ended September 30, 2001, one customer represented approximately 16% of our net sales and 12% of our accounts receivable balance as of September 30, 2001.

We generally do not enter into long-term supply commitments with our customers. Instead, we bid on a project basis and have supply contracts in place for each project. 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 these expenditures 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 would have a material adverse effect on our business and operating results.

The market for smart card products and solutions is new, intensely competitive and rapidly evolving. We expect competition to continue to increase with both our existing competitors and new market entrants. 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, Diebold, CyberMark and Schlumberger.

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

OUR LONG PRODUCT SALES CYCLES SUBJECT US TO RISK. Our products fall into two categories, those that are standardized and ready to install and use and those that require significant development efforts to implement within the purchasers' own systems. Those products requiring significant development efforts tend to be newly developed technologies and software applications that can represent major investments for customers. We rely on 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 for production volumes, 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, 2000, we had federal net operating loss carryforwards, subject to review by the Internal Revenue Service, totaling approximately $84.0 million for federal income tax purposes, approximately $9.0 million of which will expire at the end of 2001 and $25.0 million of which will expire at the end of 2002. We do not expect to earn any significant taxable income prior to 2003, and may not do so until later. A federal net operating loss can generally be carried back two or three 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 in the future. In addition, the exercise of outstanding warrants and 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 we would not be able to use a substantial amount of our available federal net operating loss carryforwards 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.

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.

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 would 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 programmers, creative designers and application developers, 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. There is currently a shortage of qualified senior technical personnel in the software development field, and this shortage is likely to continue. 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. International sales represented approximately 74% and 66% of total sales for the three and nine months ended September 30, 2001, 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 international operations. We cannot assure you that such factors will not have a material adverse effect on our future international 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.

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 -- $964,000; and Mr. Jay S. Goldsmith -- $964,000. 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. We would not be able to deduct these 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:

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

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

- 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;

- 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.

OUR STOCK MAY BE DELISTED FROM THE NASDAQ NATIONAL MARKET. On August 6, 2001, we received 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 The Nasdaq National Market Rules. Therefore, in accordance with such rules, we were to be provided 90 calendar days,



or until November 5, 2001, to regain compliance with this rule. On September 27, 2001, Nasdaq implemented a moratorium on the minimum bid price and market value of public float requirements. The moratorium applies to all companies that were previously subject to these requirements and suspends the compliance requirement until January 2, 2002. Accordingly, the matter referenced in Nasdaq's letter dated August 6, 2001 was deemed closed.

At the present time, the Company's common stock has continued to trade below $1.00. If the minimum bid price of the Company's common stock is below $1.00 on January 2, 2002, the compliance time-frames and notice periods indicated above would be triggered. If we are unable to demonstrate compliance with the minimum bid price rule and the Nasdaq provides written notification that our securities would be delisted, we may appeal the decision to a Nasdaq Listing Qualification Panel. We cannot assure you that we will continue to meet Nasdaq's other quantitative or qualitative listing criteria, that any appeal in the event of non-compliance will be successful or that our common stock will not be delisted.

Should our common stock be delisted, the liquidity of our common stock would be adversely affected. This could impair our ability to raise capital in the future. If we are not successful in raising additional capital when required

in sufficient amounts and on terms acceptable to us or at all, we may be required to scale back the scope of our business plan, which would have a material adverse effect on our financial condition and results of operations. We cannot make any assurances that we will generate sufficient cash flow from operations in the future, that anticipated revenue growth will be realized or that future borrowings or equity contributions will be available in amounts sufficient to finance our business plan or at all.

WE ARE SUBJECT TO GOVERNMENT REGULATION. Federal, state and local regulations impose various environmental controls on the discharge of chemicals and gases, which may be used in our present or future assembly 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, would subject us to liabilities and would materially adversely affect our operations.



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. Our investment policy calls for investment in short-term, low risk instruments. As of September 30, 2001, short-term investments (principally U.S. Treasury bills) were $6.0 million. Due to the nature of these investments, any decrease in rates would not have a material impact on our financial condition or results of operations.

Investment Risk

As of September 30, 2001, the value of our investment in TecSec, a privately held company, was $5.1 million. 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. 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 permanently impaired and subject to a significant write-down.



PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

GENERAL LITIGATION

Various legal proceedings are pending against the Company. The Company considers all such 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 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.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

None.



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: November 14, 2001

/s/ Jan-Erik Rottinghuis
Jan-Erik Rottinghuis, President and Chief Executive Officer

/s/ Antonio L. DeLise
Antonio L. DeLise, Chief Financial Officer, Secretary and Principal Accounting Officer