

L-1 IDENTITY SOLUTIONS, INC.

Form 10-K

February 27, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

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

For the Fiscal Year Ended December 31, 2008

OR

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

For the Transition Period from to .

Commission File Number 001-33002

L-1 IDENTITY SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

02-0807887

(I.R.S. Employer
Identification No.)

177 Broad Street, 12th Floor, Stamford, CT

(Address of principal executive offices)

06901

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: Common Stock \$.001 par value NYSE

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by a check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by a check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 No

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

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by a check mark whether the Registrant is a shell company (as defined in Rule 12b-2). Yes No

The aggregate market value of the voting stock held by nonaffiliates of the registrant as of June 30, 2008, was approximately \$1,038.9 million.

As of February 24, 2009, the registrant had 86,472,745 shares of Common Stock outstanding.

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PART I

Item 1. Business

In this Annual Report on Form 10-K, the words L-1 , the Company , we , our , ours , and us refer to L-1 Identity Solutions, Inc. and, except as otherwise specified herein, to our subsidiaries. Our fiscal year ended on December 31, 2008.

L-1 Identity Solutions, Inc. and its subsidiaries (L-1 or the Company) is a provider of technology, products, systems and solutions, and services that protect and secure personal identities and assets. Together our business delivers the full range of offerings required for solving complex problems associated with managing identity.

The Company operates in two reportable segments: Identity Solutions and Services.

The Identity Solutions segment includes Secure Credentialing, Biometrics, and Enterprise Access solutions marketed to federal agencies, state and local government agencies, including law enforcement and departments of corrections, foreign governments and commercial entities, such as financial, casinos and health care institutions. Our Identity Solutions revenues include products and related services, which comprise hardware, components, consumables and software, as well as maintenance, consulting and training services integral to sales of hardware and software. Customers, depending on their specific needs, may order solutions that include hardware, equipment, consumables, software products or services or combine hardware products, consumables, equipment, software products and services to create an integrated solution.

The Services segment provides enrollment services to federal and state government agencies and commercial enterprises and financial institutions. We also provide comprehensive consulting, program management, information analysis, training, security, technology development and information technology solutions to the U.S. intelligence community. Depending upon customer needs, our services can be bundled with identity solutions, product and services offerings to create an integrated solution.

We evaluate our business primarily through operating and financial metrics such as revenues, operating income (loss), and earning before interest, depreciation and amortization, intangible asset impairments and in process research and development charges, and stock-based compensation expense (Adjusted EBITDA) and free cash flow.

Our identity solutions and services are organized into several core capabilities:

Secure Credentialing Solutions

This offering includes complete solutions for integration and verification of the entire secure credential lifecycle, from testing through issuance and inspection. L-1 systems are used to produce the majority of U.S. driver s licenses and our systems support all types of production systems including over the counter, central and hybrid models. L-1 credentialing solutions are used in 20 countries for producing the U.S. passport, U.S. Passport Card and Border Crossing Card, as well as various citizen credentialing programs including voter registration, passports, National ID and others. More than 100 million secure credentials are produced annually with L-1 solutions.

Biometric Solutions

Biometric solutions are used to capture, manage and move biometric data for positive, rapid ID and tracking of persons of interest. L-1's biometric solutions provide a full range of finger and palm, facial, iris, and multi-modal biometric technologies that empower the identification of individuals in large-scale identity management programs. Our biometric solutions include a multi-modal automated biometric identification and matching system (ABIS). Our products include finger and palm print scanners, iris-based capture devices (PIER and HIIDE), integrated multi-biometric (finger, face and iris) devices, automated facial recognition systems both static (digital photo or mug shot) and dynamic (video) and automated iris recognition systems (AIRS).

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Enterprise Access Solutions

These solutions include finger and facial (including 3D) biometric-based readers used to secure buildings and restricted areas. Our enterprise access solutions are offered through more than 400 global partners today and are used by commercial enterprises around the world.

Enrollment Services

These services include background checks and processing of applicant data required for federal and state licensed programs and jobs in the banking, finance, insurance, healthcare, child care, legal, real estate, education and other industries. L-1 operates a network of more than 650 convenient and secure centers located across 46 U.S. states and in most Canadian provinces. The centers have enrollment stations, live scan systems and software that are used for fingerprinting and processing as fingerprints for background checks. More than 6.5 million people have been printed to date through L-1 enrollment services, of which more than 1.5 million were printed in 2008.

Government Consulting Services

These services include a specialized set of capabilities that address the most pressing issues in security facing intelligence agencies today. It includes McClendon Engineering and Analytical Services that focuses on GEOINT and MASINT science; SETA, PMO and acquisition; intelligence analysis and operations; systems engineering and integration and; IT and software development. Advanced Concepts Information Technology Services offers IT services, program management, Cyber security services systems engineering, 911 planning and help desk support. SpecTal Intelligence Services provides intelligence analysis, operations support, training and information technology/technical development.

Despite the challenges posed by current economic conditions, the market for identity solutions has continued to develop. We believe that users of identity protection solutions are demanding complete solutions with increased functionality that can solve their spectrum of needs across the identity life cycle. Our objective is to meet those growing needs by continuing to broaden our product and solution offerings, leveraging our existing customer base to provide additional products and services, expanding our customer base both domestically and abroad, and augmenting our competitive position through strategic acquisitions.

Reportable Segments and Geographical Information

Reference is made to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for financial information about reportable segments and geographic information and revenues by class of products and services.

Acquisition History

Viisage Technology Inc. (Viisage). In December 2005, L-1 Investment Partners made a strategic investment in Viisage, which is now part of the Secure Credentialing Division of L-1.

Integrated Biometric Technology (IBT). In December 2005, Viisage acquired IBT, adding fingerprint services to enable the processing of civilian enrollment and credentialing for government-licensed jobs. IBT is now part of the Enrollment Services Division of L-1.

AutoTest division of Openshaw Media Group (OMG). In December 2005, Viisage acquired the AutoTest division of Openshaw Media Group (OMG), adding automated DMV knowledge testing capabilities.

AutoTest is now a part of the Secure Credentialing Division of L-1.

SecuriMetrics, Inc. (SecuriMetrics). Acquired in February 2006, SecuriMetrics develops, customizes and sells multi-biometric solutions using its proprietary iris recognition technology, typically consisting of multi-biometric capture devices bundled with proprietary software. SecuriMetrics is now a part of the Biometrics Division of L-1.

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Iridian Technologies, Inc. (Iridian) . In August 2006, we acquired Iridian, which owns and licenses an extensive portfolio of intellectual property related to iris recognition technology. Iridian is now a part of the Biometrics Division of L-1.

Identix Incorporated (Identix) . In August 2006, Viisage merged with Identix, a provider of fingerprint, facial and skin biometric technologies, and related system components, as well as fingerprinting services which are critical to biometric capture and knowledge discovery in large scale identification management applications. Identix is now part of the Biometrics Division of L-1 with the exception of the fingerprint services business that has been integrated into the Enrollment Services Division.

SpecTal, LLC (SpecTal) . In October 2006, we acquired SpecTal, which provides comprehensive consulting and security solutions primarily to the U.S. intelligence community. SpecTal is now a part of the Government Consulting Services Division of L-1.

ComnetiX Inc. (ComnetiX) . In February 2007, we acquired ComnetiX Inc., a Canadian company providing biometric identification and authentication technologies and solutions to private and public sector customers, particularly within the law enforcement community, as well as fingerprinting services in Canada . The ComnetiX biometric technologies and solutions business is now part of the Biometrics Division of L-1. The services component of the business has been integrated with the Enrollment Services Division of L-1.

McClendon LLC, (McClendon) . In July 2007, we acquired McClendon, which provides technical, network security and professional services to the U.S. intelligence community. McClendon is now part of the Government Consulting Services Division of L-1.

Advanced Concepts, Inc. (ACI) . In July 2007 we acquired Advanced Concepts, which provides information technology solutions to the U.S. intelligence community. ACI is now part of the Government Consulting Services Division of L-1.

Bioscrypt Inc. (Bioscrypt) . In March 2008, we acquired Bioscrypt Inc., a Canadian company that is a leader in the enterprise access control market. Bioscrypt is now the Enterprise Access Solutions Division of L-1.

ID Systems Business of Digimarc Corporation (Old Digimarc) . In August 2008, we acquired the ID Systems business of Digimarc Corporation, a U.S. based business in the secure credentialing market. The business is now part of the Secure Credentialing Division of L-1.

Financing Activities

In October 2006, we entered into a revolving credit agreement under which we could borrow up to \$150.0 million, with the potential of increasing the facility to \$200.0 million. Borrowings under the revolving credit agreement were primarily used to fund our acquisitions. In August 2008, all outstanding borrowings under this facility were repaid from the proceeds of borrowings under the amended and restated credit facility described below.

In May 2007, we issued \$175.0 million of Convertible Notes, the net proceeds of which were used to purchase a pre-paid forward contract of \$69.8 million and to prepay the then outstanding borrowings under our revolving credit facility.

In August 2008, we entered into amended credit facilities under which we could borrow up to \$435.0 million consisting of a \$300.0 million term loan facility, and a \$135.0 million revolving credit facility. The proceeds of the

term loan facility of \$295.0 million were used to partially fund the acquisition of the Old Digimarc and repay debt outstanding under the then existing revolving credit facility. Under the terms of the revolving credit facility, \$120.5 million is available at December 31, 2008, after deducting outstanding letters of credits of \$14.5 million, subject to continuing compliance with the covenants contained in the agreement.

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On August 5, 2008, pursuant to the terms and conditions of (i) the Securities Purchase Agreement, by and between L-1 and Robert V. LaPenta, our chairman and CEO, (the LaPenta Agreement), (ii) the Securities Purchase Agreement (the Iridian Agreement), by and between L-1 and Iridian Asset Management LLC (Iridian) and (iii) the LRSR LLC Agreement (together with the LaPenta Agreement and Iridian Agreement, the Investor Agreements), L-1 issued an aggregate of approximately 8.1 million shares of L-1 common stock and 15,107 shares of Series A Convertible Preferred Stock (the Series A Preferred Stock) convertible into approximately 1.1 million shares of common stock, for aggregate net proceeds to L-1 of \$119.0 million, which were used to fund a portion of L-1 s acquisition of Old Digimarc.

Industry Overview

Biometric Markets and Trends

Government-issued breeder documents (such as birth certificates and social security cards) and IDs granted based on these documents (such as driver s licenses or passports) serve as the primary means for confirming the identity of an individual. The integrity, however, of these documents and credentials can be compromised because they can be counterfeited or altered, issued under false pretenses and historically have rarely been linked to an identity database. Failure to provide adequate identification protection can lead to breaches of security and identity theft, the consequences of which can range from national security threats and loss of life to significant economic loss. Within this context, we believe that there is increasing pressure on governments and businesses to accelerate the adoption of advanced technology identity solutions to validate identities.

L-1 delivers solutions and services that protect and secure personal identities and assets. A core element to the L-1 identity management value proposition is biometrics. Biometrics are unique, individual physiological or behavioral characteristics, such as fingerprints, palm prints, facial characteristics, iris and voice patterns, hand geometry and handwriting patterns, which can be used to determine or verify an individual s identity. Technology digitally captures and encodes these individual biometric characteristics and then compares that uniquely personal characteristic against previously encoded biometric data to determine or validate an individual s identity.

Each biometric is unique to each person, making it the best means possible today to verify that a person is whom he/she claims to be. Furthermore, biometric technology provides improved accuracy and security of the credential, as well as convenience and cost-effectiveness for the individual, overcoming the limitations inherent in traditional identification and authentication processes such as paper credentials, passwords, PIN codes and magnetic access cards.

Governments and their agencies were the early adopters of biometrics and today remain the primary customers for the industry. For law enforcement, biometric technology permits more efficient criminal booking and processing and also allows officers in the field to identify potential suspects more reliably and efficiently. Within the military biometrics are used for the verification and identification of military personnel and contractors and collection and processing of biometrics from non-military personnel for the purpose of identifying potential hostile persons. At the national level, governments throughout the world have taken steps to improve security in response to heightened concerns over public safety from the threat of terrorism. National governments have mandated increased spending on security measures, implemented new regulations and placed greater emphasis on technology to address growing security concerns.

We believe that the market for biometrics will continue to grow significantly. This growth is a function of customer demand and the ability for the industry to meet the demand. We believe that major drivers of biometric growth in the future will include:

Implementation of biometrics in national security-related applications broadly characterized as anti-terror , such as border management, national ID, immigration control and critical infrastructure applications such as employee authentication and access control.

Integration into commercial access control solutions that grant entry and confirm presence in buildings and restricted areas based on biometric recognition.

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Expansion of biometrics within law enforcement to enroll, verify and ID suspects, detainees and prisoners and confirm if the individual is wanted, incarcerated or has a criminal history.

Inclusion of biometrics as a component of solutions that address identity theft.

Incorporation of biometrics into licensing processes and background checks required for people employed in licensed positions, such as daycare workers, insurance agents and those employed in education-related fields.

In addition, we believe that identity-related mandates within the government will drive growth by increasingly recommending, and in some cases mandating, the use of secure authentication, such as biometrics, as a key component of identity verification. Some of the programs include:

U.S. Visitor and Immigrant Status Indicator Technology program (U.S. VISIT), which uses biometric data as part of new screening procedures for non-U.S. citizens entering the United States.

Department of State (DoS) Western Hemisphere Travel Initiative (WHTI) Passport Card and Border Crossing Card programs that issue limited use passports in a wallet size format for use in crossing U.S. borders. DoS is also implementing contactless chips for use in passports which are electronic chips that hold the bearer s biographic and photographic data.

Transportation Workers Identification Credential (TWIC), a credentialing program that may eventually cover an estimated 12 million national transportation workers.

Transportation Security Administration s (TSA) Hazardous Material Threat Assessment Program (HAZMAT), mandating fingerprinting and security threat assessment of commercial truck drivers applying for, renewing or transferring the hazardous materials endorsement (HME) on their state-issued commercial drivers licenses (CDL).

TSA s Registered Traveler Program (RT) under which the TSA will conduct a security assessment to determine eligibility of an individual for an expedited screening process at TSA security checkpoints. RT participants provide both fingerprint and iris biometrics, allowing either biometric to be used for positive identity verification at the airport.

Homeland Security Presidential Directive 12 (HSPD-12), which mandates that a common identification card be utilized by all federal government employees and contractors. In 2004, the U.S. Federal Government issued the Federal Information Processing Standard for Personal Identity Verification of Federal Employees and Contractors as part of HSPD-12. HSPD-12 includes a requirement for document authentication in connection with the issuance of secure credentials to federal government employees.

REAL ID Act, signed into law in May 2005, which mandates authentication of a person s identity before they are issued a driver s license.

While fingerprints are expected to continue to be the most prevalent biometric technology in the near term, iris, face, palm print and other technologies are being adopted and combined with fingerprinting in multi biometric applications to provide an additional level of security and accuracy and to allow for increased flexibility for applications where fingerprints are not suitable.

Automated Fingerprint Identification Systems (AFIS) / Live Scan is the largest market space for biometrics. These are large scale and highly complex systems used in law enforcement, background checks, and civil identification programs. Live scans are deployed as a front end to most AFIS systems and include hardware and software that captures and processes fingerprint images prior to submission to AFIS systems. This AFIS / Live Scan market is considerably more mature than any other biometric market sector. Increasingly, multiple biometrics are also being incorporated into these systems, augmenting fingerprints with hand/palm prints, facial images and iris patterns.

Internationally many countries have established or are establishing more secure national identification, driver's license, passport, border crossing control and voter registration programs and many of these systems

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are expected to utilize biometric technologies. In addition to protecting citizens, some of these programs are also aimed at helping identify potential terrorist threats. The United States established legislation requiring biometric identifiers to be included in the passports of current Visa Waiver countries (countries where citizens are not required to obtain a Visa prior to entering the U.S.). We offer a range of solutions, products and technologies that can be utilized in national identification, and/or passport and border crossing programs to enroll and verify citizens, visitors and potential threats and/or to add biometric identifiers to national identification and/or passport programs. Accordingly we believe that international markets provide an opportunity for revenue growth.

While we anticipate consistent revenue growth, the following may adversely affect the rate of this growth, among other factors:

The global economic slowdown and its impact on government funding and procurements related to security,

Dependence on complex government programs that are experiencing elongated procurement, sales and implementation cycles,

Competition from non-biometric technologies that provide more affordable, but less robust, authentication (such as token rings and smart cards),

Privacy and legal challenges relating to biometric identifiers by private citizens and advocacy groups, and

The potential for changes in government policy relating to privacy issues by the new executive branch administration.

Government Services Markets and Trends

The federal government is the largest consumer of information technology services and solutions in the United States. We believe that the federal government's spending on information technology and services will continue to increase in the next several years, driven by the expansion of national defense and homeland security programs, the continued need for sophisticated intelligence gathering and information sharing, increased reliance on technology service providers due to shrinking ranks of government employee technical professionals, and the continuing impact of federal procurement reform and Office of Management and Budget mandates regarding IT spending. Federal government spending on information technology has consistently increased in each year since 1980.

Across our core intelligence community customers, we believe the following trends will continue to impact spending and dependence on technology and support contractors:

The emphases on irregular warfare, homeland defense, and combating the spread of weapons of mass destruction remain overarching guiding principles for current and out-year funding priorities. We believe intelligence agencies will increase demand for data and text mining solutions to enable them to extract, analyze, and present data gathered from the massive volumes of information available through open sources such as the Internet. This increased focus on national security, homeland security, and intelligence has also reinforced the need for interoperability among the many disparate information technology systems throughout the federal government. We believe the Department of Defense, Department of Homeland Security and the intelligence community will continue to be interested in systems that strengthen the coordination within and among agencies and departments.

Although certain agencies within the intelligence community have indicated a goal of reducing reliance on contractors, the demand for technology service providers is expected to increase due to the need for federal

agencies to maintain core operational functions while the available technical workforce shrinks. Given the difficulty the federal government has experienced in hiring and retaining skilled technology personnel in recent years, we believe the federal government will continue to rely on technology service providers that have experience with government systems, can sustain mission-

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critical operations and have the required government security clearances to deploy qualified personnel in classified environments.

In recent years, federal agencies have had increased access to alternative choices of contract acquisition vehicles-such as indefinite delivery/indefinite quantity (ID/IQ) contracts, Government Wide Acquisition Contracts (GWACs), the General Services Administration (GSA) schedule and agency specific Blanket Purchase Agreements (BPAs). These choices have created a market-based environment in government procurement. The environment has increased contracting flexibility and provides government agencies access to multiple channels to contractor services. Contractors' successful past performance, as well as technical capabilities and management skills, remain critical elements of the award process. We believe the increased flexibility associated with the multiple channel access, such as ID/IQ contracts, GWACs, GSA schedule contracts and BPAs, will result in the continued utilization of these contracting vehicles in the future, and will facilitate access to service providers to meet the demand for, and delivery of, required services and solutions.

An emphasis on addressing cyber-security is expected to drive greater demand for a variety of L-1 government services. The Comprehensive National Cyber Security Initiative of 2008 has a dozen components intended to better protect computer systems and networks from cybercrime and improve information technology processes and policies within the government. Specific improvements aimed at cyber counter intelligence, situational awareness, and implementation of information technology will have the most impact on L-1.

We believe that the current strategic environment dictates the need for more dependencies in the form of alliances and partnerships. Alliances with large and small companies who have agency mission knowledge and/or established credentials related to specific solutions and services are critical in winning large contracts.

Our Solutions

L-1 solutions combine industry-leading face, finger and iris recognition biometric technologies with state-of-the-art credentialing and access control systems, enrollment services and government consulting, to successfully meet all aspects of managing identity. L-1 Identity Solutions maintains specialized offerings for customers across both the public and private sector.

U.S. Federal Solutions

Federal agencies depend on L-1 Identity Solutions to provide efficient and reliable products and services that help improve the security of the nation and protect citizens, both at home and abroad. Our history of dependability and trust established across all levels of government includes every major U.S. government department and most U.S. military branches. We offer a comprehensive array of solutions that make it easier to implement civilian and criminal identification systems, border security programs and data protection measures. Our solutions are designed to address the federal identity needs set forth by various initiatives, programs and agencies such as:

Homeland Security Presidential Directive 12 (HSPD-12) Requires a common identification credential with Personal Identity Verification (PIV) for federal employees and contractors. L-1 Identity Solutions provides complete capabilities for identity proofing as well as modular, customizable components and outsourcing services to ensure fast and easy compliance. Our offerings are GSA and National Institute of Standards and Technology (NIST) certified.

HAZPRINT Requires focused background checks, including fingerprint-based biometric criminal history checks, for all commercial drivers who apply for, renew or transfer an endorsement to transport hazardous

materials (HAZMAT), including explosives.

U.S. DoD Common Access Card (CAC) The standard identification credential for active duty military personnel, selected reserve personnel, civilian employees, and eligible contractor personnel.

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Western Hemisphere Travel Initiative (WHTI) Requires all citizens of the U.S., Canada, British Overseas Territory of Bermuda and Mexico to have a passport or other accepted secure document to enter or re-enter the U.S.

Registered Traveler Program (RT) A nationwide private sector program designed to accelerate the screening process at participating airports for passengers who voluntarily choose to enroll by providing biometric fingerprint and/or iris data.

US-VISIT Program (U.S. Visitor and Immigrant Status Indicator Technology) An automated entry/exit tracking program requiring foreign visitors to submit biometric information upon arrival and departure to and from the U.S.

Transportation Workers Identification Card (TWIC) A program mandating a standardized secure credential containing biometric data for all transportation workers in order to enter into any secure area of a port.

We also provide solutions for:

Department of Defense (DoD) / Intelligence Agencies We help the DoD and Intelligence communities in the fight against terrorism across the globe by providing technology for insurgent registration, combatant identification, watchlist ID, credentialing and high security access control. Our solutions help agencies process background checks of military personnel faster in order to provide them with secure credentials and verify their identity for the purposes of issuing benefits or accessing secure facilities and networks.

Department of State (DoS) / Department of Homeland Security (DHS) We supply and integrate the technologies, software, hardware, consumables and services that help with the identity enrollment, de-duplication and production of safer and more secure travel documents. These include passports, U.S. Passport Cards, Border Crossing Cards and Visas.

Border Management Solutions

L-1's border management solutions offer a faster and more convenient process for travelers to pass through borders. They also empower border control officers to perform real-time searches against known watchlists and to scan more types of documents faster than ever before, ensuring that unwanted individuals do not enter the country. The flexibility of L-1 solutions enables the process of border management and control to happen seamlessly and with the same level of protection and security regardless of location, whether at a highly populated and wired checkpoint or a remote location connected wirelessly. Our biometric technologies and document authentication readers are tested and deployed by border control agencies all over the world. More than 10,000 L-1 live scan systems are deployed today across a wide range of agencies, including the U.S. Department of Homeland Security for use at the nation's border crossings. We believe we are the only U.S. company offering multi-biometric solutions for fixed and mobile environments. Our solutions include:

Frequent Traveler Solutions speed processing times and ensure high quality biometric capture every time for maximum verification accuracy and convenience for travelers.

Watchlist Screening Solutions seamlessly integrate into the immigration process, providing more accurate, real-time notification of possible matches against watchlists.

Document Authentication Solutions automate the reading and authentication of e-passport documents with contactless smart chips, as well as existing passports, driver's licenses and other ID cards.

Mobile ID Solutions allow for highly accurate and fast identification of individuals seeking passage through borders at remote sites, land and sea crossings.

Law Enforcement Solutions

Law enforcement agencies across the U.S. and globally rely on us to provide solutions that help identify suspects and criminals faster and more accurately. With the power to scan millions of criminal records in

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seconds, and provide officers in the field with critical identity information in minutes, L-1 Identity Solutions is paving the way for a new era in identification for law enforcement agencies. Our companies have a long history of experience serving the needs of law enforcement agencies. Our solutions are installed in all 50 states and in more than 20 countries around the world. We are known for innovation and setting new standards for the industry that lead the way in greater efficiencies for law enforcement agencies. Our solutions include:

Booking Systems help quickly identify known criminals at the booking process by capturing high quality biometric data, checking watchlists and building online photo lineups even when a picture or composite sketch is the only information that is available.

Mobile ID Solutions offer immediate and accurate identity information on suspects to officers in the field. Our mobile ID systems support multiple biometrics, providing officers in the field with accurate identity information in minutes while saving time, enhancing officer safety and minimizing false arrests.

Investigation Systems analyze finger, palm and facial information, as well as latent and partial prints found at crime scenes. With expert forensic examiners estimating that nearly 1/3 of all latent prints from crime scenes coming from parts of the hand other than the fingertips, and legislation requiring the capture of offenders hand or palm prints in addition to fingerprints, L-1 solutions are leading to faster identifications, regardless of the quality of latents or surveillance tapes.

Next Generation Multi-Biometric ABIS (Automated Biometric Identification System) incorporates finger, face and iris recognition in a single platform to improve the speed and accuracy of criminal identification. Our solution is designed for maximum flexibility in the workflow for lower risk and greater return on investment.

Omni Jail Management System uses iris-based biometric recognition and innovative workflow processes to offer sheriffs and wardens a more accurate way to identify inmates during critical stages of incarceration. This includes initial subject identification, intake, custody and eventual release.

Civil Solutions

Producing valid and secure civil identity documents necessitates a wide range of requirements. Each step in these processes represents the potential for error and fraud that can compromise the integrity of the ID. Civil agencies trust us to provide large-scale secure credentialing systems. We design thousands of card types, deploy more than 6,000 authentication systems globally, and produced more than 700 million ID credentials in the last 10 years alone. Our solutions include:

Enrollment Systems help ensure the integrity of the ID with high quality biometric data capture, document authentication, and demographic data capture for integration with identity databases and human resources management software. Our offerings ensure superior downstream performance and create enrollment efficiencies.

Multi-Biometric ABIS (Automated Biometric Identification System) uses finger, face and iris to help prevent fraud in the issuance of secure documents, aids in the speedy identification of criminals and deters terrorists from obtaining ID documents or crossing borders.

Card Production and Document Authentication Systems produce long-lasting, tamper-proof credentials.

Verification Solutions confirm identities before credentials are issued and received.

Driver s License Solutions offer processes for verifying an applicant s claimed identity by integrating client and back-end software, services, document reader hardware, biometric technology, and internal

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and external database queries. We also partner with U.S. states to address the requirements of the REAL ID Act.

Voter, National and Other Government-Issued IDs produced by L-1 help deter counterfeiting, enhance traffic safety and national security, combat identity theft and fraud, and facilitate the effectiveness of voter ID programs. L-1 provides identification solutions in more than 20 countries today.

Commercial Solutions

Protection of a business's valuable information and physical assets in today's operating environments demands a sophisticated security platform. Regulatory mandates that require proof of requisite steps taken to protect critical personal information is adding to the pressure. We offer the latest innovation in biometric technologies to vet an identity before an individual is hired or granted access to a company's data and physical assets. We also offer state-of-the-art access control systems. We serve the following markets:

Financial Services We help maintain the integrity of client records for new accounts, manage the background check process for prospective employees, and control access to secure facilities and online accounts.

Healthcare Organizations We preserve patient privacy and confidentiality of records using biometrics to ensure that only authorized individuals have access to sensitive patient information. Our information security software also helps enterprises with Health Insurance Portability and Accountability Act (HIPAA) compliance.

Casino and Gaming We provide fast and accurate background checks on prospective employees and offer biometric-based surveillance to identify known card counters and cheaters. We also offer superior access control systems to the world's largest casinos.

Corporate We help companies quickly and easily identify terminated employees and those that obtain unauthorized access to certain facilities or network areas without hindering the overall productivity of their workforce employees. As a result, our customers experience enhanced privacy, increased security and reduced fraud that helps ensure that internal losses are minimized.

Enterprise Access Solutions

Our enterprise access solutions protect corporate assets, offices and restricted areas with the strongest form of multifactor authentication available using fingerprint or face biometrics. The market leading Veri-Series fingerprint readers and MV-Series embedded fingerprint modules for physical access use advanced, patented pattern- and minutiae-based biometric algorithms for fast and secure verification. Leading-edge VisionAccess 3D face recognition readers use three-dimensional face geometry based algorithms for authentication in under a second. More than 290,000 access control reader units are installed today globally and we maintain a distribution network of more than 400 global partnerships worldwide. Our growing commercial and government market share is fueled by strong relationships within enterprises, government agencies, transportation authorities, insurance and financial institutions, healthcare operations, casino properties and other organizations around the world. Our solutions include:

HSDP-12 / PIV We offer FIPS approved finger readers for the HSPD-12 / PIV market.

Physical access applications Our finger and 3D face readers are used for a wide range of physical access applications.

Advanced software Advanced software for enrollment and device management is used with our finger and 3D face readers.

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Enrollment Services

L-1 operates more than 650 enrollment centers across the U.S. and Canada for processing pre-employment civilian background checks. Our customers include daycare workers, health-care personnel, prospective foster parents, and those employed in educational environments such as teachers, administrators, custodians and bus drivers legally required to have criminal history checks. Our centers also handle processing for various financial services, banking and brokerage submissions. Fingerprints are captured quickly in a friendly, professional environment by one of our certified fingerprint technicians. The prints are taken using state-of-the-art live scan equipment that captures fingerprints without the use of ink and submits them electronically. As a result, our customers can receive criminal history results in days. Faster results mean licensing, or putting employees to work, more quickly and with peace of mind. Our services include:

Live Scan Fingerprinting enables applicants to call and schedule an appointment at a convenient location. Upon arrival, fingerprints are captured and submitted electronically the same day. Results are typically returned within 2-3 days.

Card Scan Fingerprinting allows applicants to capture fingerprints with ink and mail the cards to us. We convert the ink cards to an electronic format and submit the fingerprint records to the appropriate channeling agency within one business day. Results are typically returned within 2-3 days.

Onsite Fingerprinting brings our live scan systems directly to the customer's location, helping fulfill short-term fingerprinting needs due to a large fingerprinting backlog, hiring surge or opening of new locations. We handle jobs all over the world, ranging from one day to many months.

Government Consulting Services

Our highly specialized services encompass the most important areas of security and intelligence in the U.S. today including information technology, engineering and analytics and intelligence services. Intelligence services include counterterrorism, homeland defense, information sharing and analysis, physical, technical and personal security, personnel surety, behavioral science, counterintelligence, vulnerability assessment, forensics, surveillance and surveillance detection, crisis management, computer forensics and operational support. Our IT services span network design, administration, system performance tuning, help desk support, and information assurance through systems security monitoring, threat and risk assessments, reverse engineering and policy development. Our systems and software engineering capabilities offer requirements development and integration, software application development and database design. Scientific, Engineering and Technical Assistance (SETA) capabilities provide mission and collection management, architecture analysis, program and acquisition management support. Our more than 850 consulting personnel represent what we believe are the most qualified professionals in the industry, with approximately 95 percent holding high-level government security clearance. Our team includes all-source regional, functional, and technical analysts; field operations officers; trainers; software engineers; program managers; specialized government consultants; and operational support professionals. Our professional consulting staff provides support to the federal intelligence agencies, law enforcements, and the uniformed military services. Our multi-lingual team speaks 20 languages and are experts in Middle East, Asian and Eastern European countries. Our clients include:

Intelligence Community Our Government and Security Consultants are engaged across the intelligence community and overseas. They assist in the development of intelligence reporting programs, train and mentor the next generation of reports officers. Our established program develops well-rounded report officers to assist with tasks where staffing shortages are critical, and provide training and mentoring without adding to the demands of government officers. They help develop and support large scale and complex IT

infrastructures for highly sophisticated mission critical applications and systems. In concert with their understanding of IT systems, they assist in the development and monitoring of critical networks for the intelligence agencies.

Geospatial Community In addition to various human intelligence services capabilities, we offer highly complementary geospatial services. This includes imagery intelligence, all source intelligence analysis, systems engineering and acquisition capabilities.

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Federal, State and Local Government Agencies Our professionals offer expert consulting based on extensive operational experience. We provide a wide range of analytical, linguistic, technical, and other support to intelligence, defense, and law enforcement agencies, including the DHS and FBI, and our cleared personnel can seamlessly augment and/or provide specialized training to current staff.

Private Sector We can conduct an eye of the attacker evaluation, identifying security vulnerabilities from an adversarial perspective, a distinctive and proven approach to measuring and mitigating risk from internal and external threats.

Customers

Over 90% of our sales are to federal, state, local and foreign governments and government agencies. Contracts with governments and agencies generally allow the customer to terminate the contract for convenience of or for failure of the government to appropriate funds. For the year ended December 31, 2008, U.S. Federal government agencies accounted for 64% of L-1's consolidated revenues.

Historically, we have experienced minimal customer turnover. We believe this is a result of our strong product portfolio and emphasis on customer service and support.

Our customers include:

Many federal agencies and branches of the U.S. military,

More than 29 international governments,

Majority of Department of Motor Vehicles across the U.S.,

Numerous local law enforcement agencies and

Commercial enterprises including those in gaming, finance, healthcare and more.

Business Development, Sales, Marketing, Bids and Proposals

We market our biometric solutions and services through a direct sales force, through channel partners and through strategic partnerships and alliances. Our direct sales force is responsible for marketing and selling our entire identity solutions and services portfolio. We have a worldwide sales force responsible for delivering customer solutions and services to North and South American, Europe, the Middle East, Africa, Russia, India and Asia Pacific markets. In addition, we have established a dedicated U.S. Federal sales team in Washington, D.C. responsible for marketing and selling to U.S. government agencies such as the Department of Defense, Department of State, Department of Justice and Department of Homeland Security, among others. We have a dedicated sales and services team operating from locations in Germany, the United Kingdom, Australia, UAE and Switzerland, strengthening our coverage and access to the international markets for our products, services and solutions. We have also realigned our marketing efforts to better coordinate the state and local marketing offerings of our divisions. Finally, we have established a team approach to pursuing intelligence agency opportunities to coordinate and provide broader and stronger service offerings to the U.S. intelligence agencies. As of December 31, 2008, we employed 154 people in our business development and sales and marketing organization.

We also continue to seek to develop strategic partnerships and distribution channels to broaden our coverage and increase the size of our market worldwide. We have established original equipment manufacturer, or OEM, distribution agreements with partners to leverage our technologies. We have established channels of distribution for our document authentication products to open new markets outside of the U.S. Additionally, we work with systems integrators, solution providers and service organizations to deliver identity solutions in combination with their core capabilities to expand our access to such organizations existing relationships, marketing resources and credibility in new markets. Local agents are also utilized to expand our international access to identity solutions opportunities around the world.

Our sales strategy is organized around specific markets: federal, state and local, international and commercial. Each sales organization is supported by functional groups, which design, engineer, manufacture,

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market, fulfill and support our market-specific offerings. Each of our sales organizations is further supported by a professional service group, which customizes solutions for each market, and a field service group to ensure ongoing performance of our systems at customer sites throughout the world.

Substantially all of our government services business and much of our solutions business is won through submission of formal competitive bids. Commercial bids are frequently negotiated as to terms and conditions for schedule, specifications, delivery and payment. With respect to bids for government work, however, in most cases the client specifies the terms and conditions and form of contract. In situations where the client-imposed contract type and/or terms appear to expose us to inappropriate risk, we may seek alternative arrangements or opt not to bid for the work. Our contracts and subcontracts are composed of a wide range of contract types, including firm fixed-price, cost reimbursement, time-and-materials, indefinite delivery/indefinite quantity (ID/IQ) and government wide acquisition contracts such as General Services Administration (GSA) schedule contracts.

Substantially all of our sales to new customers have been the result of competitive bidding for contracts pursuant to public sector procurement rules. In some cases, we may be competing with an entity that has a pre-existing relationship with a potential customer, which could put us at a significant competitive disadvantage. In other cases, however, we have pre-existing relationships with customers, which give us an advantage relative to our competitors for that customer. All material bids and proposals are subject to review and approval by senior corporate management prior to submission.

Sales and marketing costs were \$37.1 million, \$27.7 million and \$14.4 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Research and Product Development

We have organized our research and development activities in what we believe is an efficient model using centers of excellence distributed among our divisions. Our research and development team, which totals approximately 271 developers, scientists and engineers, is distributed among focused centers of excellence that are maintained under the Company's divisions. Their activities are coordinated at the corporate level under the Company's Chief Strategic Officer to ensure support of the overall innovation goals and mission of L-1 and the realization of synergies in our research and development investment.

We focus our research and development efforts on critical components for advanced technology identity solutions. These include but are not limited to proprietary software that addresses image capture, image processing, face recognition, iris recognition, fingerprint and palm recognition, biometric fusion logic and intelligent decision making, information retrieval from identity databases, scalability of search, and the accuracy of searching and matching algorithms within very large databases, and document authentication. In addition, we invest in the development of capture technologies for finger, palm and iris. We also maintain an active program for the development of new security features for credentials.

We believe our next generation biometric matching algorithms fingerprint, facial, and iris recognition technology developments will be more reliable and cost effective than current technology, as well as provide additional functionality, including the storage of fingerprint and/or facial and iris templates on smart cards and similar storage devices. In addition, we focus on expanding our capabilities in solutions for the civil identification, criminal identification and border management markets.

We also benefit from research and development activities conducted by the manufacturers of the components integrated into our systems such as cameras, database software and computers and research and development, we perform research and development for our customers, including the U.S. government and its agencies.

Gross research and development expenditures aggregated to \$43.0 million for the year ended December 31, 2008 compared to \$26.4 million in the prior year. Virtually all of our research and development costs are attributable to our Identity Solutions segment. As a percentage of Identity Solutions revenues, gross research and development costs were 15% and 13% for years ended December 31, 2008 and 2007, respectively.

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Intellectual Property

We rely on patent, copyright, trademark and trade secrets and contract law to establish and maintain our proprietary rights in our technology products and manufacturing processes. The success of our business will depend in part on our proprietary technology and protection of that technology. While our intellectual property rights are important to our success, we believe that neither our business as a whole nor any segment of our business is materially dependent on any particular patent, trademark, license or other intellectual property right.

We have a portfolio of 213 U.S. and foreign patents. In addition, we have 164 U.S. and foreign patent applications in process for biometrics and document authentication technologies. While the duration of our patents varies, we believe that the duration of our patents is adequate relative to the expected lives of our products.

We have filed applications to register the trademarks of L-1 and L-1 Identity Solutions, and both applications have been approved for publication by the U.S. Patent and Office. We have a broad portfolio of other vital registered and pending trademarks in the U.S. and foreign jurisdictions.

Backlog

Backlog represents sales value of firm orders for products and services not yet delivered and, for long term executed contractual arrangements (contracts, subcontracts, and customer commitments), the estimated future sales value of estimated product shipments, transactions processed and services to be provided over the term of the contractual arrangements, including renewal options expected to be exercised. For contracts with indefinite quantities backlog reflects estimated quantities based on current activity levels. Backlog will not necessarily result in future revenue because firm orders may be cancelled, firm orders from governmental agencies may remain subject to funding options, renewals may not be exercised by the customers, and the quantities ordered, the volume of transaction processed or services to be provided may be less than estimated. Backlog includes deferred revenues. Contractual arrangements could be cancelled by our customers without penalty for lack of performance. Contracts terminated by our customers for convenience generally would result in recovery of actual costs incurred and profit, if any, on work performed through the date of cancellation. At December 31, 2008 backlog, determined as described above, approximated \$1.1 billion, of which approximately \$520.0 million is expected to be realized in 2009. Revenues from backlog, together with other recurring revenues not in backlog, are expected to approximate \$620.0 million or 84% of 2009 revenues. At December 31, 2007, backlog was approximately \$715 million.

Competition

The market for our identity solutions and services is extremely competitive. Our ability to differentiate ourselves from our competition is predicated on:

A customer-focused solution set approach that enables us to package our products and services together to solve the unique identity-challenges of markets such as federal, civil, state and local, criminal, border management and commercial.

Strong and tenured relationships with customers. Today L-1 customers include most federal agencies and branches of the U.S. military, more than 29 international governments and the majority of U.S. state DMVs and local law enforcement agencies. The pervasiveness of our relationships makes L-1 a trusted choice for others seeking relationships with proven vendors.

State-of-the-art technologies and solutions, including every major biometric modality. Furthermore, L-1 remains at the forefront of innovation through our strong organic and strategic acquisitive growth.

The flexibility of our products and services that can be used together to form a complete solution or as modular components within an existing end-to-end identity management solution.

The ability to offer multi modal identity solutions incorporating finger, face, palm/hand and iris technologies together with search and matching software to work with large databases.

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The comprehensive nature of our solutions and services that encompass the full spectrum of identity management needs including:

Delivering the best means of uniquely identifying individuals through advanced multi-modal biometric recognition technologies

Producing the most secure credentials possible that serve as proof of identity

Providing biometrically-enabled access control for more secure buildings and restricted areas

Offering enrollment service centers for fast, accurate electronic civilian fingerprinting and background checks necessary for licensed employment positions

Delivering government consulting services that address the most important areas of security in the U.S. today including IT, engineering and analytics, and intelligence

We face competition from a number of companies who are actively engaged in developing and marketing identity management related solutions and services. All of our divisions are also potentially affected by large system integrators entering the market through various avenues. The markets for our solutions and services are characterized by rapid technological change as a result of technical developments exploited by competitors, the changing technical needs of the customers, and frequent introductions of new features. We expect competition to increase as other companies introduce products that are more price competitive, may have increased performance or functionality, or that incorporate technological advances not yet developed or implemented by L-1. In order to compete effectively in this environment, we must continually develop and market new and enhanced products at competitive prices, and have the resources to invest in significant research and development activities.

We compete on the basis of the following factors: technology, service and support, product quality, price, reliability, capability to work with large criminal history networks and flexibility in accommodating customer technical and business needs.

Specific competitive issues as they relate to our core focus areas include:

Biometrics. A significant number of established and startup companies are developing and marketing solutions and related software and hardware for fingerprint, face, iris and other biometric security applications that could compete directly with our offerings. Some are developing alternative algorithms for biometric matching, some are developing alternative capture technology such as ultrasound, semiconductor or alternative types of optically and non optically based contact and contactless fingerprint image capture devices and others are developing and marketing other methods of biometric identification such as retinal blood vessel, signature recognition, hand geometry and voice and DNA. If one or more of these approaches were widely adopted, it would significantly reduce the potential market for our products. Our competitors include traditional AFIS vendors such as Sagem, Cogent and NEC and manufacturers and technology companies such as Cross Match Technologies, Inc., Cognitech Inc., Asia Software, CryptoMetrics, Inc., Precise Biometrics, BIO-key International, Inc., and Greenbit, among others. From time to time, we also face competition from divisions of large multinational companies such as Lockheed Martin Corporation. In some markets, we may also partner with some of these competitors.

Secure Credentialing. We believe that we are considered one of the most significant players in the state driver's license market with nearly every U/S state using L-1 solutions for secure driver's license production as

well as in the federal and international credentialing market. However, U.S. mandates such as REAL ID, WHITI and Enhanced Driver's License that call for more secure credentialing is also creating opportunities for competitors to enter or expand their presence in the market. Greater demand for increased security content on the credential is attracting more security printing companies and card manufacturers. Credentialing issuance systems are becoming increasingly data intensive. This provides an opportunity for systems integrators and technology blue-chip companies that bring expertise in the complexities of information technology content to enter the market. These same issues and advantages hold true for international opportunities, with the extensive global experience and

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footprint of larger entities providing significant competitive advantage. Our competitors in this area include Marquee ID, Canadian Banknote, Bundesdruckerei, G&D, Trub, DeLaRue, Gemalto, and Oberthur, among others. We also see competition sometimes from major system integrators. As in the case in our other divisions on some opportunities, we compete and on others we team up with the same company.

Enterprise Access. L-1 access solutions are marketed through an indirect sales channel using a network of more than 400 partners globally; the ability to successfully partner is essential to generating new opportunities as a front-end access control device and to access vertical markets traditionally outside L-1's core markets, such as commercial enterprises. Changing specifications and requirements for integration, functionality, and interoperability of access control systems is being driven by a variety of government mandates, such as secure credentialing requirements for U.S. Federal employees and contractors via Personal Identity Verification (PIV) and Transportation Worker Identification Credential (TWIC). These mandates, as well as others internationally, place significant constraints on the product manufacturing process, requiring the ability to rapidly and efficiently modify products to adhere to each program specification and integrate successfully into the total solution. In the commercial market, L-1 is facing competitive pressure from commodity manufacturers that are developing access control terminals for commercial applications that are not required to meet more stringent government specifications. On the other hand, L-1 has an inherent advantage in coupling access control solutions with the expertise resident within other L-1 divisions for large scale enrollment hardware, software and services; a combination not readily available from most competitors today. Finally, successfully teaming with other system integrators and hosting systems, and the ability to integrate seamlessly with these systems, is essential to gaining strength and market as a back-end to large integrated identity programs and systems. Our principal competitors are Sagem, Cogent, RGC and Suprema, among others.

Enrollment Services. L-1 is a significant player in the fingerprinting services market, printing more than six million individuals to date. Competition is diverse and includes AFIS vendors, other live scan manufacturers, and others. Large federal programs recently introduced such as those noted in the Secure Credentialing competition section, as well as other programs, have provided opportunities for large system integrators, some of whom are our partners today, to compete against us. The division also competes with Cogent and a large number of small local / regional fingerprinting services companies. However, L-1 is well positioned in the enrollment services market due to the size of its network (more than 650 centers located in 46 states and Canadian provinces) and because of its ability to provide a total enrollment solution, from biometric capture to processing. Ease of use and convenience is also a major competitive benefit to L-1 due to the wide range of locations and the ability to register online.

Government Consulting Services. We operate in a competitive industry that includes many firms, some of which are larger in size and have greater financial resources than we do. Also, the demand for qualified intellectual capital to staff government consulting projects is growing exponentially, while there remains a relatively small group of resources available. This issue poses significant pressure on all companies in the market, including L-1, and our ability to quickly retain individuals who have the appropriate skill sets and clearance levels is critical to our success. We obtain much of our business on the basis of proposals submitted in response to requests from potential and current customers, who generally also receive proposals from competitors such as BAE Systems, Computer Sciences Corporation, General Dynamics, Boeing Corporation, Lockheed Martin Corporation, Raytheon Corporation, Northrop Grumman Corporation, Science Applications International Corporation as well as a large number of US government contractors with specialized capabilities such as CACI International, Inc., Booz, Allen and Hamilton, SRA International and Mantech International Corporation. Additionally, we face indirect competition from certain government agencies that perform services for themselves similar to those we provide. Our competitors include divisions of large defense contractors as well as a large number of smaller U.S. government contractors with specialized capabilities. Because of the diverse requirements of U.S. government customers, shortage

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of quality personnel and the highly competitive nature of large procurements, we frequently team with others to pursue contract opportunities. Competitors will, at times, team with us or subcontract to us in the pursuit of new business. We believe that the major competitive factors in our market are technical competencies, the ability to hire qualified personnel, successful past contract performance, intelligence and military work experience, price of services, reputation for quality and the experience and clearance level of our employees.

Manufacturing

We engineer and design the hardware products we sell and develop much of the software embedded in them. Except as described below with respect to secure credentials, we either limit our manufacturing activities to the assembly, repair, and testing of these products or we manage their production through contract manufacturers. In either case, we qualify suppliers for the core components which typically have established supply chains. We believe this permits rapid expansion of production capacity to meet any significant increase in product demand and minimizes both development costs and the cost of scaling of our manufacturing capabilities. We believe that these costs will decline if manufacturing volumes increase.

We also engineer, design and produce most of our card products used for the production of secure credentials that have proprietary features or functionality and which account for over 50% of our credentialing volume. We purchase the remaining card products from established sources.

We produce driver licenses for 19 states in secure central issuance facilities in Texas, Florida, North Carolina, Pennsylvania, California and Washington and in 2009 we expect to open new central issuance facilities Georgia and Massachusetts to accommodate states converting or expected to convert to central issuance in 2009, 2010 and 2011. We also produce the Mexican voter identifications in a central issuance facility in Mexico City.

We purchase certain components, sub-assemblies and finished products used in our manufacturing and supply chain operations from sole source suppliers. While we are careful to partner with stable, reliable suppliers, the partial or complete loss of supplies available from sole sources or limited sources of supply or the delay in receiving supplies from these sources could result in delays in manufacturing and shipping products to customers which may result in the assessment of liquidated damages in certain contracts and which may require the incurrence of development and other costs to establish alternative sources of supply. While we made every effort to maintain inventory on sole sourced components, it may take us several months to locate alternative suppliers if required, or redesign our products to accommodate components from different suppliers.

Seasonality

Our business in general is not seasonal. However, because most of our government services revenue is earned on a time and material and fixed price level of effect basis, we are impacted by holidays and vacations our employees may take during the summer and holiday seasons. We are also impacted by the fiscal funding and appropriation cycles of our major customers. For example, the U.S. government's fiscal year ends on September 30 of each year, and it is not uncommon for government agencies to award extra tasks or complete other contract actions in the weeks before the end of the fiscal year in order to avoid the loss of unexpended fiscal year funds. Moreover, in years when the U.S. government does not complete its budget process before the end of its fiscal year, government operations typically are funded pursuant to a continuing resolution that authorizes agencies of the U.S. government to continue to operate, but traditionally does not authorize new spending initiatives. When much of the U.S. government operates under a continuing resolution, as occurred during the federal fiscal year ending September 30, 2008, delays can occur in procurement of products and services, and such delays can affect our revenue and profit during the period of delay.

Financial Information about Foreign and Domestic Operations and Export Sales

For the years ended December 31, 2008, 2007 and 2006, export sales were approximately \$47.7 million, \$29.0 million, and \$14.6 million, respectively. Foreign operations and export sales may increase in relative and

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absolute terms in the future due to our increased focus on markets outside the United States. See Note 12 to our consolidated financial statements for additional information.

Capital Requirements

Our most significant capital requirements arise primarily from acquisitions in support of our business strategy, capital expenditures for new secure credentialing contracts, expenditures for research and development and working capital needs. For example, when we bid on new state drivers license contracts, we must commit to provide up front capital expenditures in order to install systems necessary to perform under the contract. The most significant capital expenditures are related to our Secure Credentialing business, which has increased in size and scope due to the acquisition of Old Digimarc. Accordingly, we expect our capital requirements to increase as we bid on and are awarded new contracts or as contracts are renewed. We expect to meet our requirements from operating cash flows, equity issuances and bank borrowings. See Item 7, Liquidity and Capital Resources.

On May 17, 2007, we issued \$175.0 million of Convertible Notes with a conversion feature which allows us the option to settle the debt either in shares of common stock or to settle the principal amount in cash and the conversion spread in cash or stock. The net proceeds of the Convertible Notes offering, net of deferred financing costs amounted to \$168.7 million of which \$69.8 million was used to fund the repurchase of our common stock pursuant to a pre-paid forward contract. The remaining net proceeds of the Convertible Notes offering were utilized to repay outstanding indebtedness. The Convertible Notes and the related forward share repurchase transaction are described in Item 7-Management's Discussion and Analysis of Results of Operations and Financial Condition-Liquidity.

On August 5, 2008, we entered into a Second Amended and Restated Credit Agreement (the Credit Agreement), among L-1 Identity Operating, L-1, Bank of America, N.A., Wachovia Bank, National Association, Banc of America Securities LLC, Wachovia Capital Markets LLC, Royal Bank of Canada, Societe Generale and TD Bank, N.A. to amend and restate the Amended and Restated Credit Agreement, dated October 19, 2006 by and among L-1, Bank of America, N.A. (Administrative Agent), Bear Stearns Corporate Lending, Inc., Bear Stearns & Co., Inc., Banc of America Securities LLC, Wachovia Bank, N.A. and Credit Suisse, Cayman Islands Branch. Other lenders under the Credit Agreement include Credit Suisse, Cayman Islands Branch, the Bank of Nova Scotia, CIT Bank and RBS Citizens N.A. The Credit Agreement provides for a senior secured term loan facility in an aggregate principal amount of up to \$300.0 million, with a term of five years, and a senior secured revolving credit facility in an aggregate principal amount of up to \$135.0 million. The proceeds of the senior secured facilities were used to (i) fund, in part, the purchase price paid, and fees and expenses incurred, in connection with the acquisition of Old Digimarc, (ii) repay our previous revolving credit facility and (iii) provide ongoing working capital and fund other general corporate purposes of L-1. As of December 31, 2008, the Company has approximately \$120.5 million, net of outstanding letters of credit of \$14.5 million, available under its revolving credit facility, subject to continuing compliance with the covenants contained in the agreement.

Under the terms of the senior secured credit facility, the Company has the option to borrow at LIBOR (subject to a floor of 3%) plus 2.75% to 4.5% per annum or at prime (subject to a floor of 2%) plus 1.75% to 3.5% per annum. L-1 is required to pay a fee of 0.5% on the unused portion of the revolving credit facility. The senior secured term loan facility requires quarterly principal payments beginning at 5.0% of the outstanding borrowings under such facility for the initial year, increasing over the duration of the facility. All obligations of L-1 Operating under the Credit Agreement are guaranteed on a senior secured basis by L-1 and by each of L-1's existing and subsequently acquired or organized direct or indirect wholly-owned subsidiaries (subject to certain exceptions). At December 31, 2008, the variable interest rate was based on three month LIBOR plus 4.5% or 7.5%. Subsequent to December 31, 2008, the interest rate was changed to 6.75%.

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Under the terms of the Credit Agreement, we may incur, assume or guarantee unsecured subordinated indebtedness in an amount up to \$200.0 million, provided that no default or event of default shall have occurred or would occur as a result of the incurrence of such subordinated debt and we are in pro forma compliance, after giving effect to the incurrence of such subordinated debt, with each of the covenants in the Credit Agreement. Pursuant to the terms of the Credit Agreement, we may incur, assume or guarantee any amount of unsecured subordinated indebtedness, provided, that no default or event of default shall have occurred or would occur as a result of the incurrence of such subordinated debt and our pro forma Consolidated Leverage Ratio (as defined in the Credit Agreement) after giving effect to the incurrence of such subordinated debt shall be less than 4.75:1.00. The Credit Agreement limits our ability to (i) pay dividends or other distributions or repurchase capital stock, (ii) create, incur, assume or suffer to exist any indebtedness, (iii) create, incur, assume or suffer to exist liens upon any of its property, assets or revenues, (iv) sell, transfer, license, lease or otherwise dispose of any property, (v) make or become legally obligated to make capital expenditures above certain thresholds, (vi) make investments, including acquisitions, and (vii) enter into transactions with affiliates. These covenants are subject to a number of exceptions and qualifications. The Credit Agreement provides for customary events of default which include (subject in certain cases to customary grace and cure periods), among others: nonpayment, breach of covenants or other agreements in the Credit Agreement or the other Loan Documents (as defined in the Credit Agreement), payment defaults or acceleration of other indebtedness, failure to pay certain judgments, inability to pay debts as they become due and certain events of bankruptcy, insolvency or reorganization. Generally, if an event of default occurs, the Administrative Agent may, with the consent of the Required Lenders (as defined in the Credit Agreement) declare all outstanding indebtedness under the Credit Agreement to be due and payable.

Environmental Protection Regulations

We believe that our compliance with federal, state and local environmental regulations will not have a material adverse effect on our financial position or results of operations.

Employees

As of December 31, 2008, we had 2,264 full time employees. None of our employees are covered by collective bargaining agreements. We believe that our relations with our employees are good.

Officers

Our executive officers are appointed by our Board of Directors and serve until their successors have been duly appointed and qualified.

Robert V. LaPenta, 63, has served as the Chairman of the Board since December 2005, President and Chief Executive Officer of L-1 since August 2006. Mr. LaPenta is the founder and Chief Executive Officer of L-1 Investment Partners, LLC, a private investment management firm. From April 1997 to April 2005, Mr. LaPenta served as President, Chief Financial Officer and a Director of L-3 Communications Holdings, Inc., which he co-founded in April 1997. From April 1996, when Loral Corporation was acquired by Lockheed Martin Corporation, until April 1997, Mr. LaPenta was a Vice President of Lockheed Martin and was Vice President and Chief Financial Officer of Lockheed Martin's Command, Control, Communications and Intelligence and Systems Integration Sector. Prior to the April 1996 acquisition of Loral, he was Loral's Senior Vice President and Controller, a position he held since 1991. He joined Loral in 1972 and was named Vice President and Controller of its largest division in 1974. He became Corporate Controller in 1978 and was named Vice President in 1979. Mr. LaPenta is on the Board of Trustees of Iona College, the board of directors of Core Software Technologies and the board of directors of Leap Wireless International, Inc.

Dr. Joseph Atick, 44, joined L-1 in August 2006 as Executive Vice President and Chief Strategic Officer effective with the merger of Identix with L-1. Prior to that, he served as President & Chief Officer of Identix since June of 2002. Prior to that, he had co-founded one of the original facial recognition companies, Visionics Corporation. Over the years, Dr. Atick co-founded and managed several companies focused on technology transfer and development, and has served as a technical advisor to many high-tech enterprises and

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organizations, including NATO. He had also led the Computational Neuroscience Laboratory at Rockefeller University and the Neural Cybernetics Group at the Institute for Advanced Study in Princeton, New Jersey. Dr. Atick holds a Ph.D. in Mathematical Physics from Stanford University.

James DePalma, 57, joined L-1 as Executive Vice President, Chief Financial Officer and Treasurer effective with the merger of Identix with L-1. He brings three decades of operational and finance experience in the defense and technology industries to his role within the company. Prior to joining L-1, Mr. DePalma was a founding partner of L-1 Investment Partners. Prior to the formation of L-1 Investment Partners, Mr. DePalma served as a consultant to L-3 Communications Holdings, Inc. and was chief executive officer of Core Software Technology, a leading software provider to the intelligence community and an equity investment of L-3 Communications Holdings, Inc. Mr. DePalma has also held high level executive positions with Westinghouse Electric Corporation, CBS Corporation and Viacom International. He also was a senior partner at PricewaterhouseCoopers.

Doni Fordyce, 49, joined L-1 as Executive Vice President of Corporate Communications effective with the merger of Identix with L-1. Prior to August 2006, she was a founding partner of L-1 Investment Partners and brings two decades of senior executive and investment management experience to the company, serving most recently as chief executive officer, president and chief operation officer of Bear Stearns Asset Management (BSAM) Inc. Prior to that Ms. Fordyce was vice president of Goldman Sachs Inc. from 1986 to 1996 where she was one of the founders of the asset management business. She has also worked in IT solutions consulting, specializing networking, data management and printing for investment banks and financial institutions.

Mark S. Molina, 49, joined L-1 in August 2006 as Executive Vice President, Chief Legal Officer and Secretary in August 2006 effective with the merger of Identix with L-1. Prior to joining L-1, he was Executive Vice President, Chief Legal Officer and Secretary at Identix, which he joined as Vice President and General Counsel in 1999. Mr. Molina is a business and technology lawyer with over 20 years experience structuring and negotiating mergers, acquisition, dispositions, joint ventures, technology licenses, financings and investments. He has considerable experience with public offerings and private placements as well as SEC reporting compliance and obligations of publicly traded companies.

Joseph Paresi, 53, joined L-1 in August 2006 as Executive Vice President and Chief Marketing Officer effective with the merger of Identix with L-1. He was a founding partner of L-1 Investment Partners LLC. Mr. Paresi brings three decades of executive management, product development, and design engineering experience in the technology and defense industries to his role with the company. Prior to joining L-1 Investment Partners, he served as corporate vice president of product development for L-3 Communications and as president of L-3 security & Detection Systems from 1997 to 2005.

Vincent A. D Angelo, 64, joined L-1 as Senior Vice President of Finance in August 2006 effective with the merger of Identix with L-1. Prior to that, he was a consultant for L-1 Investment Partners. Prior to that, Mr. D Angelo was a senior audit partner with PricewaterhouseCoopers for more than 35 years where he was involved in all facets of the business, including client service, management, operations, governance, SEC filings, and mergers and acquisitions.

There are no family relationships among any of our executive officers and directors.

On April 23, 2007, the Company entered into an employee arrangement with Mr. Robert LaPenta, Jr., the son of the Company's Chief Executive Officer, to serve as Vice President, M&A/Corporate Development.

L-1's Internet Website

We maintain a corporate website with the address www.L1id.com. We intend to use our website as a regular means of disclosing material non-public information and for complying with our disclosure obligations under Regulation FD promulgated by the SEC. Such disclosures will be included on our website under the heading Investor Relations Events and Presentations. Accordingly, investors should monitor such portions of our website, in addition to following our press releases, SEC filings and public conference calls and webcasts. We are not incorporating information contained in our website by reference into this Annual Report on Form 10-K. We make available, free of charge through our website, our Annual Reports on Form 10-K,

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Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and any amendments to these reports as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. You may read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. The SEC also maintains a website, www.sec.gov containing the reports, proxy and other information we file with the SEC.

Item 1A. Risk Factors

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

Risks Related to Our Business

We have a history of operating losses.

We have a history of operating losses. Our business operations began in 1993 and, except for 1996 and 2000, have resulted in pre-tax operating losses in each year, which in 2006, 2007 and 2008, include significant asset impairments and merger related expenses, amortization of intangible assets and stock-based compensation expense. At December 31, 2008, we had an accumulated deficit of approximately \$618.5 million.

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

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

include provisions that allow the government agency to unilaterally terminate the contract without penalty under some circumstances;

be subject to purchasing decisions of agencies that are subject to political considerations;

include bonding requirements;

be subject to onerous procurement procedures; and

be subject to cancellation or reduction if government funding becomes unavailable or is cut back.

Securing government contracts can be a protracted process involving competitive bidding. In many cases, unsuccessful bidders may challenge contract awards, which can lead to increased costs, delays and possible loss of the contract for the winning bidder. Protests, and similar delays, regarding any future government contracts of a material nature that may be awarded to us could result in materially adverse revenue volatility,

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making management of inventory levels, cash flows and profitability inherently difficult. Outright loss of any material government contract through the protest process or otherwise, could have a material adverse effect on our financial results and stock price.

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

Our government contracts are subject to continued appropriations by Congress and availability of funding for state and local programs. Reduced funding could result in terminated or delayed contracts and adversely affect our ability to meet our sales and earnings goals.

For the year ended December 31, 2008, U.S. Federal Government agencies, directly or indirectly, accounted for 64% of our consolidated revenues. For the year ended December 31, 2007, U.S. Federal Government agencies, directly or indirectly accounted for 69% of our consolidated revenues. Future sales under existing and future awards of U.S. government contracts are conditioned upon the continuing availability of Congressional appropriations, which could be affected by current or future economic conditions.

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

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

There can be no assurances that our backlog estimates will result in actual revenues in any particular fiscal period because our clients may modify or terminate projects and contracts and may decide not to exercise contract options or the estimate of quantities may not materialize. Our backlog represents sales value of firm orders for products and services not yet delivered and, for long term executed contractual arrangements (contracts, subcontracts, and customer's commitments), the estimated future sales value of estimated product shipments, transactions processed and services to be provided over the term of the contractual arrangements, including renewal options expected to be exercised. For contracts with indefinite quantities backlog reflects estimated quantities based on current activity levels. Our backlog includes estimates of revenues that are dependent on future government appropriation, option exercise by our clients and/or is subject to contract modification or termination. Due to current economic environment and potential spending constraints experienced by state and local governments, in particular, realization of our backlog may be adversely impacted. At December 31, 2008, our backlog approximated \$1.1 billion, of which approximately \$520.0 million is expected to be realized in 2009. Revenues from backlog, together with other recurring revenues not in backlog approximate \$620.0 million or 84% of 2009 revenues. These estimates are based on our experience under such contracts and similar contracts, and we believe such estimates to be reasonable in the circumstances. However, we believe that the estimate of revenues reflected in our backlog for the following twelve months will generally be more reliable than our estimate for periods thereafter. If we do not realize a substantial amount of our backlog, our operations could be harmed and our expected future revenues could be significantly reduced.

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Our quarterly results are difficult to predict, and if we miss quarterly financial expectations, our stock price could decline.

Our quarterly revenue and operating results are difficult to predict and fluctuate from quarter to quarter. Our operating results in some periods may be below or above the guidance we provide and may not meet investor expectations. If this happens, the market price of our common stock could be adversely impacted. Fluctuations in our future quarterly operating results may be caused by many factors, including:

The size and timing of customer orders, which may be received unevenly throughout a fiscal year;

The mix of revenues between solutions and services;

The application of new accounting standard or interpretations;

Cancellation or modification of contracts or changes in contract revenue estimates; and

Contract performance delays.

We have a long sales cycle, which can result in significant revenue fluctuations between periods.

The sales cycle for our solutions and services is typically long and subject to a number of significant risks over which we have little control. As our operating expenses are based on anticipated revenue levels, fluctuations in the revenues as a result of the timing of contract awards and the exercise of options and task orders can cause our operating results to vary significantly between periods. If revenue falls significantly below anticipated levels, our business and the market price of our stock would be negatively impacted.

Purchasing decisions for our solutions and services may be subject to delay due to many factors that are outside of our control, such as:

Appropriation of funds by governments;

Political and economic uncertainties;

Time required for a prospective customer to recognize the need for our solutions;

Customers requirements for customized features and functionalities;

Turnover of key personnel at existing and prospective customers;

Customer internal budgeting process; and

Customer internal procedures for the approval of large contracts.

We may be unable to obtain additional capital required to finance our growth and our acquisition strategy may be adversely affected by the current volatile market conditions.

Our strategy includes growth of our business through strategic acquisitions. In addition, the installation of our secure credentialing systems requires significant capital expenditures. Our need to fund such expenditures has increased following our acquisition of Old Digimarc. During 2008, our expenditures increased to \$22.5 million and are expected

to increase in 2009. At December 31, 2008, we had cash and cash equivalents of \$20.4 million and availability under our line of credit of \$120.5 million, subject to continuing compliance with covenants contained in the agreement. While we believe we have adequate capital resources to meet current working capital and capital expenditure requirements and have been successful in the past in obtaining financing for capital expenditures, and acquisitions, we expect to have increased capital needs as we continue to expand our business. In addition, our ability to execute on our acquisition strategy may be adversely affected by the current volatile market conditions, which may continue over a prolonged period. We may be unsuccessful in raising additional financing to fund growth or we may have difficulty in obtaining financing at attractive rates or on terms that are not excessively dilutive to existing stockholders. Failure to secure additional financing in a timely manner and on favorable terms could have a material adverse effect on our

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growth strategy, financial performance and stock price and could require us to delay or abandon our expansion plans.

We are subject to government regulation, and our failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.

We are affected by and must comply with various government regulations that impact our operating costs, profit margins and the internal organization and operation of our business. Our failure to comply with applicable regulations, rules and approvals could result in the imposition of penalties, the loss of our government contracts or our disqualification as a U.S. Government contractor, all of which could adversely affect our business, financial condition and results of operations. Among the most significant regulations affecting our business are:

export control regulations;

Federal Acquisition Regulation, or the FAR, and agency regulations supplementing the FAR, which comprehensively regulate the formation and administration of, and performance under government contracts;

Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;

Foreign Corrupt Practices Act; and

laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

These regulations affect how we and our customers do business and, in some instances, impose added costs on our business. Any changes in applicable laws and regulations could restrict our ability to conduct our business. Any failure by us to comply with applicable laws and regulations could result in contract termination, price or fee reductions or suspension, debarment or disqualification from contracting with the federal, state and local governments.

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

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

national or international events which may affect the need for or interest in biometric solutions or services;

the cost, performance and reliability of the solutions and services and those of our competitors;

customers' perception of the perceived benefit of biometric solutions and services and their satisfaction with the solutions and services;

public perceptions regarding the confidentiality of private information;

proposed or enacted legislation related to privacy of information;

marketing efforts and publicity regarding these solutions and services;

competition from non-biometric technologies that provide more affordable, but less robust, authentication (such as tokens and smart cards);

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privacy and legal challenges relating to biometric identifiers driven by private citizens and advocacy groups; and

the potential for changes in government policy regarding privacy issues with a new executive branch administration.

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

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

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

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

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

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

Many of the systems included in the solutions we sell manage private personal information and protect information involved in sensitive government functions. The protective security measures that we use in these

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

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

Our reliance on external suppliers and contract manufacturers may result in delays and loss of sales or customers.

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

We rely on contract manufacturers to produce our hardware products under short term manufacturing arrangements. Although we believe we can find alternative sources of manufacturing our hardware, any disruption of contractual arrangements could result in delaying deliveries or in the loss our sales. We obtain certain hardware and services, as well as software applications, from a limited group of suppliers. Our reliance on these suppliers involves risks, including reduced control over quality and delivery schedules. Any financial instability of our suppliers could result in our having to find new suppliers. We may experience delays in manufacturing and deliveries of our products and services to customers if we lose our sources or if supplies and services delivered from these sources are delayed, which could result in the loss of sales or customers.

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

The market for identity solutions is still developing. The evolution of this market may result in the development of different technologies and industry standards that are not compatible with our current solutions, products or technologies. Several organizations, such as the International Civil Aviation Organization, sets standards for travel documents that its member states then put into effect, and the National Institute for Standards and Testing, which is part of the U.S. Department of Commerce, set standards for biometrics to be used in identification and documentation. Although we believe that our biometric technologies comply with existing standards for finger, face and iris recognition, these standards may change and any standards adopted could prove disadvantageous to or incompatible with our business model and current or future solutions, products and services.

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

In the year ended December 31, 2008, we derived approximately 8% of our total revenues from international sales and our strategy is to expand our international operations. However, there is a risk that we may not be able to successfully market, sell and deliver our products in foreign countries.

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

regional economic or political conditions;

delays in or absolute prohibitions on exporting products resulting from export restrictions for certain products and technologies;

loss of, or delays in importing products, services and intellectual property developed abroad, resulting from unstable or fluctuating social, political or governmental conditions;

fluctuations in foreign currencies and the U.S. dollar;

loss of revenue, property (including intellectual property) and equipment from expropriation, nationalization, war, insurrection, terrorism, criminal acts and other political and social risks;

liabilities resulting from any unauthorized actions of our local partners, resellers or agents under the Foreign Corrupt Practices Act or local anti-corruption statutes;

risks of increases in taxes and other government fees; and

involuntary renegotiations of contracts with foreign governments.

We expect that we will have increased exposure to foreign currency fluctuations. For example during the year ended December 31, 2008, we recorded foreign currency translation losses of \$6.6 million, primarily related to goodwill and long-lived assets related to foreign acquisitions, in accumulated other comprehensive income. In addition, we have significant Japanese Yen denominated transactions with Japanese suppliers of hardware and consumables for the delivery to customers under certain contracts. In addition, we have exposure to fluctuations to the Euro, Canadian dollar and the Mexican Peso as a result of operations conducted in such countries, which could result in unexpected fluctuations to our results of operations, which could be material and adverse.

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

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

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

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

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

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

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

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

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

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

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

In addition, foreign laws treat the protection of proprietary rights differently from laws in the United States and may not protect our proprietary rights to the same extent as U.S. laws. The failure of foreign laws or judicial systems to adequately protect our proprietary rights or intellectual property, including intellectual property developed on our

behalf by foreign contractors or subcontractors may have a material adverse effect on our business, operations, financial results and stock price.

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

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

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

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

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

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

If we fail to recruit and retain skilled employees or employees with the necessary security clearances, we might not be able to perform under our government services contracts or win new business.

To be competitive, we must have employees who have advanced information technology and technical services skills and who work well with our customers in a government or defense-related environment. Often, these employees must have some of the highest security clearances in the United States. These employees are in great demand and are likely to remain a limited resource in the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees, our ability to maintain and grow our business could be negatively impacted. In addition, some of our government services contracts contain provisions requiring us to commit to staff a program with certain personnel the customer considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutions, the customer may terminate the contract, and we may not be able to recover certain incurred costs.

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

In connection with the Aston investment in our Company, Aston became the largest shareholder of L-1, currently owning approximately 8.8% of our outstanding common stock. As a result, Aston (together with its affiliate, L-1 Investment Partners LLC) have an influence on matters requiring approval by our shareholders,

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including the election of directors and most corporate actions, such as mergers and acquisitions. In addition, we have significant relationships with each of L-1 Investment Partners LLC and Aston including:

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

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

We have entered into certain transactions with Aston, L-1 Investment Partners and Mr. LaPenta, including a sublease of office space from L-1 Investment Partners, an agreement in principle to purchase a portfolio company of Aston at fair market value, and a private placement issuance of securities to Mr. LaPenta in connection with his participation in our \$120 million private placement to fund in part our acquisition of ID Systems business of Digimarc. See Note 4 to our Consolidated Financial Statements, Related Party Transactions for a more detailed description of these transactions.

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

Risks Related to Our Acquisition Strategy

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

Our operating philosophy is to let acquired businesses operate in autonomous manner subject to corporate oversight but integrating and rationalizing duplicative functions to achieve revenue and cost synergies. We may encounter substantial difficulties, costs and delays in integrating the operations recently acquired and future acquisitions such as:

exposure to unknown liabilities of acquired companies or assets;

higher than anticipated acquisition costs and expenses;

assumption of ongoing litigation matters that may be highly complex and involve significant time, cost and expense ;

potential conflicts between business cultures;

adverse changes in business focus perceived by third-party constituencies;

disruption of our ongoing business;

potential conflicts in distribution, marketing or other important relationships;

potential constraints of management resources;

failure to maximize our financial and strategic position by the successful incorporation of acquired technology;

failure to realize the potential of acquired technologies, complete product development, or properly obtain or secure appropriate protection of intellectual property rights; and

loss of key employees and/or the diversion of management's attention from other ongoing business concerns.

The geographic distance between acquired businesses and their respective offices and operations increases the risk that the integration will not be completed successfully or in a timely and cost-effective manner. We

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may not be successful in overcoming these risks or any other problems encountered in connection with the integration of the companies. The simultaneous integration of these acquisitions may place additional strain on our resources and increase the risk that our business may be adversely affected by the disruption caused by the acquisitions. Our strategy contemplates acquiring additional businesses, the integration of which may consume significant financial and managerial resources, and could have a severe negative impact on our business, financial condition and results of operations.

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

At December 31, 2008, goodwill, intangible assets and property and equipment of \$891.0 million, \$108.3 million and \$81.3 million, respectively and in 2008, we recorded impairment charges aggregating \$528.6 million for impairments of goodwill and long-lived assets, primarily related to our biometric businesses. Because goodwill represents a residual after the purchase price is allocated to the fair value of acquired assets and liabilities, it is difficult to quantify the factors that contribute to the recorded amounts and subsequent impairments, if any. Nevertheless, management believes that the following factors have contributed to the amount recorded:

technological development capabilities and intellectual capital;

expected significant growth in revenues and profits from the expanding market in identity solutions; and

expected synergies resulting from providing multi modal product offerings to existing customer base and to new customers of the combined company.

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

Subsequent to December 31, 2008 through February 25, 2009 our stock price has averaged \$6.67 per share compared \$6.24 per share for the 60 days prior to December 31, 2008. However during both periods the price has fluctuated significantly. If our stock price were to decrease and remain at that level for a sustained period of time we may be required to assess the carrying amount of goodwill and long-lived assets of our reporting units before our scheduled annual impairment test. If at that time the estimated fair values of our reporting units are less than their respective carrying amounts, we would need to determine whether our goodwill and long-lived assets would be impaired. Moreover, if economic conditions continue to deteriorate and capital markets conditions continue to adversely impact the valuation of enterprises, the estimated fair values of our reporting units could be adversely impacted, which could result in future impairments.

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

We expect that the acquisitions that we consummated in 2006, 2007 and 2008 as well as the acquisitions that we have made previously will enhance our leadership in the identity solutions industry through the combination of their respective technologies. However, the combination of such technologies might not meet the demands of the marketplace. If our technologies fail to meet such demand, customer acceptance of our biometric products could decline, which would have an adverse effect on our results of operations and financial condition. Further, we expect that the additions to our solutions offerings will extend our reach into

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our current markets and provide a critical component to our comprehensive offering for new markets in need of identity solutions. However, there can be no assurance that our current customers or customers in new markets will be receptive to these additional offerings. Further, we might not be able to market successfully our products and services to the customers of the companies we acquired. If our solutions offerings and services fail to meet the demands of this marketplace, our results of operations and financial condition could be adversely affected. There is also a risk that we will not achieve the anticipated benefits of the acquisitions as rapidly as, or to the extent, anticipated by financial or industry analysts, or that such analysts will not perceive the same benefits to the acquisitions as we do. If these risks materialize, our stock price could be adversely affected.

Item 1B. *Unresolved Staff Comments*

None

Item 2. *Properties*

We do not own any properties. The following describes our most significant leasing arrangements.

Our corporate headquarters comprises approximately 17,000 square feet of space in facilities located in Stamford, Connecticut. We sublease space from L-1 Investment Partners LLC. The sublease terminates on the earlier of the date that the Company's Chairman and Chief Executive Officer ceases employment with the Company or March 2010. We use this property for corporate, administrative, customer support and other general business needs. Information about our office leases is set forth below:

	Square Feet	Expire
Stamford, Connecticut	17,000	March 2010
Jersey City, New Jersey	18,000	July 2017
Arlington, Virginia	20,000	December 2012
Billerica, Massachusetts	90,000	April 2016(1)
Burlington, Massachusetts	60,000	October 2010(1)
Fort Wayne, Indiana	48,000	January 2010
Springfield, Illinois	15,000	June 2010
Bloomington, Minnesota	59,000	October 2014
Martinez, California	26,000	February 2011
Reston, Virginia	16,000	May 2012
Markham, Canada	15,000	November 2010
Oakville, Canada	8,000	January 2010
El Segundo, California	8,000	January 2011
Lacey, Washington	8,000	June 2010
Columbia, Maryland	7,000	December 2012
Nashville, Tennessee	7,000	July 2009
Chantilly, Virginia	24,000	May 2010
Carrollton, Georgia	5,000	December 2009

(1) Facilities to be consolidated in 2009.

We also lease sales and support offices in multiple locations throughout the United States and internationally.

While we believe that these facilities are adequate to meet our immediate needs, it may become necessary to secure additional space in the future to accommodate any future growth. We believe that such additional space will be available as needed in the future on commercially reasonable terms.

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Item 3. *Legal Proceedings*

Old Digimarc Litigation

In connection with the Company's August 2008 acquisition of Old Digimarc, which consisted of its Secure ID Business following the spin-off of its digital watermarking business, the Company assumed certain legal proceedings of Old Digimarc, renamed L-1 Secure Credentialing, Inc., as described below.

In 2004, three purported class action lawsuits were filed in the U.S. District Court for the District of Oregon against Old Digimarc and certain of its then-current and former directors and officers on behalf of purchasers of Old Digimarc's securities during the period April 17, 2002 to July 28, 2004. These lawsuits were later consolidated into one action for all purposes. The amended complaint, which sought unspecified damages, asserted claims under the federal securities laws relating to the restatement of Old Digimarc's financial statements for 2003 and the first two quarters of 2004 and alleged that Old Digimarc issued false and misleading financial statements and issued misleading public statements about its operations and prospects. On August 4, 2006, the court granted Old Digimarc's motion to dismiss the lawsuit with prejudice and entered judgment in Old Digimarc's favor. The plaintiffs appealed to the Ninth Circuit Court of Appeals. The appeal was fully briefed, and oral argument was held before a three-judge panel on August 26, 2008. The Ninth Circuit affirmed the dismissal on January 12, 2009.

On or about October 19, 2004, two purported shareholder derivative lawsuits were filed against certain of Old Digimarc's then-current officers and directors, naming Old Digimarc as a nominal defendant, in the Superior Court of the State of California for the County of San Luis Obispo. These lawsuits were consolidated into one action for all purposes on March 14, 2005. This suit claims that certain of the identified officers and directors breached their fiduciary duties to Old Digimarc's stockholders and to Old Digimarc. The complaint is derivative in nature and does not seek relief from Old Digimarc. Old Digimarc's then-current board of directors appointed an independent committee to investigate the claims asserted in this derivative lawsuit. On July 19, 2005, the court granted Old Digimarc's motion to dismiss these consolidated actions in favor of a shareholder derivative action to be filed by plaintiffs in the Circuit Court of the State of Oregon for the County of Washington. On August 25, 2005, the California plaintiffs filed two new derivative lawsuits in the United States District Court for the District of Oregon. On October 17, 2005, the defendants filed a motion to dismiss these complaints for lack of subject matter jurisdiction and failure to state a claim. In May of 2006, Old Digimarc's then-current board committee, after completing its investigation, concluded that pursuit of the allegations would not be in the best interests of Old Digimarc or its stockholders. On August 24, 2006, the court granted the defendants' motion and dismissed the lawsuit with prejudice. The plaintiffs appealed to the Ninth Circuit Court of Appeals. The appeal was fully briefed, and oral argument was held before a three-judge panel on August 26, 2008. On December 11, 2008, the Ninth Circuit upheld the district court's holding that there is no right of private action under Section 304 of Sarbanes-Oxley. However, they reversed the district court's holding that Old Digimarc should be re-aligned as a plaintiff, and remanded the case to the district court for further proceedings. Subsequently, the plaintiffs agreed to an order and stipulation of dismissal with prejudice, given that plaintiffs are no longer shareholders of Digimarc. On January 29, 2009 the Chief Judge signed and entered the order and the case was dismissed with prejudice.

Beginning in May 2001, a number of substantially identical class action complaints alleging violations of the federal securities laws were filed in the United States District Court for the Southern District of New York naming approximately 300 companies, including Old Digimarc, and their officers and directors and underwriters as defendants in connection with the initial public offerings of these companies. The complaints have since been consolidated into a single action, and a consolidated amended complaint was filed in April 2002. The amended complaint alleges, among other things, that the underwriters of Old Digimarc's initial public offering violated securities laws by failing to disclose certain alleged compensation arrangements in Old Digimarc's initial public offering registration statement and by engaging in manipulative practices to artificially inflate the price of Old

Digimarc's stock in the aftermarket subsequent to the initial public offering. Old Digimarc and certain of its officers and directors are named in the amended complaint pursuant to Section 11 of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 on the basis of an alleged failure to disclose the underwriters' alleged compensation arrangements and manipulative practices. The complaint seeks unspecified damages. The individual officer and director defendants entered into tolling agreements and, pursuant to a court order dated October 9, 2002, were dismissed from the

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litigation without prejudice. The plaintiffs have continued to litigate their claims primarily against the underwriter defendants. The district court directed that the litigation proceed within a number of focus cases rather than in all of the 309 cases that have now been consolidated. Old Digimarc was not one of these focus cases. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the district court's class certification decision for the six focus cases. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. The court issued an opinion and order on March 26, 2008, denying the motion to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. The class certification motion was withdrawn without prejudice on October 10, 2008.

On October 10, 2007, an Old Digimarc stockholder filed a lawsuit in the United States District Court for the Western District of Washington against several companies that acted as lead underwriters for the Old Digimarc initial public offering. The complaint, which also named Old Digimarc as a nominal defendant but did not assert any claims against Old Digimarc, asserted claims against the underwriters under Section 16(b) of the Securities Exchange Act of 1934 for recovery of alleged short-swing profits on trades of Old Digimarc stock. On February 28, 2008, an amended complaint was filed, with Old Digimarc still named only as a nominal defendant. Similar complaints have been filed by this same plaintiff against a number of other issuers in connection with their initial public offerings, and the factual allegations are closely related to the allegations in the litigation pending in the United States District Court for the Southern District of New York which is described above in this Form 10-K. On July 25, 2008, Old Digimarc joined with 29 other issuers to file the Issuer Defendants' Joint Motion to Dismiss. On that same date, the Underwriter Defendants also filed a Joint Motion to Dismiss. Plaintiff filed her oppositions to the motions on September 8, 2008. Replies in support of the motions were filed on or about October 23, 2008, and oral arguments were heard on January 16, 2009. The Judge has stayed discovery until a ruling is rendered on all motions to dismiss.

Other

In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company records a liability for any claim, demand, litigation and other contingency when management believes that it is both probable that a liability has been incurred and can reasonably estimate the amount of the potential loss. Based on current information and belief, the Company believes it has adequate provisions for any such matters. The Company reviews these provisions quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. However, because of the inherent uncertainties of litigation (including the Old Digimarc litigation described above) the ultimate outcome of litigation cannot be accurately predicted by the Company; it is therefore possible that the consolidated financial position, results of operations or cash flows of the Company could be materially adversely affected in any particular period by the unfavorable resolution of one or more of these matters and contingencies.

LG Settlement

On May 1, 2008, the Company settled its breach of contract and intellectual property litigation with LG Electronics USA, Inc. (LG USA) and LG Electronics, Inc. (LG) which was based on a historical dispute with Iridian Technologies Inc. (Iridian), a wholly owned subsidiary of the Company acquired in August 2006. The settlement resolved all historical issues and disputes among the parties and dismissed with prejudice the litigation in the U.S. District Court for the District of New Jersey. Concurrently with the settlement, LG and LG USA entered into a new license agreement with Iridian to license Iridian's proprietary 2pi iris recognition software, and LG USA entered into a separate agreement to obtain certain limited telephonic assistance for a period of twelve months from Iridian and L-1. In addition, Iridian agreed to assign to LG USA its IRIS ACCESS trademark which was determined to have minimal

value to the Company.

Item 4. *Submission of Matters to a Vote of Security Holders*

None.

Table of Contents**PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market for Our Common Stock*

Our common stock is traded on the New York Stock Exchange under the symbol ID. As of February 24, 2009, there were 813 holders of record of our common stock.

The quarterly high and low sales prices, as reported by the New York Stock Exchange or NASDAQ, as applicable, of our common stock during 2008 and 2007 were as follows:

Quarter	2008		2007	
	High	Low	High	Low
First Quarter	\$ 18.54	\$ 10.66	\$ 17.12	\$ 14.15
Second Quarter	\$ 16.02	\$ 12.77	\$ 21.87	\$ 16.31
Third Quarter	\$ 17.22	\$ 11.66	\$ 20.95	\$ 13.75
Fourth Quarter	\$ 15.28	\$ 4.33	\$ 19.54	\$ 16.50

Dividend Policy

We paid no dividends in 2008 or 2007. We presently intend to retain our cash for use in the operation and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, we are prohibited from paying dividends pursuant to our revolving credit agreement.

Recent Sales of Unregistered Securities

None.

Repurchases of Common Stock

None.

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Stock Performance Chart

The following performance chart assumes an investment of \$100 on December 31, 2003 and compares the change through December 31, 2008 in the market price for our common stock with the Russell 2000 Index, the NASDAQ Composite Index, and a peer group identified by the Company (the Selected Peer Group Index). The Selected Peer Group Index was selected to include publicly-traded companies engaging in one or more of the Company's lines of business.

The Selected Peer Group Index is weighted according to the respective issuer's stock market capitalization and is comprised of the following companies: CACI International, Inc., Cogent, Inc., LaserCard Corporation, AcityIdentity Corporation, Bio-Key International and ImageWare Systems, Inc.

The Selected Peer Group replaces the previous peer group, which consisted of Cogent, Inc. LaserCard Corporation, ImageWare Systems, Inc, which continue to be included in the Selected Peer Group, and Saflink Corporation, Digimarc Corporation and Bioscript, Inc. , which are no longer public companies.

The comparisons in the graph below are based on historical data and are not intended to forecast the possible future performance of our common stock.

Stock Performance Chart

Item 6. *Selected Financial Data*

The financial data set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements as of December 31, 2008 and 2007 and for each of the three years in the period ended December 31, 2008 and the related notes included elsewhere in this Annual Report on Form 10-K. The historical results of operations are not necessarily indicative of future results.

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	Years Ended December 31,				
	2008⁽¹⁾⁽³⁾	2007⁽¹⁾⁽²⁾⁽³⁾	2006⁽¹⁾⁽³⁾	2005⁽³⁾	2004⁽³⁾
	(in thousands, except per share data)				
Statement of Operations Data:					
Revenues	\$ 562,872	\$ 389,507	\$ 164,386	\$ 66,224	\$ 67,466
Cost of revenues	394,869	268,431	113,529	47,568	48,804
Gross profit	168,003	121,076	50,857	18,656	18,662
Operating expenses:					
Sales and marketing	37,055	27,719	14,430	7,832	6,925
Research and development	25,244	18,482	11,589	4,618	3,837
General and administrative	86,721	62,279	29,953	12,068	9,779
Asset impairments and merger related expenses ⁽²⁾	529,683	5,000	22,767		2,000
Amortization of acquired intangible assets	2,996	2,519	401	681	153
Total operating expenses	681,699	115,999	79,140	25,199	22,694
Operating income (loss)	(513,696)	5,077	(28,283)	(6,543)	(4,032)
Interest income	288	407	1,770	362	162
Interest expense	(23,346)	(11,311)	(1,598)	(159)	(1,933)
Other (expense) income, net	(260)	(508)	(122)	369	(235)
Loss before income taxes	(537,014)	(6,335)	(28,233)	(5,971)	(6,038)
Benefit (provision) for income taxes	(11,690)	24,001	(2,804)	(1,382)	(959)
Net income (loss)	\$ (548,704)	\$ 17,666	\$ (31,037)	\$ (7,353)	\$ (6,997)
Net income (loss) per share:					
Basic	\$ (7.08)	\$ 0.25	\$ (0.71)	\$ (0.37)	\$ (0.45)
Diluted	\$ (7.08)	\$ 0.24	\$ (0.71)	\$ (0.37)	\$ (0.45)
Weighted average common shares outstanding:					
Basic	77,518	71,663	43,823	19,630	15,466
Diluted	77,518	72,385	43,823	19,630	15,466
Balance Sheet Data:					
Current assets, net of current liabilities	\$ 24,371	\$ 40,869	\$ 11,658	\$ 77,482	\$ 15,233
Total assets	1,317,902	1,445,645	1,227,225	294,108	175,629
Long-term debt, including current maturities	467,714	259,000	80,000	215	149

Shareholders equity	697,338	1,084,717	1,067,085	274,660	154,790
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- (1) The results reflect the adoption of SFAS No. 123(R) on January 1, 2006.
- (2) See Note 14 to the consolidated financial statements.
- (3) The results have been materially impacted by acquisitions. See Note 13 to the consolidated financial statements.

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Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Introduction

The following discussion and analysis should be read in conjunction with our consolidated financial statements and the accompanying notes thereto included in Item 8. Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

Business Overview

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

The Company's identity solutions include products and related services, comprising of hardware, components, consumables and software, as well as maintenance, consulting and training services integral to the sale of hardware and software. In addition, the Company provides fingerprinting enrollment services and government consulting, training, security, technology development and information technology services. A customer, depending on its needs, may order solutions that include hardware, equipment, consumables, software products or services or combine hardware products, consumables, equipment, software products and services to create a multiple element arrangement.

The market for identity solutions has continued to develop. In particular, consumers of identity protection solutions are demanding end-to-end solutions with increased functionality that can solve their spectrum of needs across the identity life cycle. Our objective is to meet those growing needs by continuing to broaden our product and solution offerings to meet our customer needs, leveraging our existing customer base to provide additional products and services, expanding our customer base both domestically and abroad, and augmenting our competitive position through strategic acquisitions.

We evaluate our business primarily through financial metrics such as revenues, operating income (loss) and earnings before interest-net, income taxes, depreciation and amortization, asset impairments and in-process research and development charges, and stock-based compensation expense (Adjusted EBITDA), and free cash flow.

Our revenues increased to \$562.9 million for the year ended December 31, 2008 from \$389.5 million for the year ended December 31, 2007. Our net loss for the year was \$548.7 million compared to net income of \$17.7 million in 2007. The 2008 loss includes impairments of long-lived assets of \$98.6 million and goodwill of \$430.0 million, as well as merger related expenses of \$1.1 million. In addition, the 2008 results reflect an increase in the deferred tax valuation allowance of \$48.0 million and an income tax benefit of \$37.4 million for the tax benefit of the impairment of long-lived assets. Also in 2008 we incurred interest expense of \$23.3 million compared to interest expense of \$11.3 million in 2007, as a result of increased borrowings to fund our acquisition of Old Digimarc. The 2007 results include an income tax benefit of \$21.8 million resulting from the reduction of a portion of the deferred tax asset valuation allowance and intangible asset impairments of \$5.0 million. Our Adjusted EBITDA increased to \$82.1 million from \$60.1 million in 2007.

Sources of Revenues

Our Secure Credentialing Division which prior to December 15, 2005 comprised our sole business, generates revenues from the sales of solutions consisting of bundled proprietary software with commercial off-the-shelf equipment and related maintenance and services, the sale of secure printing solutions and related consumables, and the design, customization and installation of secure credential issuance systems which

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generate revenues as the credentials are issued by the customer. The division also generates revenues from solutions using biometric technologies of other divisions. The division is included in our Identity Solutions segment.

Our Biometrics division, also included in our Identity Solutions segment, generates revenues from the sale of biometric solutions incorporating fingerprint, facial, skin and iris biometrics and system components necessary for the biometric capture and knowledge discovery and the sale of biometrics solutions using proprietary multi-biometric capture devices bundled together with our proprietary software and other biometric technologies, as well as sales of licenses and software. The division's offerings include Live Scan and mobile systems and services for biometric capture and identification, systems and biometric solutions that include modules and software for biometric matching and verification, and related maintenance services. Revenues are generated by sales of hardware, software and maintenance and other services.

Our Enterprise Access division provides solutions that include biometrics-based readers used to secure buildings and restricted areas. The division is included in our Identity Solution segment.

Our Enrollment Services division, included in our Services segment, generates revenues through the sales of enrollment and background screening products and fingerprinting services.

We provide government consulting services through SpecTal, McClendon and ACI. SpecTal provides comprehensive security consulting services to U.S. government intelligence agencies. McClendon provides technical and professional services to the U.S. intelligence and military communities. ACI provides information technology and network security solutions, and system engineering and development services for the U.S. intelligence and military communities. All these businesses are included in the Services segment.

We market our solutions and services primarily to U.S. and foreign, federal, state and local government agencies and law enforcement agencies. We also are working to expand the use of our solutions in commercial markets, particularly financial services, transportation and healthcare. In a typical contract with a government entity for an identity solution, we design the system, supply and ins