

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

FORM 10-KSB

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

For the fiscal year ended **December 31, 2004**, or

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

For the transition period from _____ to _____

Commission file number 0-24431

INKSURE TECHNOLOGIES INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

84-1417774
(I.R.S. Employer Identification No.)

1770 N.W. 64th Street Fort Lauderdale, FL 433309
(Address of principal executive offices)
(Zip Code)

(954) 772-8507
(Registrant's telephone number, including area code)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
----------------------------	------------------------------------------------------

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value \$0.01 per share

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, as amended, 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 Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is an accelerated filer (as defined by Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, based on the average bid and asked price of such common equity of \$1.35 per share, as of March 30, 2005 was \$11,501,000.

At March 30, 2005, 15,011,579 shares of the Registrant's common stock, par value \$0.01 per share, were outstanding.

Documents Incorporated By Reference

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-KSB: certain information required in Part III of this Annual Report on Form 10-KSB is incorporated from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on July 7, 2005.

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This Annual Report on Form 10-KSB contains statements which constitute forward-looking statements. These statements appear in a number of places in this Form 10-KSB and include statements regarding the intent, belief or current expectations of InkSure Technologies Inc. (together with our subsidiaries, referred to in this report as "we", "us" and "our") with respect to (i) our financing plans, (ii) trends affecting our financial condition or results of operations, (iii) the impact of competition, and (iv) the expansion of certain operations. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that the actual results may differ materially from those in the forward-looking statements as a result of various factors. The information contained in this Form 10-KSB, including, without limitation, the information under "Risk Factors," "Management's Discussion and Analysis or Plan of Operations" and "Description of Business," identifies important factors that could cause or contribute to such differences. See "Description of Business-Risk Factors-All forward looking statements should be read with caution."

PART I

Item 1. Description of Business

General

We develop, market and sell customized authentication systems designed to enhance the security of documents and branded products and to meet the growing demand for protection from counterfeiting and diversion. In this context, "counterfeit items" are imitation items that are offered as genuine with the intent to deceive or defraud. "Diversion" (also termed "parallel trading" or "gray market commerce") is the selling of goods (often genuine goods) in a geographic market where both wholesale and retail prices are high while falsely purchasing them for another market where wholesale prices are lower, thus taking advantage of the price difference between the two markets. We operate within the "authentication industry," an industry that includes a variety of firms providing technologies and services designed to prevent the counterfeiting and diversion of valuable documents and products. The United Kingdom's Counterfeit Intelligence Bureau estimates that losses by companies and governments from counterfeiting and diversion range from \$300 billion to as high as \$1 trillion annually. Security Solution Consultancy reported that their research had revealed a market of approximately \$25 billion for document and product protection – a mere 5% to 6% of the total estimated losses due to counterfeiting.

Our products are based on two principal technologies – customizable security inks that are suitable for almost every type of digital and impact printing on a wide variety of surfaces or substrates (e.g., paper documents, plastic identification cards, packaging materials and labels), and a sophisticated "full-spectrum" reader that uses proprietary software to quickly analyze marks printed with our specialty inks. Our security solutions are considered to be covert because our specialty inks are indistinguishable from standard non-security inks and are easily incorporated into variable and fully personalized data on documents, products, product labels, packaging, and designs.

Our ink-based products provide a customized solution by creating a unique chemical code for each product line or document batch that can only be authenticated by our reader. We have applied for three patents covering various methods of marking documents for the purpose of authentication and three patents related to the radio frequency ("RF") technology being developed by us. We are also seeking protection under the Patent Cooperation Treaty. See "Description of Business — Patents and Proprietary Technology."

We are currently working on the development of next-generation RF technology that is being designed to enable low-cost tagging of items. This RF technology is being designed to permit "no line of sight" identification and will be suitable for a variety of applications, including authentication, supply chain management and traceability, proof of ownership, and data carrying transactions. If successfully developed, we believe that such technology could eventually replace the familiar barcode technology and other electronic article surveillance solutions currently available. See "Description of Business — Research and Development" and "Description of Business — Products."

Corporate History

We were incorporated under the laws of the state of Nevada on April 22, 1997 under the name "Lil Marc, Inc." We were incorporated as a development stage enterprise in the baby products industry to develop, manufacture and market the "Lil Marc", a plastic toilet training device for young boys. Pursuant to an Agreement and Plan of merger, dated as of July 5, 2002, a wholly owned subsidiary of Lil Marc, Inc., LILM Acquisition Corp., a Delaware

corporation, merged with and into InkSure Technologies Inc., a Delaware corporation, or InkSure Delaware. InkSure Delaware was the surviving corporation in the merger and became a wholly owned subsidiary of Lil Marc, Inc.

Pursuant to the merger agreement, each share of InkSure Delaware common stock outstanding immediately prior to the effective time of the merger was converted into the right to receive one share of our common stock. The total number of issued and outstanding shares of our common stock was 11,982,166 immediately after giving effect to the merger and a reverse stock split that was consummated on October 23, 2002.

As a result of the merger, the former stockholders of InkSure Delaware held, immediately after the merger, approximately 88.0% of the issued and outstanding shares of our common stock; the remaining 12.0% of the issued and outstanding shares of our common stock were held by the stockholders who held our common stock immediately before the merger became effective. On a fully diluted basis, the former holders of securities of InkSure Delaware held, immediately after the merger, approximately 90.5% of the shares of Lil Marc, Inc. common stock.

Pursuant to the merger agreement, all outstanding options and warrants to purchase shares of InkSure Delaware common stock were exchanged or converted into options and warrants to purchase shares of our common stock on the same terms and conditions as were in effect prior to the effective time of the merger. The options and warrants issued with respect to such exchanged options and warrants are exercisable for such number of shares of our common stock equal to the number of whole shares of InkSure Delaware common stock subject to each such exchanged option or warrant immediately prior to the effective time of the Merger. The per share exercise price of options and warrants issued by us with respect to the exchanged options and warrants remained unchanged from the per share exercise price of the exchanged options and warrants. Upon consummation of the merger, our board of directors and management resigned and were replaced by InkSure Delaware's board of directors and management, and we began to carry on InkSure Delaware's business activities.

On October 28, 2002, we also filed an amendment of its Articles of Incorporation to, among other things, change our name from "Lil Marc, Inc." to "InkSure Technologies Inc." Effective on October 30, 2002, the OTC Bulletin Board stock symbol for our common stock was changed from "LILM" to "INKS." We conduct our operations with and through our direct and indirect subsidiaries, InkSure Inc., a Delaware corporation formed in March 2000, IST Operating Inc., a Delaware corporation formed in May 2000 (formerly known as InkSure Technologies Inc. and referred to throughout this prospectus as InkSure Delaware), and InkSure Ltd., which was formed in December 1995 under the laws of Israel. We also have a subsidiary, InkSure RF Inc., a Delaware corporation formed in March 2000, which does not currently conduct any operations.

On July 8, 2003, we reincorporated as a Delaware corporation by merging with and into a newly formed, wholly owned subsidiary.

Market Opportunity

In general, brand owners that are victims of counterfeiting do not publicize their losses, nor do they publish their expenditures related to controlling the problem. In a survey conducted by the International Anti Counterfeiting Coalition in the year 2000, Fortune 500 companies reported that they spend an average of between \$2 - \$4 million per year to combat counterfeiting and some reported spending up to \$10 million.

There are a growing number of companies, banks, organizations and other entities that recognize, acknowledge and are able to quantify or estimate the scope of their counterfeiting problem, and are willing to invest in security solutions to combat them, and are potential customers for our products and services. We believe that the number of entities willing to invest in security solutions will grow as the magnitude of the problem continues to grow.

Once the end user has decided to implement a security plan and introduce new security features or technology, there are various criteria by which the selected technology will be measured. We believe that our products provide a high level of security and flexibility, while remaining cost-effective. See "Business — Competition."

Traditional Authentication Technologies

Technologies used to authenticate and protect products and documents can be divided into two general categories: overt and covert. Overt technologies are visible to the naked eye and are typically used by the consumer

to identify the product or document as genuine. Holograms, intricate graphic design and color changing inks are among the most common overt security features used in both products and documents.

Covert technologies are invisible and, historically, designed to be used by investigators, customs officials and other law enforcement agents to verify authenticity. There are numerous covert technologies currently in use in the market, including specialty substrates (e.g., papers with security fibers or magnetic threads) and in-product marking (e.g., tracers placed in fields). However, one of the most frequently used features for product and document security is specialty ink for the obvious reason that ink is the main consumable for printing on documents, packaging and labels.

The rapid rise in counterfeiting and diversion, however, has led to the need for increasingly sophisticated security techniques for companies and organizations to mark and protect high-value products and documents. Accordingly, the market for countermeasures to counterfeiting and diversion is characterized by a constant inflow and introduction of new authentication techniques as a result of rapid technological progress. Complex new technologies that are difficult for counterfeiters to circumvent are in demand.

Typically, currency and high value documents incorporate more than one security feature (high denominations of United States currency have up to 20 security features). Brand owners are increasingly adopting this same strategy and are using several security features simultaneously to make reproducing the document or packaging increasingly difficult and costly for the counterfeiter. In addition, layered security features provide continued protection for products in the market even if one of the features is compromised.

InkSure Solutions

We believe that our authentication technology can be distinguished from other authentication solutions, such as visible and invisible ultra-violet marks, fluorescent inks, watermarks and fibers, optically variable inks, and holograms, currently offered by our competitors because our solutions offer a high level of security and flexibility while remaining cost-effective. Due to the nature of our technology, which is based upon multi-disciplinary technologies, including chemistry, printing, electro-optics and software, the solution is customized for each customer.

High Level of Security. Each security ink manufactured by us has a unique "signature" that is comprised of a variety of factors, including the amounts and the unique properties of the chemicals included in the ink, the type of ink, the ink color, the printing method and the substrate. Since the reader utilized by our solution reads a "full-spectrum" rather than sampling a specific point or points in a signature, a counterfeit item would have to replicate an entire unique signature – i.e., every variable upon which the signature depends – rather than merely replicating certain portions of the signature. In addition, because a coded ink's unique signature is comprised of various factors, with numerous possible permutations thereof, our inks are extremely difficult to reverse engineer. We believe that holograms, color changing inks and other more common overt security features are more easily replicated than our products. In addition, to thwart any counterfeiting attempts that successfully replicated a unique signature, we could alter any of the variables upon which a signature is comprised of and create an entirely new unique signature without significant expense.

Flexibility. Our solution is highly flexible, applicable to almost every standard ink or toner used by standard printing devices. In addition, we believe that our specialty inks are suitable for printing on any type of surface or substrate for which digital and impact printing is suitable. Our readers are available either as hand-held devices designed for quick and accurate field inspection, or as a technology that can be integrated in existing terminals and readers (e.g., ATMs, MICR readers and access control systems) to allow automated identification and verification in mass quantities. According to the client's security needs, several different coded inks can be incorporated in a single product or document and the corresponding reader can be programmed to authenticate and verify each of the different codes – and indicate which code was verified.

Cost Effective. Our technology provides a cost-effective solution to prevent counterfeiting and diversion because of our positive cost-performance ratio. In addition, because our readers are designed to detect even trace amounts of the specific chemical markers, our solutions provide a relatively high level of security, including through the use of chemicals, such as tagging agents, at reasonable incremental costs to our customers.

Marketing and Business Strategy

Our business strategy utilizes a "razor / razor blade" approach with respect to the sale of our readers and inks. We regard the selling of our proprietary readers as infrastructure similar to a hand held razor, while our specialty inks may be considered analogous to the blades of a razor that represent continuing sales. The potential anti-counterfeit market segments for our products can generally be divided into two major groups: documents (e.g., bank notes, checks, transportation and event tickets, pre-paid telephone cards, identification cards, and passports) and brand products (e.g., pharmaceuticals, software, automotive, toys, and apparel). We have entered into strategic relationships with Sun Chemicals Group B.V. and with Merck KGaA, to leverage the development, distribution and co-marketing of their security products.

We believe that the most receptive market segment for our authentication applications – the middle and high-end of the security market – includes customers who have experienced significant problems with counterfeiting and have been unable to reduce or eliminate the effects of counterfeiting through the authentication solutions that are more easily circumvented than our solutions. In addition, we have targeted customers that need a covert security feature that is extremely difficult to reverse engineer.

More specifically, we have identified and targeted the following market segments:

- *Packaging.* We believe our product may facilitate brand protection through use in 1st level (on the product), 2nd level (on the packaging) and 3rd level packaging (through the use of labels, stickers, etc.). We believe our products are suitable for a number of industries, including consumer goods (e.g., apparel, cosmetics, fragrances, software, tobacco), pharmaceuticals, and industries that rely upon component parts (e.g., automotive, computer hardware).
- *Games and Entertainment.* Tickets and wrist bands for major sporting events and entertainment venues can be printed using our coded inks and authenticated at the entrance using either hand-held or stationary readers. Similarly, lottery tickets and gaming chips are subject to counterfeiting. Lottery tickets and gaming chips may be authenticated at the time of submission for payment.
- *Transportation.* Both national and local transportation authorities issue travel passes, season tickets and single-use tickets, all of which are subject to counterfeiting.
- *Financial Documents.* Historically checks and other financial documents have incorporated security features in the substrate or the pre-printed form, all in an effort to protect the fixed and variable data imprinted on the document. With our technology, both fixed and variable data can now be protected directly.
- *Government Identity Documents.* We believe that our ability to mark toners, inkjet ink and thermal transfer ribbons and therefore provide authentication capabilities to the variable data on government identity documents such as passports, visas, drivers licenses, ID cards, birth certificates, and motor vehicle registrations is unique. We view these market segments as requiring a long-term marketing and selling process given the typical government bid process and cycles for initiating new features, as well as government cost constraints.
- *Retail Vouchers and Gift Certificates.* Retail establishments currently use printed vouchers and gift certificates for increased sales. Certificates of Authenticity, which are printed documents that accompany a wide variety of retail goods ranging from software products to luxury goods are also an area of opportunity.
- *Tax Stamps.* Government issued tax stamps for a variety of taxed items such as tobacco, wine, alcohol and export tax stamps offer opportunities for our authentication technology.

We have focused the bulk of our initial efforts on market segments where we have already achieved market penetration in actual sales and where we believe sales potential is highest – packaging, financial documents, entertainment (i.e., ticketing) and transportation. As a result of this focused strategy, we have increased awareness of our products in these segments, established a presence in targeted markets throughout the world, and formed strategic alliances with companies that provide access to specific markets. See "Business — Sales and Marketing."

Sales and Marketing

Initially, we relied solely on intermediaries to market and distribute our products and services. However, we currently sell our products and services through a combination of our own sales personnel, strategic alliances and licenses with intermediaries. To date, we have established key strategic alliances or valuable relationships with end-users.

We had revenues this year pursuant to several orders received from MTM Guvenlik ve Holografik Kart Sistemleri A.S., a corporation incorporated under the laws of Turkey. Pursuant to these orders, MTM Guvenlik purchases readers and ink for use in hologram-related products. Revenues from this agreement were \$237,000 for the fiscal year ended December 31, 2004, representing approximately 25% of our revenues for that year.

In March 2004 and August 2004 we entered into two sales agreements to supply our authentication solutions to two separate customers in North America for brand protection projects. Each project involves the protection of millions of items using our coding solutions and handheld authentication readers, as well as our quality assurance tools, which are used to ensure that our inks are applied according to specifications. Revenues from these two agreements were \$616,000 for the fiscal year ended December 31, 2004, representing approximately 65% of our revenues for that year.

On June 9, 2003 we entered into a strategic marketing alliance with Sun Chemical Group B.V., the world's largest manufacturer of printing inks. Under such alliance, Sun Chemical will work with us to offer machine-readable ink-based brand and document authentication solutions under the SunSure™ brand name. This agreement is terminable by either party on 180 days notice, which such termination becoming effective on April 1, 2005.

Although we intend to continue marketing our products and services through licensees and strategic alliances, we believe that expanding our customer base through our direct sales personnel and maintaining a direct relationship with the end user are necessary elements to achieving deep market penetration.

Products

We have created "Solution Packages" designed to meet various market needs. These packages rely primarily on our core technology, best described as "line of sight authentication" (i.e. electro-optical detection and analysis of organic and inorganic materials). The micro-processing unit within the readers uses a proprietary algorithm to authenticate genuine codes, as well as differentiate between various codes.

We have designed several generic readers that provide different levels of security for the various target applications. For specific projects, due to the flexibility upon which the technology is built, we customize the generic readers to fit customer needs according to size and speed. Our current line of products, which support our customizable solutions, include the following:

- **SignaSure™ – Advanced Authentication Readers for Smart Protection**

We believe that our new SignaSure™ series features advanced readers for fast, on-the-spot authentication of sensitive documents and branded products. The SignaSure™ readers are equipped with technology to provide users with maximum value by combining high security, exceptional functionality and cost effective solutions. The readers utilize proprietary algorithms and unique electro-optical techniques to authenticate covert SmartInk™ codes, which are created by mixing special chemical markers (taggants) into commercial inks, coatings and other media, and applying them, using standard printing processes, onto documents, tickets, product packaging and labels.

- **TranSure™ – Automatic Anti-Counterfeiting Public & Mass Transit Tickets**

We believe that our high-speed and automated TranSure™ Security Tickets system improves travelers' satisfaction, enhances security, curbs revenue loss and provides new earning streams. This tickets system has numerous applications such as Mass Transit (bus, rail and tram) System Entry, Travel and Flight Tickets, Automatic Fare Collection (AFC) Systems and Access Control Gate (ACG) Systems.

We have developed an advanced automatic secure admission tickets and passes system for public transportation and mass-transit systems to prevent the loss of income caused by counterfeit tickets. This system

contains features such as invisible coded ink. Our electro-optic detector can only decode these invisible features. Our unique security tickets system is highly flexible and customizable and therefore, can protect all types of tickets: paper cards, PVC, PET, Teslin, magnetic cards, smart cards, contactless smart cards, etc. Our machine-readable encoded tickets ensure maximum security and are processed in fractions of a second, which allows mass-quantity processing and on spot processing (such as at the point-of-entrance to a terminal).

- **SortSure™ – In-Line Verification for High-Speed Processing, Quality Control and Audit Function**

Our SortSure™ readers provide high-speed authentication in mass quantities. The embedded OEM kits enable seamless integration within existing equipment, whether backroom processing units, printing presses or inspection systems in distribution/return centers.

The readers utilize proprietary technology and unique electro-optical techniques to authenticate covert SmartInk™ codes.

- **SmartInk™ – Machine Readable Authentication Codes for Advanced Security**

Our SmartInk™ codes are secure encoded inks and coatings that provide authentication solutions ranging from a definitive "yes/no" verification to multi functional systems that allow for item identification, track & trace functionality, real-time encoding and debiting applications. SmartInk™ codes are created by mixing special chemical markers (taggants) into commercial inks, coatings and other media, and applying them, using any standard printing process, onto documents, tickets, product packaging and labels. All SmartInk™ marker/carrier mixtures are allocated with covert signatures, that, while being completely invisible and protected from reverse-engineering attempts, are easily detected by our line of readers, the handheld field verification SignaSure™ readers, the automatic TranSure™ reader or the high speed SortSure™ validator.

- **HoloSure™ – Combining Covert & Overt Security: A Multi-Tier Protection**

The HoloSure™, Machine-Readable Hologram System consists of a Holographic image and a machine readable, coding. The HoloSure™ system combines the benefits of both systems into one feature that contains multiple levels of security.

The machine-readable element is a unique fingerprint signature of a highly secure code, incorporated in the hologram during standard production. The combination of this with an advanced decoding system, and processing multiple and changeable parameters provides a high level of protection.

We plan to develop products that permit high volume tagging and authentication without requiring a line of sight. See "Description of Business — Research and Development."

Competition

We are aware of other technologies, both covert and overt surface marking techniques, requiring decoding implements or analytical methods to reveal relevant information. These technologies are offered by other companies for the same anti-counterfeiting and anti-diversion purposes that we market our products. Our competitors, many of whom have greater financial resources than us, include:

- Technology providers, that typically offer a specific range of security solutions.
- Security printers, which are generally well established companies whose core business is printing. Security printing tends to be segregated from the bulk of the printing industry, implementing fundamentally the same technologies as those generally used by the printing industry but with specific 'twists' that are more complex, difficult to access or expensive to use.
- Systems Integrators, which have often evolved from other sectors in the printing industry, mainly security print manufacturers, technology providers or packaging and label manufacturers. These companies offer a wide range of security solutions, enabling them to offer a complete suite tailored to the customer's specific needs.

- Security consultancy groups, which offer a range of technologies from several technology providers and tailor a specific solution to end-customers, based on a preliminary process involving risk analysis and characterization of a comprehensive organizational security program.

Competition in our markets is based upon price, service, quality, reliability and the ability to offer secure transaction products and services with the flexibility to meet a customer's particular needs. We believe our technology provides a unique and cost-effective solution that has certain common competitive advantages over other technologies. However, even technologies that are not as secure or reliable as our products may be competitive if they are marketed effectively and may also compete on the basis of other criteria, such as price. We believe that prospective customers typically consider the following criteria when choosing a security technology:

- Level of security (e.g., multi-layer or single layer solution, covert, overt).
- Ability to support or be integrated with existing production, logistical processes and equipment.
- Ease of utilization/verification.
- Ability to extend the use for various organizational uses (e.g., alteration, simulation, counterfeiting, diversion, supply chain management).
- Safety and durability (i.e., ability to withstand environmental factors such as temperature, humidity, sunlight).
- Consistency and integrity of solution.
- Need for protection of variable vs. fixed data.
- Flexibility of code location (e.g., location on package, on product, on different substrates).
- In the case of overt features, attractiveness to consumer (i.e., added marketing value).
- Conclusiveness (i.e., Can the technology provide conclusive evidence of counterfeiting-).

Strong competitive pricing pressures exist, particularly with respect to products whose customers seek to obtain volume discounts and economies of scale. In addition, alternative goods or services, such as those involving electronic commerce, could replace printed documents and thereby also adversely affect demand for our products.

Research and Development

The technology and know-how upon which our products are based are subject to continued development of materials and processes to meet the demands of new applications and increased competition. We conduct most of our research and development activities at our facility in Rehovot, Israel. We believe our future success depends upon our ability to identify the requirements for future products and product enhancements, and to define, implement and successfully develop the technologies, including, without limitation, our next generation RF technology, needed to deploy those products and product enhancements.

We pursue a process-oriented strategy in which it conducts efforts aimed at developing new or enhanced classes of products and services. As part of this strategy, we work closely with current and potential customers, distributors and other members of the industry to identify market needs and define appropriate product specifications. Our research and development expenditures totaled approximately \$1,184,000 and \$775,000 for fiscal years 2003 and 2004, respectively.

Manufacturing and Production

The principal raw materials used by us for the manufacturing of our specialty inks include trace amounts of various chemicals and inks suitable for various printing methods. We believe that there are many sources for both these chemicals and the printing inks, which we currently purchase from major suppliers in Europe. Some of these chemicals, however, are considered rare, with prices in excess of \$20,000 per pound for certain chemicals. We do not believe that we will have difficulty in continuing to procure these chemicals and printing inks given the number of suppliers, including, without limitation, suppliers located in the United States, Europe and Japan, from whom they

can be procured. We currently subcontract the manufacturing of our specialty inks to various ink suppliers, who incorporate chemicals provided by us into the inks. To maintain the integrity and security of our specialty inks, we do not disclose the precise chemical ingredients to these ink suppliers.

The principal raw materials used by us for the manufacturing of our readers include electronic components, optic components, plastics and other raw materials. We believe that these materials are in good supply and are available from multiple sources. We currently utilize subcontractors for the manufacturing of our readers.

Patents and Proprietary Technology

Although our policy is to file patent applications to protect technology, inventions and improvements that are important to the development of our business, and although we will continue to seek the supplemental protection afforded by patents, we generally consider protection of our products, processes and materials to be more dependent upon proprietary knowledge, know-how and rapid assimilation of innovations than patent protection. We have applied for three patents covering various methods of marking documents for the purpose of authentication and three patents related to the RF technology being developed by us. We are also seeking protection under the Patent Cooperation Treaty. Recently one of our patent applications related to our RF technology was approved and a patent was issued for such technology in the United States. In addition, the patent application for such technology was approved in the European Union. We are now seeking additional patent protection for such technology in certain countries in Europe.

We require our employees, consultants and advisors to execute confidentiality agreements upon the commencement of any employment or consulting relationship with us. Each agreement provides that all confidential information developed or made known to the individual during the course of the relationship will be kept confidential and not disclosed to third parties except in specified circumstances. In the case of employees, the agreements provide that all inventions conceived by an individual will be the exclusive property of us, other than inventions unrelated to our business and developed entirely on the employee's own time. There can be no assurance, however, that these agreements will provide adequate protection or remedies for misappropriation of our trade secrets in the event of unauthorized use or disclosure of such information or that an independent third party will not develop functionally equivalent technology.

Our patent position is uncertain and may involve complex legal and factual issues. Consequently, we do not know whether any of our patent applications will result in the issuance of any patents, or whether patents, if issued, will provide significant proprietary protection or will not be circumvented or invalidated. Since patent applications are maintained in secrecy until patents issue, and since publications of discoveries in scientific or patent literature tend to lag behind actual discoveries by several months, we cannot be certain that it was the first creator of inventions covered by pending patent applications or that it was the first to file patent applications for such inventions. Moreover, we may have to participate in interference proceedings declared by the United States Patent and Trademark Office or other patent offices to determine the priority of inventions, which could result in substantial cost to us.

Government Regulation

Our scanning device and the next-generation radio frequency technology scanning equipment must comply with the regulations of the United States Federal Communications Commission (the "FCC"), which may require certification, verification or registration of the equipment with the FCC. Certification and verification of new equipment requires testing to ensure the equipment's compliance with the FCC's rules. In addition, the equipment must be labeled according to the FCC's rules to show compliance with these rules. Electronic equipment permitted or authorized to be used by the FCC through our certification or verification procedures must not cause harmful interference to licensed FCC users, and it is subject to radio frequency interference from licensed FCC users.

Employees

At March 30, 2005, we had 13 employees located in Israel, including seven engineers, two sales and marketing personnel, three management and administrative personnel, and one operations personnel. In addition, as of March 30, 2005, we had five employees located in the United States, one of whom is a member of our management, one of whom manages our operations in the United States, with the remaining three being sales, marketing and customer support personnel. We consider our relations with our employees to be satisfactory. We believe our future will depend in large part on our ability to attract and retain highly skilled employees.

The employees of InkSure Ltd. are entitled to "Dmey Havra'a" as provided in a Collective Bargaining Agreement to which the General Labor Union of the Workers in Israel is a party. Dmey Havra'a is an employee benefit program whereby employees receive payments from their employer for vacation. In addition, InkSure Ltd. pays a monthly amount equal to 14.53% of the salary of each employee to an insurance policy, pension fund or combination of both, according to the request of such employee. Each employee pays a monthly amount to such insurance policy equal to 5% of such employee's salary. InkSure Ltd. pays a monthly amount up to 7.5% of each employee's salary to an educational fund in the name of such employee. Each employee pays a monthly amount to such fund equal to 2.5% of such employee's salary. Our wholly owned subsidiary, InkSure Ltd. makes cars available to some employees for their exclusive use. InkSure Ltd. pays all costs associated with these cars, whether fixed or variable, including without limitation, fuel, repairs and insurance.

Risk Factors

All forward-looking statements should be read with caution. Statements in this annual report on form 10-KSB under the captions "Description of Business," "Management's Discussion and Analysis or Plan of Operations," and elsewhere in this form 10-KSB, as well as statements made in press releases and oral statements that may be made by us or by officers, directors or employees acting on our behalf, that are not statements of historical fact, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, including those described in this form 10-KSB under the caption "Risk Factors," that could cause our actual results to be materially different from the historical results or from any future results expressed or implied by such forward-looking statements. In addition to statements which explicitly describe such risks and uncertainties, readers are urged to consider statements labeled with the terms "believes," "belief," "expects," "plans," "anticipates," or "intends," to be uncertain and forward-looking. All cautionary statements made in this form 10-KSB should be read as being applicable to all related forward-looking statements wherever they appear. Investors should consider the following risk factors as well as the risks described elsewhere in this form 10-KSB.

We have a history of operating losses and negative cash flows; we may not be profitable in the future

We have incurred substantial losses and negative cash flows since our inception. We had an accumulated deficit of approximately \$9,774,000 at December 31, 2004 and had a working capital (current assets less current liabilities) of approximately \$1,990,000 at December 31, 2004. We incurred losses of approximately \$2,061,000 for the year ended December 31, 2004. We expect to spend significant amounts to enhance our products and services, develop further sales and operations, and fund expansion. As a result, we will need to generate significant revenue to break even or achieve profitability. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis.

Our operating expense levels are based on internal forecasts for future demand and not on firm customer orders for products or services. Our results may be affected by fluctuating demand for our products and services from one quarter to the next and by increases in the costs of components acquired from suppliers.

We have a limited operating history, which makes it difficult to evaluate our business.

InkSure Delaware was formed in May 2000. We have a limited operating history on which to base an evaluation of our business and prospects. Our revenue and income potential are unproven. An investor must consider the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages, particularly companies with limited capital in new and rapidly evolving markets. These risks and difficulties include our ability to develop our infrastructure; attract and maintain a base of end users; develop and introduce desirable products and services; provide customer support, personnel, and facilities to support our business; establish and maintain strategic relationships; and respond effectively to competitive and technological developments. Our business strategy may not be successful or may not successfully address any of these risks or difficulties.

We will face a need for additional capital and may need to curtail our operations if it is not available.

We believe that our current cash and cash equivalents will satisfy our operating capital needs for at least twelve months based upon our currently anticipated business activities. We will need additional capital even within twelve months if we undertake large projects. Our need for additional capital to finance our operations and growth will be greater should, among other things, our revenue or expense estimates prove to be incorrect. We may not be able to

obtain additional financing in sufficient amounts or on acceptable terms when needed, which would adversely affect our prospects, business, operating results and financial condition by forcing us to curtail our operations or not pursue opportunities which present themselves.

If we continue to rely on one major customer for most of our revenues, the loss of such customer could adversely affect our business.

For the fiscal year ended December 31, 2004, sales to one of our new customers in the United States accounted for approximately 63% of our revenues. The loss of this customer, or any other customer that accounts for a significant portion of our revenues from time to time, could adversely affect our business, operating results and financial condition due to the substantial decrease in revenue such loss would represent.

If our product offerings are not accepted by the market, our business may be adversely affected.

We generate all of our revenue from sales of products relating to the "authentication industry." The market for providing these products and services is highly competitive and is affected by the introduction of new products and services that compete with the products and services offered by us. Demand for these products and services could be affected by numerous factors outside our control, including, among others, market acceptance by prospective customers, the introduction of new or superior competing technologies or products and services that are available on more favorable pricing terms than those being offered by us, and the general condition of the economy. Any market acceptance for our products and services may not develop in a timely manner or may not be sustainable. New or increased competition may result in market saturation, more competitive pricing, and lower margins. Our business, operating results and financial condition would be materially and adversely affected if the market for our products and services fails to grow, grows more slowly than anticipated, or becomes more competitive or if targeted customers do not accept our products and services and we experience a corresponding reduction in revenues, a higher loss and a failure to generate substantial revenues in the future.

We have a long and variable sales cycle which can result in significant fluctuations in our revenue from quarter to quarter.

The sales cycle of our products, which is the period of time between the identification of a potential customer and completion of the sale, 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, a small fluctuation in the timing of sales can cause our quarterly operating results to vary significantly from period to period. If revenue falls significantly below anticipated levels, our business would be seriously harmed. Investors can also anticipate uneven revenue results, which may be reflected in a volatile market price for our stock.

We face potential liability due to product defects and may incur significant liabilities in defending lawsuits over any such defects.

Authentication products as complex as those offered by us may contain undetected errors or defects when first introduced or as new versions are released. Despite testing by us and by current and potential customers, errors may be found in new authentication products after commencement of commercial shipments resulting in product recalls and market rejection of our authentication products and resulting in damage to our reputation, as well as lost revenue, diverted development resources and increased support costs. In addition, our product liability insurance, if any, may be insufficient to cover claims related errors or defects in our authentication products.

We may not be able to protect our proprietary technology, which would adversely affect our ability to compete in the authentication market.

Our performance and ability to compete are dependent to a significant degree on our proprietary technology. We regard protection of our proprietary rights as critical to our success, and rely on patent, trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. We have applied for three patents covering various methods of marking documents for the purpose of authentication and three patents related to the radio frequency authentication and security technology, or RF technology, being developed by us. Currently, only one of our patent applications related to our RF technology has been approved in the United States. In addition, the patent application for such technology

has been approved in the European Union. We are currently seeking additional patent protection for such technology in certain European countries.

We are also seeking protection under the Patent Cooperation Treaty. We may file for additional patents as we determine appropriate. A patent may not be issued with respect to any patent application filed by us or the scope of any claims granted in any patent may not provide meaningful proprietary protection or a competitive advantage to us. The validity or enforceability of patents which may be issued or licensed to us may be challenged by others and, if challenged, may not be upheld by a court. In addition, competitors may be able to circumvent any patents that may be issued or licensed to us. Due to our reliance on our proprietary technology, our inability to protect our proprietary rights adequately would have a material adverse effect on us.

We generally have entered into agreements containing confidentiality and nondisclosure provisions with our employees and consultants and limits access to and distribution of our documentation and other proprietary information. However, the steps taken by us may not prevent misappropriation of our technology and agreements entered into for that purpose may not be enforceable.

Notwithstanding the precautions taken by us, a third party may be able to copy or otherwise obtain and use our proprietary information without authorization or to develop similar technology independently. Policing unauthorized use of our technology is difficult. The laws of other countries may afford us little or no effective protection of our intellectual property. Effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our products and services are made available. In the future, we may also need to file lawsuits to enforce our intellectual property rights, protect our trade secrets, and determine the validity and scope of the proprietary rights of others. Such litigation, whether successful or unsuccessful, could have a material adverse effect on our business, operating results, and financial condition due to the substantial costs and diversion of resources. See "Business Risk Factors — We are a co-defendant in a litigation, and we could incur significant liabilities in defense of this lawsuit or in damages if our defense is unsuccessful."

In addition, we have entered into several agreements pursuant to which we have granted third parties broad, exclusive rights to distribute and sell certain of our technology, subject to customary provisions governing confidentiality and nondisclosure. Failure of these third parties to effectively market products and services based upon our technology could have a material adverse effect on our business, operating results, and financial condition due to the lack of revenues expected to be generated from such agreements.

We will have to keep pace with new products and rapid technological change in order to remain competitive in the marketplace.

If we are able to sufficiently penetrate the market with our products and services, our future success will depend upon our ability to keep pace with technological developments and respond to evolving customer demands. Failure to anticipate or respond adequately to technological developments or significant delays in product development could damage our potential position in the marketplace and could have a material adverse effect on our business, operating results, and financial condition. With our current limited financial and technical resources, we may not be able to develop or market new products, services or enhancements to our existing product and service offerings. It is possible that we could experience significant delays in these endeavors. Any failure to successfully develop and market products and services and product and service enhancements could have a material adverse effect on our business, operating results and financial condition. See "Business Risk Factors— If our product offerings are not accepted by the market, our business may be adversely affected."

We face competition and pricing pressures from larger, well financed and more recognized companies and we may not be able to effectively compete with such companies.

The market for our products and services is highly competitive. Many of our competitors have far greater financial, human, and other resources. Barriers to entry in our business are relatively insubstantial and companies with substantially greater financial, technical, marketing, manufacturing and human resources, as well as those with far greater name recognition than us, may also attempt to enter the market. We believe that our ability to compete depends on our technology and price, as well as on our distribution channels and the quality of products and services. If we do not successfully compete, we will not generate significant revenues or profits.

We depend on third parties for infrastructure and supplies, the loss of which could adversely affect our operations.

With regard to our products, we are dependent in part on the availability of equipment, supplies and services provided by independent third parties. Currently we use a limited number of suppliers in order to take advantage of volume discounts. If one of our suppliers were unable to meet our supply demands and we could not quickly replace the source of supply, it could have a material adverse effect on our business, operating results and financial condition, for reasons including a delay of receipt of revenues and damage to our business reputation.

We depend on our senior management and key employees, the loss of which could adversely affect our operations.

Our success depends to a large degree upon the skills of our senior management team and current key employees and upon our ability to identify, hire, and retain additional sales, marketing, technical and financial personnel. We may be unable to retain our existing key personnel or attract and retain additional key personnel. We do not maintain key person life insurance for any of our officers or key employees. We require our executives and key employees to enter non-competition agreements with us. Due to our reliance on our senior management and key employees, the loss of any of our key executives, the use of proprietary or trade secret data by former employees who compete with us, or the failure to attract, integrate, motivate, and retain additional key employees could have a material adverse effect on our business, operating results and financial condition.

We may not be able to manage our growth to successfully implement our business plan and such mismanagement could adversely affect our business and our ability to grow.

We anticipate a period of significant growth in connection with expansion of our marketing efforts and business. The resulting strain on our managerial, operational, financial, and other resources could be significant and could render our increased marketing efforts useless. Our ability to manage our growth effectively will require us to continue to improve our operations, financial and managerial controls, reporting systems and procedures. If we are successful in achieving our growth plans, such growth is likely to result in increased responsibility for our management; and our management may not be able to successfully manage such growth due to their lack of experience in managing companies of our size.

Our specialty inks include various chemicals and are subject to certain environmental regulations, for which we could incur significant liabilities for problems relating to their shipping and storage.

Our operations are subject to federal, state, local, and foreign environmental laws and regulations. Our specialty inks include various chemicals, some of which may be hazardous substances and subject to various government regulations relating to our transfer, handling, packaging, use, and disposal. We may store these chemicals or inks at our facilities in the United States and Israel, and a shipping company ships them at our direction. We could face potential liability for problems that may arise when we store or ship these inks or chemical components. To the extent future laws and regulations are adopted or interpretations of existing laws and regulations change, new requirements may be imposed on our future activities or may create liability retroactively. Failure to comply with applicable rules and regulations could subject us to monetary damages and injunctive action, which could have a material adverse effect on our business, financial condition or results of operations.

Some of our products in development will be subject to government regulation of radio frequency technology which could cause a delay or inability to introduce such products in the United States and other markets.

The rules and regulations of the United States Federal Communications Commission, or the FCC, limit the radio frequency used by and level of power emitting from electronic equipment. Our scanning device and the next-generation radio frequency technology scanning equipment will be required to comply with these FCC rules which may require certification, verification or registration of the equipment with the FCC. Currently we do not have FCC approval for our equipment. Certification and verification of new equipment requires testing to ensure the equipment's compliance with the FCC's rules. The equipment must be labeled according to the FCC's rules to show compliance with these rules. Testing, processing of the FCC's equipment certificate or FCC registration, and labeling may increase development and production costs and could delay introduction of our verification scanning device and next-generation radio frequency technology scanning equipment into the United States' market.

Electronic equipment permitted or authorized to be used by the FCC through our certification or verification procedures must not cause harmful interference to licensed FCC users, and it is subject to radio frequency interference from licensed FCC users. Selling, leasing or importing non-compliant equipment is considered a violation of FCC rules and federal law and violators may be subject to an enforcement action by the FCC. Any failure to comply with the applicable rules and regulations of the FCC could subject us to monetary action or an injunction and could have a material adverse effect on our business, operating results and financial condition. In addition, certain other countries may impose similar or more burdensome regulations.

We are a co-defendant in a litigation, and we could incur significant liabilities in defense of this lawsuit in damages if our defense is unsuccessful.

On December 12, 1999, Secu-Systems filed a lawsuit with the District Court in Tel Aviv-Jaffa against Supercom Ltd. (InkSure Delaware's former parent company) and InkSure Ltd. seeking a permanent injunction and damages. The plaintiff asserted in its suit that the printing method applied to certain products that have been developed by InkSure Ltd. constitutes inter alia: (a) breach of a confidentiality agreement between the plaintiff and Supercom; (b) unjust enrichment of Supercom and InkSure Ltd.; (c) breach of fiduciary duties owed to the plaintiff by Supercom and InkSure Ltd.; and (d) a tort of misappropriation of trade secret and damage to plaintiff's property. Secu-Systems seeks, among other things, an injunction and a 50% share of profits from the printing method at issue. We received a letter, dated March 16, 2005, from the law firm of Yossi Avraham & Co., which stated that, based on the facts provided to it by Supercom and InkSure Ltd., the probability is small that a court would grant either the permanent injunction or a substantial amount of damages in connection with Secu-Systems' complaint. At the beginning of 2004 we submitted our closing arguments to the court, and Secu-Systems replied to our closing arguments. We expect the Court to render its decision by the end of 2005. If Secu-Systems were to win the litigation we could be forced to make a one-time payment in connection with past damages and/or payments based on our future revenues and profits. Such payments could have a material adverse effect on our business, operating results and financial condition.

Conditions in Israel affect the operations of our subsidiary in Israel and may limit our ability to sell our products and services.

InkSure Ltd., our principal operating subsidiary, is incorporated under Israeli law and its principal office, manufacturing facility and research and development facility are located in Israel. Political, economic and military conditions in Israel directly affect InkSure Ltd.'s operations. Since the establishment of the state of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite negotiations to effect peace between Israel and its Arab neighbors, the future of these peace efforts is uncertain. Since October 2000, there has been a significant increase in violence primarily in the West Bank and Gaza Strip, negotiations between Israel and the Palestinian Authority have ceased and there has been increased military activity characterized by some as war. Violence has spread to Jerusalem and areas near Tel Aviv. Furthermore, several countries still restrict trade with Israeli companies, which may limit our ability to make sales, or purchase components from, in those countries. Any future armed conflict, political instability, continued violence in the region or restrictions could limit our ability to operate our business and could have a material adverse effect on our business, operating results and financial condition.

Our operations could be disrupted as a result of the obligation of management or key personnel of InkSure Ltd. to perform military service.

Generally, all male adult citizens and permanent residents of Israel under the age of 45 are, unless exempt, obligated to perform up to 36 days of military reserve duty annually. Additionally, all Israeli residents of this age are subject to being called to active duty at any time under emergency circumstances. Some of the officers and employees of InkSure Ltd. are currently obligated to perform annual reserve duty. Our operations could be disrupted by the absence for a significant period of one or more of InkSure Ltd.'s officers or key employees due to military service. Any such disruption could limit our ability to operate our business and could affect our business, results and financial condition.

Under current Israeli law, InkSure Ltd. may not be able to enforce covenants not to compete which could have a negative effect on our operations in Israel.

InkSure Ltd. has non-competition agreements with all of its employees. These agreements prohibit its employees, if they cease working for InkSure Ltd., from directly competing with it or working for its competitors, generally, for up to twelve months. However, we have been advised by our Israeli counsel, Yossi Avraham & Co., that Israeli courts are reluctant to enforce non-compete undertakings of former employees.

Fluctuations in the exchange rate between the United States dollar and foreign currencies may adversely affect our operating results.

We incur expenses for our operations in Israel in new Israeli shekels (NIS) and translate these amounts into United States dollars for purposes of reporting consolidated results. As a result, fluctuations in foreign currency exchange rates may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. Fluctuations may adversely affect the comparability of period-to-period results. In addition, we hold foreign currency balances, primarily Israeli shekels, that will create foreign exchange gains or losses, depending upon the relative values of the foreign currency at the beginning and end of the reporting period, affecting our net income and earnings per share. Although we may use hedging techniques in the future (which we currently do not use), we may not be able to eliminate the effects of currency fluctuations. Thus, exchange rate fluctuations could have a material adverse impact on our operating results and stock price. In addition, future currency exchange losses may increase if we become subject to exchange control regulations restricting our ability to convert local currencies into United States dollars or other currencies.

We are exposed to special risks in foreign markets which may restrict our ability to convert local currency into United States dollars or Israeli shekels and thereby force us to curtail our business operations.

In conducting our business in foreign countries, we are subject to political, economic, legal, operational and other risks that are inherent in operating in other countries. These risks range from difficulties in settling transactions in emerging markets to possible nationalization, expropriation, price controls and other restrictive governmental actions. We also face the risk that exchange controls or similar restrictions imposed by foreign governmental authorities may restrict our ability to convert local currency received or held by it in their countries into United States dollars or other currencies, or to take those dollars or other currencies out of those countries.

Under Israeli law, our stockholders may face difficulties in the enforcement of civil liabilities against our subsidiary InkSure Ltd., its officers, directors or professional advisors.

InkSure Ltd. is incorporated under Israeli law and its principal office, manufacturing facility and research and development facility are located in Israel. Certain of the directors and InkSure Ltd.'s professional advisors are residents of Israel or otherwise reside outside of the United States. All or a substantial portion of the assets of such persons are or may be located outside of the United States. It may be difficult to effect service of process within the United States upon InkSure Ltd. or upon any such directors or professional advisors or to realize in the United States upon judgments of United States' courts predicated upon civil liability of InkSure Ltd. or such persons under United States federal securities laws. InkSure Ltd. has been advised by our Israeli counsel, Yossi Avraham & Co., that Israeli courts may not (i) enforce judgments of United States' courts obtained against InkSure Ltd. or such directors or professional advisors predicated solely upon the civil liabilities provisions of United States' federal securities laws, or (ii) impose liabilities in original actions against InkSure Ltd. or such directors and professional advisors predicated solely upon such United States' laws. However, subject to certain time limitations, Israeli courts will enforce foreign (including United States) final executory judgments for liquidated amounts in civil matters, obtained after due trial before a court of competent jurisdiction which recognizes similar Israeli judgments, provided that (1) due process has been observed, (2) such judgments or the execution thereof are not contrary to Israeli law, public policy, security or sovereignty, (3) such judgments were not obtained by fraud and do not conflict with any other valid judgment in the same matter between the same parties and (4) an action between the same parties in the same matter is not pending in any Israeli court at the time the law suit is instituted in the foreign court.

We have a stockholder that is able to exercise substantial influence over us and all matters submitted to our stockholders which may make us difficult to be acquired and less attractive to new investors.

ICTS International, N.V. and its affiliates beneficially own, as of March 30, 2005, 4,825,555 shares of our common stock, representing approximately 32.1% of our outstanding common stock. Such ownership interest gives ICTS and its affiliates substantial influence over the outcome of all matters submitted to our stockholders, including

the election of directors and the adoption of a merger agreement, and such influence could make us a less attractive acquisition or investment target.

We are disputing the validity of the issuance of an option to purchase shares of InkSure Delaware common stock, which if determined to be valid would increase the number of our shares of common stock outstanding on a fully diluted basis.

We are disputing the valid issuance of an option to purchase 300,480 shares of InkSure Delaware Common stock that was issued prior to the reverse acquisition merger at an exercise price of \$ 0.50 per share. If our position in this dispute does not prevail we would be forced to accept the validity of the issuance of this option and convert it into an option to purchase shares of our Common stock. We are in the process of evaluating the validity of the grant with our legal counsel. This claim has not matured to legal proceeding at this point, and therefore our legal counsel and management can not predict the outcome of this claim.

Our certificate of incorporation contains anti-takeover provisions which could adversely affect the voting power or other rights of the holders of our common stock.

Our certificate of incorporation authorizes the issuance of up to 10,000,000 shares of preferred stock and our board of directors is empowered, without stockholder approval, to issue a new series of preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of common stock. Such authority, together with certain provisions of Delaware law and of our certificate of incorporation and bylaws, may have the effect of delaying, deterring or preventing a change in control of us, may discourage bids for the common stock at a premium over the market price and may adversely affect the market price, and the voting and other rights of the holders of the common stock. Although we have no present intention to issue any additional shares of our preferred stock, we may do so in the future. The board of directors of a Delaware corporation may issue rights, options, warrants or other convertible securities, (hereinafter the "rights"), entitling the holders of the rights to purchase, receive or acquire shares or fractions of shares of the corporation or assets or debts or other obligations of the corporation, upon such terms as are determined by the board of directors. Our board of directors is free, subject to their fiduciary duties to stockholders, to structure the issuance or exercise of the rights in a manner which may exclude "significant stockholders," as defined, from being entitled to receive such rights or to exercise such rights or in a way which may effectively prevent a takeover of the corporation by persons deemed hostile to management. Nothing contained in our certificate of incorporation will prohibit our board of directors from using these types of rights in this manner.

We have never paid common stock dividends and are unlikely to do so for the foreseeable future.

We have never paid cash or other dividends on our common stock. It is our intention to retain any earnings to finance the operation and expansion of our business, and therefore, we do not expect to pay any cash dividends on our common stock in the foreseeable future.

The trading of our common stock is volatile which may prevent a stockholder from selling its stock at the time or price they desire.

Our common stock is traded on the over-the-counter market with quotations published on the NASD OTC Bulletin Board under the symbol "INKS". The trading volume of our common stock historically has been limited and sporadic, and the stock prices have been volatile. For example, during the twelve months prior to March 30, 2005, our common stock traded at prices ranging from \$1.90 to \$0.50. As a result of the limited and sporadic trading activity, the quoted price for our common stock on the over-the-counter market is not necessarily a reliable indicator of its fair market value. The price at which our common stock will trade in the future may be highly volatile and may fluctuate as a result of a number of factors, including, without limitation, quarterly variations in our operating results (which have historically been, and we expect to continue to be, substantial) and actual or anticipated announcements of new products or services by us, other business partners, or competitors as well as the number of shares available for sale in the market.

"Penny stock" rules may restrict the market for our common stock and may affect our stockholders' ability to sell their shares in the secondary market.

Our common stock is subject to rules promulgated by the Securities and Exchange Commission relating to "penny stocks," which apply to companies whose shares are not traded on a national stock exchange or on the Nasdaq small-cap or national market systems, trade at less than \$5.00 per share, or who do not meet certain other financial requirements specified by the commission. These rules require brokers who sell "penny stocks" to persons other than established customers and "accredited investors" to complete certain documentation, make suitability inquiries of investors, and provide investors with certain information concerning the risks of trading in such penny stocks. These rules may discourage or restrict the ability of brokers to sell our common stock and may affect the secondary market for our common stock. These rules could also hamper our ability to raise funds in the primary market for our common stock and may affect our stockholders' ability to sell their shares in the secondary market.

Item 2. Description of Property.

We maintain our executive offices in approximately 2,000 square feet of space that is located in Fort Lauderdale, FL pursuant to a lease which expires in February 2007. Our monthly lease payments are approximately \$2,700 per month. We maintain our research and development facilities in Rehovot, Israel. The facilities we lease in Israel are approximately 1,000 square feet pursuant to a lease expiring in September 2005. Monthly lease payments for such facility are approximately \$2,800 per month.

Item 3. Legal Proceedings.

On December 12, 1999, Secu-Systems filed a lawsuit with the District Court in Tel Aviv-Jaffa against Supercom Ltd. (InkSure Delaware's former parent company) and InkSure Ltd. seeking a permanent injunction and damages. The plaintiff asserted in its suit that the printing method applied to certain products that have been developed by InkSure Ltd. constitutes inter alia: (a) breach of a confidentiality agreement between the plaintiff and Supercom; (b) unjust enrichment of Supercom and InkSure Ltd.; (c) breach of fiduciary duties owed to the plaintiff by Supercom and InkSure Ltd.; and (d) a tort of misappropriation of trade secret and damage to plaintiff's property. Secu-Systems seeks, among other things, an injunction and a 50% share of profits from the printing method at issue. We received a letter, dated March 16, 2005, from the law firm of Yossi Avraham & Co., which states that, based on the facts provided to it by Supercom and InkSure Ltd., the chances are good that a court would not grant the permanent injunction or award damages of a substantial amount in connection with the litigation. At the beginning of 2004 we submitted our closing arguments to the court, and Secu-Systems replied to our closing arguments. We expect the Court to render its decision by the end of 2005.

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

No matters were submitted to a vote of our security holders during the fourth quarter of the year ended December 31, 2004.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

Price Range of Common Stock

The following table sets forth, for the fiscal periods indicated, the high and low bid prices of a share of common stock as reported by the Over The Counter Bulletin Board under the symbol "INKS" for the periods indicated. Such quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	<u>High</u>	<u>Low</u>
Calendar Year 2003		
1st Quarter.....	\$2.45	\$1.45
2nd Quarter.....	\$2.00	\$1.30
3rd Quarter.....	\$1.50	\$1.30
4th Quarter.....	\$1.40	\$1.05
Calendar Year 2004		
1st Quarter.....	\$1.20	\$0.51
2nd Quarter.....	\$1.30	\$0.77
3rd Quarter.....	\$1.80	\$0.98
4th Quarter.....	\$1.80	\$1.20
Calendar Year 2005		
1 st Quarter (through March 30, 2005)	\$1.77	\$1.25

As of March 30, 2005, the high and low bid prices per share of common stock as reported by the Over the Counter Bulletin Board under the symbol "INKS" were \$1.40 and \$1.35 respectively and there were approximately 107 holders of record of the common stock.

We have not paid dividends on the common stock since inception and do not intend to pay any dividends to our stockholders in the foreseeable future. We currently intend to retain earnings, if any, for the development of our business. The declaration of dividends in the future will be at the election of our board of directors and will depend upon our earnings, capital requirements, financial position, general economic conditions, and other factors the board of directors deem relevant.

Equity Compensation Plan Information

The following table provides information about shares of our common stock that may be issued upon the exercise of options and warrants under all of our existing compensation plans as of December 31, 2004. Our stockholder approved equity compensation plans consist of the 2002 Stock Option Plan. We have a number of options and warrants which were granted pursuant to equity compensation plans not approved by security holders and such securities are aggregated in the table below.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Plan category	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,276,347	\$0.996	2,223,653
Equity compensation plans not approved by security holders	4,390,338(1)	\$1.460	0
Total	5,666,685		2,223,653

(1) Does not include options to purchase 300,840 shares of InkSure Delaware common stock which we believe was not validly issued.

We have authorized the issuance of equity securities under the compensation plans described below without the approval of stockholders. No additional options, warrants or rights are available for issuance under any of these plans, except for additional shares which may become purchasable under warrants with anti-dilution protection as noted below. We have either already registered or agreed to register for resale the common stock underlying all of these plans.

- Commonwealth Associates, L.P. warrants, dated July 5, 2002, July 31, 2002 and September 6, 2002: warrants to purchase shares of InkSure Delaware common stock in connection with Commonwealth's role as placement agent in a private placement of InkSure Delaware's securities. The warrants were to purchase an aggregate of 550,933 shares of InkSure Delaware common stock at an exercise price of \$1.61 per share. In connection with the merger of InkSure Delaware with our wholly owned subsidiary these warrants to purchase shares of InkSure Delaware common stock were converted into warrants to purchase shares of our common stock.
- Elie Housman option, dated February 6, 2002: options to purchase shares 478,469 shares of InkSure Delaware common stock at an exercise price of \$0.966 per share, with an expiration date of February 6, 2009. In connection with the merger of InkSure Delaware with our wholly owned subsidiary these options to purchase shares of InkSure Delaware common stock were converted into options to purchase shares of our common stock.
- In connection with the September 2002 private placement, InkSure Delaware issued 67 five-year warrants to the investors in such private placement. In the aggregate, this represented the issuance of warrants to purchase 1,456,526 Shares of InkSure Delaware common stock at a price of \$2.17 per share. In connection with the merger of InkSure Delaware with our wholly owned subsidiary, all warrants to purchase shares of InkSure Delaware common stock were converted into warrants to purchase shares of our common stock.
- In connection with a private placement which we closed on April 8, 2004, we issued warrants to purchase an aggregate of 1,904,411 shares of our common stock at a price of \$1.00 per share.
- In connection with services rendered to us, on March 15, 2005 we issued warrants to purchase 50,000 shares of our common stock to Mr. Jerry Falkner. The warrants are exercisable for 10 years and have an exercise price of \$1.40 per share.

Equity Transactions

We consummated the following equity transactions, each exempt from the registration requirements under Section 4(2) and Regulation D of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder:

September 2002 Private Placement of Units

In the third quarter of the fiscal year ended December 31, 2002, InkSure Delaware received gross proceeds of \$6,700,000 in three tranches, with the third tranche closing on September 6, 2002, from the private sale to investors of 67 units, with each unit consisting of 62,112 shares of InkSure Delaware common stock and a five-year warrant to purchase 21,739 shares of InkSure Delaware common stock at a price of \$2.17 per share. In the aggregate this represented a sale to the investors of 4,161,505 shares of common stock and warrants to purchase 1,456,526 shares of common stock, which at the time represented approximately 43% of InkSure Delaware's outstanding common stock on a fully diluted basis. In connection with the merger of InkSure Delaware with our wholly owned subsidiary, all of the shares of InkSure Delaware common stock issued in the private placement were exchanged for shares of our common stock and all warrants to purchase shares of InkSure Delaware common stock were converted into warrants to purchase shares of our common stock. Commonwealth Associates, L.P. acted as the placement agent in such private placement.

In connection with the September 2002 private placement, InkSure Delaware paid Commonwealth Associates, L.P., a registered broker-dealer, a \$569,500 cash fee and issued three five-year warrants to purchase an aggregate of 550,933 shares of InkSure Delaware common stock at a price of \$1.61 per share. In connection with the merger of InkSure Delaware with our wholly owned subsidiary these warrants to purchase shares of InkSure Delaware common stock were converted into warrants to purchase shares of our common stock. In December 2002, Commonwealth distributed these warrants to certain of its employees and affiliates.

April 2004 Private Placement of Units

On April 8, 2004, we closed the sale of \$1,295,000 of units in a private placement to accredited investors, at a price per unit equal to \$0.68, which was 85% of the average of the last reported bid and ask prices for the 30 business days prior to the date of the closing of such private placement. Each unit sold consisted of (i) one share of our common stock, and (ii) a five-year warrant to purchase one share of our common stock at an exercise price of \$1.00 per share.

July 2004 Private Placement

On July 19, 2004 we closed a private placement of \$1,125,000 of shares of our common stock to accredited investors at the price of \$1.00 per share.

March 2005 Warrant Issuance

In connection with services rendered to us, on March 15, 2005 we issued warrants to purchase 50,000 shares of our common stock to Mr. Jerry Falkner. The warrants are exercisable for 10 years and have an exercise price of \$1.40 per share.

Item 6. Management's Discussion and Analysis or Plan of Operation.

In this section, "Management's Discussion and Analysis of Financial Condition and Results of Operations," references to "we," "us," "our," and "ours" refer to InkSure Technologies, Inc. and its consolidated subsidiaries.

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Financial Statements and the Notes thereto included in this report. This discussion contains certain forward-looking statements that involve substantial risks and uncertainties. When used in this report the words "anticipate," "believe," "estimate," "expect" and similar expressions as they relate to our management or us are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Overview

We specialize in comprehensive security solutions, designed to protect branded products and documents of value from counterfeiting, fraud, and diversion. By creating "Smart Protection" systems from proprietary machine-readable authentication technologies, we help companies and organizations worldwide regain control over their most valuable assets, their products, their reputation and their revenues. We employ a team of experts in the fields of material science, electro-optics and software. We utilize cross-disciplinary technological innovations to implement customized and cost efficient security systems for data and asset integrity within the customer' existing infrastructure and environment.

Our SmartInk™ solutions enable authentication and tracking of documents and products by adding special chemical markers to standard inks and coatings. The combination of markers, inks and materials produce electro-optic "signatures", unique codes that are seamlessly incorporated into the printed media used by the customer. Proprietary computerized readers, available in hand-held, stationary and modular kit configurations, quickly verify these codes by manual or automatic operation. By focusing on customer driven solutions, we are able to offer added value through enhanced reader functionality, including high-speed automatic sorting, one-to-many code matching, first and second level track and trace, code activation at the point of distribution and detrimental authentication for debit applications. The inherent flexibility of our technology also enables overlaying the machine-readable codes onto holograms and other overt features, resulting in multi-layered security that is both effective and economical.

Factors Affecting Future Results

Industry and Economic Factors: Our operations and earnings are affected by local, regional and global events or conditions that affect supply and demand for products and services. These events or conditions are generally not predictable and include, among other things, general economic growth rates and the occurrence of economic recessions; the development of new supply sources; supply disruptions; technological advances, including advances in security technology and advances in technology relating to security usage; changes in demographics, including population growth rates and consumer preferences; and the competitiveness of alternative security sources or product substitutes. Currently, the economy in general is suffering. As a result, raising capital has become extremely difficult, and there is pressure on the pricing of our products and services.

Competitive Factors: The brand and document protection industry is competitive. There is competition with the traditional document protection suppliers (mainly protection for bank notes) and also with other emergent "next generation" technology providers. We compete with other firms in the sale and purchase of various products and services in many national and international markets and employ all methods of competition, which are lawful and appropriate for such purposes. We believe that a key component of our competitive position is our technology.

Political Factors: Our operations and earnings have been, and may in the future be, affected from time to time in varying degree by political instability and by other political developments and laws and regulations, such as forced divestiture of assets; restrictions on production; imports and exports; war or other international conflicts; civil unrest and local security concerns that threaten the safe operation of our facilities, particularly those that are located in Israel; price controls; expropriation of property; and the cancellation of contract rights. Both the likelihood of such occurrences and their overall effect upon us vary greatly from country to country and are not predictable.

Project Factors: In addition to the factors cited above, the advancement, cost and results of particular projects depend on the outcome of negotiations with potential partners, governments, suppliers, customers or other third parties; changes in operating conditions or costs; and the occurrence of unforeseen technical difficulties.

Risk Factors: See "Risk Factors" for discussion of the impact of market risks, financial risks and other uncertainties.

Revenues

We are currently concentrating on entering and implementing large-scale projects. These potential contracts are subject to a long sales cycle and the timetable is lengthy for entering and implementing such projects. These projects involve high volume sales through multiple-year sales contracts. In the 2004 fiscal year we entered into two sales agreements of this type, and we have also completed several successful field trials during the last year related to other projects. In the 2004 fiscal year approximately 65% of our revenues were earned from customers located in

the United States. Sales related to our project with MTM in Turkey represented 25% of our sales in the 2004 fiscal year. Sales related to our agreement with Sun Chemical represented approximately 6% of our sales in fiscal year 2004.

Costs and Operating Expenses

Costs and operating expenses consist of cost of revenues, research and development expenses, selling and marketing expenses, general and administrative expenses.

Our cost of revenues consists primarily of materials including taggants and electronic and optical parts, sub-contractors and compensation costs for our operations staff

Our research and development expenses consist primarily of costs associated with development of new generic products. These expenses may fluctuate as a percentage of revenue depending on the projects undertaken during the reporting period. Since our inception, we have expensed all research and development costs in each of the periods in which they were incurred.

Our selling and marketing expenses consist primarily of costs associated with our direct sales force that have been incurred to attract potential business customers, professional advisors and commissions. We anticipate that as we add new customers we will be able to spread these costs over a larger revenue base and accordingly improve our operating margins.

Our general and administrative expenses consist primarily of costs related to compensation and employees benefits of our management (including the costs of directors' and officers' insurance), legal and accounting fees, as well as the expenses associated with being a publicly traded company.

We have not recorded any income tax benefit for net losses and credits incurred for any period from inception to December 31, 2004. The utilization of these losses and credits depends on our ability to generate taxable income in the future. Because of the uncertainty of our generating taxable income, we have recorded a full valuation allowance with respect to these deferred assets.

Critical Accounting Policies

Our financial statements are prepared in accordance with US GAAP. The significant accounting policies followed in the preparation of the financial statements, applied on a consistent basis and which have been prepared in accordance with the historical cost convention, are set forth in Note 2 to the Consolidated Financial Statements.

Of these significant accounting policies, certain policies may be considered critical because they are most important to the portrayal of our financial condition and results, and they require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition. Revenues from product sales are recognized in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements", or SAB No. 104, when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable. Delivery is considered to have occurred upon shipment of products. When a right of return exists, we defer revenues until the right of return expires. We do not grant a right of return to our customers.

Revenues from certain arrangements may include multiple elements within a single contract. The Company's accounting policy complies with the provisions of Emerging Issues Task Force Issue 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"), relating to the separation of multiple deliverables into individual accounting units with determinable fair value.

In cases where the Company has partial delivery at the cut off dates and no fair value exist for the undelivered elements revenues are being deferred and recognized only at the point where the entire arrangement has been delivered.

Inventories. Inventories are stated at the lower of cost or net realizable value. Cost is determined by calculating raw materials using the "first in, first out" method, work in process and finished products on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

Other accrued expenses. We also maintain other accrued expenses. These accruals are based on a variety of factors including past experience and various actuarial assumptions and, in many cases, require estimates of events not yet reported to us. If future experience differs from these estimates, operating results in future periods would be impacted.

Deferred Income taxes. Significant management judgment is required in determining the provision for income taxes, deferred tax assets and any valuation allowance recorded against net deferred tax assets. Due to the fact that the Company has history of losses it is likely that the deferred tax will not be realized, therefore a valuation allowance of approximately \$3,078,000 has been recorded as of December 31, 2004.

A. RESULT OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the related notes. The financial statements have been prepared in accordance with US Generally Accepted Accounting Principles, or GAAP.

This discussion contains forward-looking statements that involve risks and uncertainties.

Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors.

The following table sets forth, for the periods indicated, certain financial data expressed as a percentage of total revenue:

	YEAR ENDED DECEMBER 31,	
	2004	2003
Revenues	100%	100%
Cost of Revenues	43	22
Gross profit	<u>57</u>	<u>78</u>
Operating expenses:		
Research and development	81	195
Selling and marketing	130	256
General and administrative	62	120
Total operating expenses	<u>273</u>	<u>571</u>
Operating loss	(216)	(493)
Financial income, net	0	6
Net loss	<u>(216)</u>	<u>(487)</u>

Year Ended December 31, 2004 Compared with Year Ended December 31, 2003

Revenues. Revenues consist of gross sales of products. We are currently concentrating on entering and implementing large-scale projects. These potential contracts are subject to a long sales cycle and the timetable for entering and implementing such projects fluctuates. This affected our results in 2004. Our revenues increased by \$347,000, or 57%, to \$955,000 in 2004 from \$608,000 in 2003, primarily due to one of our new customers located in the United States and the new MTM project in Turkey. As of December, 31 2004, revenues in the amount of

\$123,000 were deferred to 2005 due to the implementation of EITF No. 00-21 "Revenue Arrangements with Multiple Deliverables".

Cost of Revenues. Cost of revenues consist of materials, sub-contractors and compensation costs. Cost of revenues increased by \$279,000, or 208%, to \$413,000 in 2004 from \$134,000 in 2003. The increase in cost of revenues is mainly due to the increase of sales and the increase of cost as a percentage of revenues. Cost of revenues as a percentage of sales was 43 % in 2004, compared with 22% in 2003. The increase in cost of revenues as a percentage of revenues is related to the mix of sales. Our revenues in 2004 consisted of sales of readers and ink, and our sales in 2003 consisted primarily of sales of ink, in which the cost of revenues is much lower.

Research and Development Expenses. Research and development expenses consist primarily of compensation costs attributable to employees engaged in ongoing research and development activities, development-related raw materials and sub-contractors, and other related costs. Research and development expenses decreased by \$409,000, or 35%, to \$775,000 in 2004 from \$1,184,000 in 2003. This decrease in research and development expenses is primarily related to our need to use fewer subcontractors in connection with the development of new products and new generations of our existing products.

Selling and Marketing Expenses, Net. Selling and marketing expenses, net consist primarily of costs relating to compensation attributable to employees engaged in sales and marketing activities, promotion, advertising, trade shows and exhibitions, sales support, travel, commissions and related expenses. Selling and marketing expenses, net decreased by \$321,000, or 21%, to \$1,239,000 in 2004 from \$1,560,000 in 2003. This decrease in selling and marketing expenses, net was primarily due to the higher marketing expenses we faced in 2003 which were related to several marketing agreements we had entered into. We believe that our significant investment in sales and marketing activities over time will contribute to our short-term and long-term sales levels.

General and Administrative Expenses. General and administrative expenses consist primarily of compensation costs for administration, finance and general management personnel, office maintenance, insurance, legal, accounting and administrative costs. General and administrative expenses decreased by \$140,000, or 19%, to \$590,000 in 2004 from \$730,000 in 2003. This decrease was primarily a result of lower legal expenses.

Financial Income, Net. Financial income, net decreased by \$34,000, or 97%, to \$1,000 in 2004 from \$35,000 in 2003 due to changes in the exchange rate between the United States Dollar and the Israeli New Shekel.

Net loss. We had a net loss of \$2,061,000 in 2004, compared with a net loss of \$2,965,000 in 2003, which is a decrease of \$904,000, or 31%. The decrease in net loss in 2004 in comparison with 2003 is primarily due to our increase in revenues and decrease in operating expenses.

B. LIQUIDITY AND CAPITAL RESOURCES

We have incurred substantial losses since our inception in May 2000. We had an accumulated deficit of approximately \$9,774,000 at December 31, 2004, and had a working capital (current assets less current liabilities) of approximately \$1,990,000 at December 31, 2004.

Capital expenditures were approximately \$72,000 in 2004 and \$33,000 in 2003. These expenditures were principally for machinery, computers and research and development equipment purchases. We do not have any material commitments for capital expenditures for the year ending December 31, 2004.

As of December 31, 2004, we had cash, cash equivalents and short-term deposits of approximately \$1,648,000, compared to \$1,453,000 in 2003. This increase is the result of the amounts we raised in the two private placement transactions we completed during 2004 as such amounts are offset by our continuing investments in research and development and selling and marketing expenses. We had \$0 short-term bank credit in each of 2004 and 2003. We generated negative cash flow from operating activities of approximately \$2,112,000 in 2004 compared to \$2,788,000 in 2003.

Our investing activities used cash of \$51,000 in 2004 and provided cash of \$4,065,000 in 2003. Our policy is to invest our funds in short-term deposits.

On April 8, 2004, we closed the sale of \$1,295,000 of units in a private placement to accredited investors, at a price per unit equal to \$0.68, which was 85% of the average of the last reported bid and ask prices for the 30

business days prior to the date of the closing of such private placement. Each unit sold consisted of (i) one share of our common stock, and (ii) a five-year warrant to purchase one share of our common stock at an exercise price of \$1.00 per share.

On July 19, 2004 we closed a private placement of \$1,125,000 of shares of its common stock, par value \$0.01 per share, at the price of \$1.00 per share.

We believe that cash generated from operations and cash from the 2004 private placements will provide sufficient cash resources to finance our operations and the projected expansion of our marketing and research and development activities for the next twelve months. However, if our operations do not generate cash to the extent currently anticipated, or we grow more rapidly than currently anticipated, it is possible that we would require more funds than presently anticipated.

C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

We believe that our future success will depend upon our ability to enhance our existing products and systems and introduce new commercially viable products and systems addressing the demands of the evolving markets for brand and document protection. As part of the product development process, we work closely with current and potential customers, distribution channels and leaders in certain industry segments to identify market needs and define appropriate product specifications. Our employees also participate in industry forums in order to stay informed about the latest industry developments.

Our research and development expenses were approximately \$809,000 in 2002, \$1,184,000 in 2003 and \$775,000 in 2004. To date, all research and development expenses have been charged to operating expense as incurred. We currently hold five pending patents on our technologies and we have been issued one patent related to our RF technology in the United States. In addition a patent application for such technology has been approved in the European Union. Currently we are seeking additional protection for such technology in certain European countries.

D. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Our contractual obligations and commitments at December 31, 2004 principally include obligations associated with our future operating lease obligations and the lease of several automobiles. Our total future obligation is \$237,000 until 2007. See Note 7 to the Consolidated Financial Statements. We expect to finance these contractual commitments from cash on hand and cash generated from operations.

Item 7. Financial Statements.

The Financial Statements and Notes thereto can be found beginning on page F-1, "Index to Consolidated Financial Statements," following Part III of this Annual Report on Form 10-KSB.

Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 8A. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures. Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Annual Report on Form 10-KSB, have concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Annual Report on Form 10-KSB was being prepared.

(b) Changes in Internal Controls. We have evaluated our internal control over financial reporting as of the end of our fourth fiscal quarter. There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control, that occurred during the fourth quarter of our last fiscal year.

that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 8B. Other Information.

None.

PART III

Item 9. Directors and Executive Officers of the Registrant.

The information set forth under the captions "Directors, Executive Officers, Promoters and Control Persons", "Compliance with Section 16(a) of the Exchange Act" and "Code of Ethics" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held on or about July 7, 2005 is hereby incorporated by reference.

Item 10. Executive Compensation.

The information set forth under the caption "Executive Compensation" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held on or about July 7, 2005 is hereby incorporated by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held on or about July 7, 2005 is hereby incorporated by reference.

Item 12. Certain Relationships and Related Transactions.

The information set forth under the captions "Certain Relationships and Related Transactions" and "Executive Compensation—Employment Agreements, Termination of Employment and Change of Control Arrangements" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held on or about July 7, 2005 is hereby incorporated by reference.

Item 13. Exhibits and Reports on Form 8-K.

(a) Exhibits

<u>Exhibit No.</u>	<u>Description</u>
2.1	Agreement and Plan of Merger, dated July 5, among the Company, LILM Acquisition and InkSure Delaware. (Incorporated by reference to the Company's Information Statement on Schedule 14C, filed with the Commission on October 8, 2002.)
3.1	Certificate of Change in Number of Authorized Shares of Class and Series of the Company. (Incorporated by reference to the Company's report filed on Form 8-K, filed with the Commission on November 8, 2002.)
3.2	Certificate of Amendment of Articles of Incorporation of the Company. (Incorporated by reference to the Company's report filed on Form 8-K, filed with the Commission on November 8, 2002.)
3.3	Articles of Incorporation of the Company. (Incorporated by reference to the Company's Form 10-SB, filed with the Commission on June 10, 1998.)
3.4	Amendment to By-Laws of the Company. (Incorporated by reference to the Company's Quarterly Report on Form 10-QSB, filed with the Commission on November 14, 2002.)
3.5	By-Laws of the Company. (Incorporated by reference to the Company's Form 10-SB, filed with the Commission on June 10, 1998.)
10.1	2002 Employee, Director and Consultant Stock Option Plan. (Incorporated by reference to the Company's Quarterly Report on Form 10-QSB, filed with the Commission on November 14, 2002.)

- 21.1 Subsidiaries of the Registrant. (Attached as an exhibit to this Form 10-KSB.)
- 23.1 Consent of Kost, Forer, Gabbay & Kasierer, a member of Ernst and Young Global
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive and Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

No matters were reports on Form 8-K were filed with the Commission during the fourth quarter of the year ended December 31, 2004.

Item 14. Principal Accountant Fees and Services.

The information set forth under the caption "Independent Public Accountants" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held on or about July 7, 2005 is incorporated by reference.

SIGNATURE PAGE

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on our behalf by the undersigned, thereunto duly authorized.

INKSURE TECHNOLOGIES INC.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Yaron Meerfeld</u> Yaron Meerfeld	Chief Executive Officer and Director	March 30, 2005

In accordance with the Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Yaron Meerfeld</u> Yaron Meerfeld	Chief Executive Officer and Director (Principal Executive Officer)	March 30, 2005
<u>/s/ Elie Housman</u> Elie Housman	Chairman and Director	March 30, 2005
<u>/s/ Eyal Bigon</u> Eyal Bigon	Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2005
<u>/s/ James Linberger</u> James Lineberger	Director	March 30, 2005
<u>/s/ Philip Getter</u> Philip Getter	Director	March 30, 2005
<u>/s/ Michael Acks</u> Michael Acks	Director	March 30, 2005
<u>/s/ Albert Attias</u> Albert Attias	Director	March 30, 2005
<u>/s/ David Sass</u> David Sass	Director	March 30, 2005

SUBSIDIARIES OF THE REGISTRANT

InkSure Inc., Delaware
InkSure RF, Inc., Delaware
InkSure Ltd., Israel
IST Operating Inc., Delaware

CERTIFICATION

I, Yaron Meerfeld, certify that:

1. I have reviewed this annual report on Form 10-KSB of InkSure Technologies Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2005

By: /s/ Yaron Meerfeld

Yaron Meerfeld
Chief Executive Officer

CERTIFICATION

I, Eyal Bigon, certify that:

1. I have reviewed this annual report on Form 10-KSB of InkSure Technologies Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2005

By:

/s/ Eyal Bigon

Eyal Bigon
Chief Financial Officer

CERTIFICATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of InkSure Technologies Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Annual Report for the fiscal year ended December 31, 2004 (the "Form 10-KSB") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-KSB fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 30, 2005

/s/ Yaron Meerfeld

Yaron Meerfeld, Chief Executive Officer

Dated: March 30, 2005

/s/ Eyal Bigon

Eyal Bigon, Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided by the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

INKSURE TECHNOLOGIES INC. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2004

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders of

INKSURE TECHNOLOGIES INC.

We have audited the accompanying consolidated balance sheet of InkSure Technologies Inc. ("the Company") and its subsidiaries as of December 31, 2004, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2004, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel
March 27, 2005

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

INKSURE TECHNOLOGIES INC.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

U.S. dollars in thousands

	<u>December 31, 2004</u>
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 1,648
Trade receivables	317
Other accounts receivable and prepaid expenses (Note 3)	111
Inventories (Note 4)	<u>530</u>
<u>Total</u> current assets	<u>2,606</u>
SEVERANCE PAY FUND	<u>115</u>
PROPERTY AND EQUIPMENT, NET (Note 5)	<u>264</u>
TECHNOLOGY, NET (Note 6)	<u>-</u>
GOODWILL	<u>271</u>
<u>Total</u> assets	<u>\$ 3,256</u>

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

**INKSURE TECHNOLOGIES INC.
AND ITS SUBSIDIARIES**

CONSOLIDATED BALANCE SHEET

U.S. dollars in thousands

	<u>December 31, 2004</u>
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Trade payables	\$ 381
Employees and payroll accruals	121
Accrued expenses	<u>114</u>
<u>Total</u> current liabilities	<u>616</u>
ACCRUED SEVERANCE PAY	<u>115</u>
COMMITMENTS AND CONTINGENT LIABILITIES (Note 7)	
STOCKHOLDERS' EQUITY:	
Stock capital (Note 8):	
Preferred stock of \$ 0.01 par value –	
Authorized: 10,000,000 shares in 2004; Issued and outstanding: 0 shares	
Common stock of \$ 0.01 par value -	
Authorized: 35,000,000; Issued and outstanding: 15,011,579	150
Additional paid-in capital	12,031
Accumulated other comprehensive income	118
Accumulated deficit	<u>(9,774)</u>
<u>Total</u> stockholders' equity	<u>2,525</u>
	\$
<u>Total</u> liabilities and stockholders' equity	<u><u>3,256</u></u>

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

**INKSURE TECHNOLOGIES INC.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except share and per share data)

	Year ended December 31,	
	2004	2003
	\$	
Revenues (Note 11)	955	\$ 608
Cost of revenues	413	134
Gross profit	542	474
Operating expenses:		
Research and development	775	1,184
Selling and marketing, net	1,239	1,560
General and administrative	590	730
<u>Total operating expenses</u>	2,604	3,474
Operating loss	(2,062)	(3,000)
Financial income, net (Note 10)	1	35
	\$	
Net loss	(2,061)	\$ (2,965)
Basic and diluted net loss per share	\$ (0.15)	\$ (0.24)
Weighted average number of shares of Common stock used in computing basic and diluted net loss per share	13,956,864	11,982,166

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

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars in thousands

	<u>Share capital</u>	<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive income</u>	<u>Accumulated deficit</u>	<u>Total stockholders' equity</u>
Balance as of January 1, 2003	\$ 119	\$ 9,741	\$ 118	\$ (4,748)	\$ 5,230
Issuance expenses in respect of reverse acquisition	-	(58)	-	-	(58)
Net loss	-	-	-	(2,965)	(2,965)
Balance as of December 31, 2003	119	9,683	118	(7,713)	2,207
Issuance of Common stock and warrants, net	31	2,348	-	-	2,379
Net loss	-	-	-	(2,061)	(2,061)
Balance as of December 31, 2004	<u>\$ 150</u>	<u>\$ 12,031</u>	<u>\$ 118</u>	<u>\$ (9,774)</u>	<u>\$ 2,525</u>

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

**INKSURE TECHNOLOGIES INC.
AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,	
	2004	2003
<u>Cash flows from operating activities:</u>		
Net loss	\$ (2,061)	\$ (2,965)
Adjustments required to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	186	151
Accrued severance pay, net	(22)	19
Decrease in trade receivables	182	231
Decrease in other accounts receivable and prepaid expenses	26	89
Increase in inventories	(425)	(17)
Increase (decrease) in trade payables	19	(108)
Increase (decrease) in employees and payroll accruals	(7)	17
Decrease in accrued expenses	(10)	(156)
Accumulated interest on short-term bank deposits	-	(49)
	(2,112)	(2,788)
Net cash used in operating activities		
<u>Cash flows from investing activities:</u>		
Purchase of property and equipment	(72)	(33)
Investment in short-term bank deposits	-	(1,224)
Proceeds from short-term bank deposits	21	5,315
Proceeds from sale of property and equipment	-	7
	(51)	4,065
Net cash provided by (used in) investing activities		
<u>Cash flows from financing activities:</u>		
Issuance of Common stock and warrants, net	2,379	-
Issuance expenses in respect of reverse acquisition	-	(58)
	2,379	(58)
Net cash provided by (used in) financing activities		
Increase in cash and cash equivalents	216	1,219
Cash and cash equivalents at the beginning of the year	1,432	213
	\$ 1,648	\$ 1,432
Cash and cash equivalents at the end of the year		

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

NOTE 1:- GENERAL

- a. InkSure Technologies Inc. (formerly: Lil Marc Inc.) and its subsidiaries (together, "the Company") was incorporated under the laws of the State of Nevada, U.S., on April 22, 1997. On July 8, 2003, InkSure Technologies Inc. effected a reincorporation from Nevada to Delaware, through a merger with and into its wholly-owned subsidiary, InkSure Technologies (Delaware) Inc., which was incorporated as of June 30, 2003. The surviving corporation in the merger was InkSure Technologies (Delaware) Inc., which thereafter renamed itself InkSure Technologies Inc.

The Company specializes in comprehensive security solutions, designed to protect branded products and documents of value from counterfeiting, fraud and diversion. During 2004, the Company generated most of its revenues from major customers (see also Note 11).

The Company conducts its operations and business with and through its direct and indirect subsidiaries, InkSure Inc., a Delaware corporation incorporated in March 2000; IST Operating Inc., a Delaware corporation, incorporated in May 2000 (formerly: InkSure Technologies Inc.) (as of December 31, 2004, IST Operating Inc. is inactive); InkSure Ltd., which was incorporated in December 1995 under the laws of Israel and InkSure RF Inc., a Delaware corporation incorporated in March 2000 (as of December 31, 2004, InkSure RF Inc. is inactive).

- b. According to the agreement signed in 2002 between LILM (a subsidiary of Lil Marc Inc.) and InkSure Technologies (Delaware) Inc. ("InkSure Delaware"), Lil Marc Inc., a public shell, issued 10,541,086 shares of Common stock to the former holders of an equity interest in InkSure Delaware. As a result of this transaction, the shareholders of InkSure Delaware own approximately 88% of the combined company, while the shareholders of Lil Marc own approximately 12%.

The merger was accounted for as a reverse acquisition of Lil Marc by InkSure Delaware. Although Lil Marc is the surviving legal entity, for financial reporting purposes, the entity whose stockholders hold in excess of 50% of the combined company, InkSure Delaware, is treated as the continuing accounting entity. The reverse acquisition is treated as a stock capital transaction in which InkSure Delaware is deemed to have issued the Common stock held by the Lil Marc stockholders for the net assets (comprised of cash only) of Lil Marc.

Upon consummation of the merger, the Company's board of directors and management resigned and were replaced by InkSure Delaware's board of directors and management, and the Company began to carry on InkSure Delaware's business activities.

On October 28, 2002, as part of the Company's amendment of its Articles of Incorporation, the Company changed its name from Lil Marc Inc. to InkSure Technologies Inc.

As of October 30, 2002, the OTC Bulletin Board stock symbol of the Company's Common stock was changed from LILM to INKS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the U.S. subsidiary's sales is made in U.S. dollars ("the dollar"). In addition, a substantial portion of the U.S. subsidiary costs is incurred in dollars and the majority of the expenses of the Israeli subsidiary is paid in new Israeli shekels ("NIS"); however, most of the expenses are dominated and determined in U.S. dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of the Financial Accounting Standards No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

Through 1999, the financial statements of InkSure Ltd., whose functional currency was the NIS, have been translated into U.S. dollars. Assets and liabilities have been translated at year end exchange rates in effect at the balance sheet date. Statement of operations items have been translated at average exchange rates prevailing during the year. The resulting translation adjustments were recorded as a separate component of shareholders' equity in accumulated other comprehensive income. Effective January 1, 2000, due to a change in its business environment, the subsidiary adopted the U.S. dollar as its functional currency.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments purchased with maturities of three months or less as of the date acquired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows:

Raw materials, parts and supplies - using the "first-in, first-out" method.

Work in progress and finished products - on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

f. Property and equipment, net:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method, over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	20 - 33
Office furniture and equipment	6 - 20
Leasehold improvements	Over the shorter of the term of the lease Or the life of the asset

g. Goodwill:

Goodwill represents excess of the costs over the fair value of net assets of businesses acquired. Under Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") goodwill acquired in a business combination on or after July 1, 2001, is not amortized.

SFAS No. 142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to the reporting unit is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is determined according to a financing round between unrelated parties.

As of December 31, 2004, no impairment losses have been identified.

h. Technology:

Intangible assets acquired in a business combination for which the date is on or after July 1, 2001, should be amortized over their useful life using the method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142.

Technology is amortized over a period of three years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Impairment of long-lived assets

The Company's long-lived assets and certain identified intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2004, no impairment losses have been identified.

j. Severance pay:

Pursuant to section 14 of the Severance Compensation Act, 1963 ("section 14"), the employees of the Company are entitled to monthly deposits, at a rate of 8.33% of their monthly salary, made in their name with insurance companies. Section 14 allows the Company to make yearly deposits in the severance pay fund according to the employees' current salary. Furthermore, the fund is made available to the employee at the time when the employer-employee relationship ends, regardless of cause of termination.

Severance expenses for the years ended December 31, 2004 and 2003 amounted to \$24 and \$ 44, respectively.

k. Revenue recognition:

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

The Company generates revenues mainly from sales of security inks and readers through a combination of its own sales personnel, strategic alliances and licenses with intermediaries.

Revenues from product sales are recognized in accordance with "Revenue Recognition in Financial Statements" ("SAB No. 104"), when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable. Delivery is considered to have occurred upon shipment of products. The Company does not grant a right of return to its customers.

Revenues from certain arrangements may include multiple elements within a single contract. The Company's accounting policy complies with the provisions of Emerging Issues Task Force Issue 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"), relating to the separation of multiple deliverables into individual accounting units with determinable fair value.

The Company recognizes revenues from sales arrangements of which all the products are being delivered in accordance with EITF 00-21 guidelines.

In cases where the Company has partial delivery at the cut off dates and no fair value exist for the undelivered elements revenues are being deferred and recognized only at the point where the entire arrangement has been delivered.

l. Warranty:

The Company provides a warranty for its products. The term of the warranty is three months for hardware products and up to 18 months for Smartink products.

As of the balance sheet date, the Company did not receive any warranty claims and does not expect to receive any material warranty claims in the future. Therefore, the Company did not record a liability in respect of the warranty.

m. Research and development costs:

Research and development costs are charged to the statement of operations, as incurred.

n. Government grants:

The Company has received non-royalty-bearing grants amounted to \$ 0 and \$ 12, during the years ended December 31, 2004 and 2003, respectively, from the Israeli Fund for Encouragement of Marketing Activity. These grants are recognized at the time the Company is entitled to such grants on the basis of the costs incurred and included as a reduction in sales and marketing expenses.

o. Basic and diluted net loss per share:

Basic and diluted net loss per share is presented in accordance with Statement of Accounting Financial Standards No. 128, "Earnings Per Share" ("SFAS No. 128") for all periods presented. Basic and diluted net loss per share of Common stock was determined by dividing net loss attributable to Common stock holders by weighted average number of shares of Common stock outstanding during the period. Diluted net loss per share of Common stock is the same as basic net loss per share of Common stock for all periods presented as the effect of the Company's potential additional shares of Common stock were antidilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

All outstanding stock options and warrants have been excluded from the calculation of the diluted net loss per share of Common stock because all such securities are anti-dilutive for the periods presented. The total number of shares related to the outstanding options and warrants excluded from the calculations of diluted net loss per share, was 4,581,313 and 3,305,261 for the years ended December 31, 2004 and 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING PRINCIPLES (Cont)

p. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

q. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables.

Cash and cash equivalents are invested in major banks in Israel and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound, and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers located in the United States. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. As of December 31, 2004 the Company did not provide an allowance for doubtful accounts. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

r. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating fair value and disclosures for financial instruments:

The carrying amounts reported in the balance sheet for cash and cash equivalents, trade receivables, and trade payables approximate their fair value due to the short-term maturities of such instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING PRINCIPLES (Cont)

s. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Statement No. 25, "Accounting for Stock Options Issued to Employees" ("APB No. 25") and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock option plans. Under APB No. 25, when the exercise price of an employee stock option is equivalent to or above the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148") which amended certain provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Company's net loss and net loss per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value for options granted in 2004 and 2003 is amortized over their vesting period and estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	Year ended December 31	
	2004	2003
Dividend yield	0%	0%
Expected volatility	1.04	2.1
Risk-free interest	3.7%	3%
Expected life of up to	5 years	5 years

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 2:- SIGNIFICANT ACCOUNTING PRINCIPLES (Cont.)

Pro forma information under SFAS No. 123 is as follows:

	Year ended December 31,	
	2004	2003
	\$	
Net loss as reported	(2,061)	\$ (2,965)
Total stock-based employee compensation determined under fair value based method for all awards	(229)	(138)
Pro forma net loss	(2,290)	\$ (3,103)
Net loss per share:		
Basic and diluted as reported	\$ (0.15)	\$ (0.24)
Basic and diluted pro-forma	\$ (0.16)	\$ (0.26)

t. Advertising expenses:

Advertising expenses are charged to the statements of operations as incurred. Immaterial advertising expenses were incurred in 2004 and 2003.

u. Impact of recently issued accounting pronouncements:

In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4." ("SAFS 151"). SFAS 151 amends Accounting Research Bulletin ("ARB") No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SAFS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. As of December 31, 2004, the Company does not expect that the adoption of SFAS 151 will have a material effect on its financial position or results of operations.

NOTE 2:- SIGNIFICANT ACCOUNTING PRINCIPLES (Cont.)

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), *Share-Based Payment* ("Statement 123R"), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("Statement 123"). Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values while Statement 123(R) requires all share-based payments to employees to be recognized based on their fair values. Statement 123R also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new standard will be effective for the Company in the first interim period beginning after December 15, 2005. Since December 31, 2004, the Company has been and is currently evaluating the impact from this standard on its results of operations and financial position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2004
Government authorities	\$ 86
Prepaid expenses	14
Other	11
	\$ 111

NOTE 4:- INVENTORIES

Raw materials, parts and supplies	\$ 252
Work in progress	97
Finished products	181
	\$ 530

NOTE 5:- PROPERTY AND EQUIPMENT, NET

Cost:	
Computers and peripheral equipment	\$ 374
Office furniture and equipment	115
Leasehold improvements	116
	605
Accumulated depreciation:	
Computers and peripheral equipment	218
Office furniture and equipment	52
Leasehold improvements	71
	341
Depreciated cost	\$ 264

Depreciation expenses for the years ended December 31, 2004 and 2003, amounted to \$ 111 and \$ 79, respectively.

As for charges, see Note 7b.

NOTE 6:- TECHNOLOGY, NET

	December 31, 2004
Original amounts:	
Technology	\$ 219
Less - accumulated amortization	219
Amortized cost	\$ -

Amortization expenses amounted to \$ 75 and \$ 72 for the years ended December 31, 2004 and 2003, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 7:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company leases its facilities and certain motor vehicles under various operating lease agreements, which expire on various dates, the latest of which is in 2007. The annual minimum future rental payments under non-cancelable operating leases as of December 31, 2004, are as follows:

Year ended December 31,

2005	\$	106
2006		82
2007		49
		<hr/>
	\$	<u>237</u>

Total rent expenses for the years ended December 31, 2004 and 2003, were approximately \$ 126 and \$ 89, respectively.

Motor vehicle lease expenses for the years ended December 31, 2004 and 2003 were approximately \$ 71 and \$ 78, respectively.

b. Charges and guarantees:

The Company obtained bank guarantees in the amount of \$ 9, to secure its lease commitments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 7:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

c. Other contingencies:

1. On December 12, 1999, Secu-Systems filed a lawsuit with the District Court in Tel-Aviv-Jaffa against Supercom Ltd. (InkSure Delaware's, former parent company) and InkSure Ltd. seeking a permanent injunction and damages. The plaintiff asserted in its suit that the printing method applied to certain products that have been developed by InkSure Ltd. constitutes inter alia: (a) a breach of a confidentiality agreement between the plaintiff and Supercom; (b) unjust enrichment of Supercom and InkSure Ltd; (c) breach of fiduciary duties owed to the plaintiff by Supercom and InkSure Ltd.; and (d) a tort of misappropriation of trade secrets and damages to the plaintiff's property. Secu-Systems seeks, among other things, an injunction and a 50% share of profits from the printing method at issue. In 2004 all parties submitted their arguments to the court. The Company expects the court will render a decision in 2005. The Company's legal counsel and management are of the opinion that, based on the facts provided by Supercom and InkSure Ltd., the chances are good that the court will not grant the permanent injunction or award damages of a substantial amount in connection with this litigation and that the amount can not be reasonably measured. Accordingly, the Company did not record any provision.

2.

The Company is disputing the valid issuance of an option to purchase 300,480 shares of InkSure Delaware Common stock that was issued prior to the reverse acquisition at an exercise price of \$ 0.5 per share. If the Company's position in this dispute does not prevail it would be forced to accept the validity of the issuance of this option and convert it into an option to purchase shares of the Company's Common stock. The Company is in the process of evaluating the validity of the grant with its legal counsel. This claim has not matured to legal proceeding at this point, and therefore the company's legal counsel and management cannot predict the outcome of this claim

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 8:- STOCK CAPITAL

a. Stockholders' rights:

Shares of Common stock confer upon the holders right to receive notice to participate and vote in the general meetings of the Company, and the right to receive dividends, if and when declared.

b. Private placements:

In March 2004, the Company entered into an investment agreement with certain accredited investors. In April 2004, under the agreement, the Company issued in a private placement 1,904,412 units with each unit consisting of a share of Common stock and a five-year warrant to purchase a share of Common stock at an exercise price of \$ 1 per share. The price per unit was \$ 0.68 with net proceeds to the Company of \$ 1,267 (net of issuance expenses).

In July 2004, the Company entered into an additional investment agreement with certain accredited investors. According to the agreement, the Company issued in a private placement an aggregate of 1,125,000 of shares of Common stock, at a price per share equal to \$ 1 with gross proceeds to the Company of \$ 1,112 (net of issuance expenses).

c. Stock options:

On August 24, 2001, the board of directors of InkSure Delaware adopted the 2001 Employee Stock Option Plan ("the 2001 Plan"). Under the 2001 Plan 600,000 shares have been reserved for issuance upon the exercise of options granted thereafter. The 2001 Plan will remain in effect until August 24, 2007.

According to the merger agreement and according to the approval of the Board of Directors of InkSure Technologies Inc., all outstanding option agreements (as mentioned above) have been replaced with new options agreements in accordance with the Company's 2002 stock option plan ("the 2002 Plan").

The terms and conditions of the 2002 Plan relating to vesting periods and exercise prices are the same as in the 2001 Plan.

Under the 2002 Plan, up to 3,500,000 options may be granted to officers, directors, employees and consultants of the Company.

The options vest ratably over a period of up to four years, commencing with the date of grant. The options generally expire no later than five years from the date of grant. Any options, which are forfeited or cancelled before expiration, become available for future grants.

As of December 31, 2004, an aggregate of 2,223,653 options are still available for future grant under the Company's stock option plans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 8:- STOCK CAPITAL (Cont.)

The following is a summary of the Company's stock options granted among the various plans:

	Year ended December 31,			
	2004		2003	
	Amount of options	Weighted average exercise price	Amount of options	Weighted average exercise price
Outstanding at beginning of year	1,026,514	\$ 1.08	863,256	\$ 1.00
Granted	809,500	\$ 1.10	174,000	\$ 1.45
Forfeited	(81,200)	\$ 1.13	(10,742)	\$ 1.20
Outstanding at end of year	<u>1,754,814</u>	<u>\$ 1.09</u>	<u>1,026,514</u>	<u>\$ 1.08</u>
Exercisable at end of year	<u>693,842</u>	<u>\$ 1.07</u>	<u>714,918</u>	<u>\$ 1.05</u>

The options outstanding as of December 31, 2004, have been separated into ranges of exercise price as follows:

Range of exercise price	Options outstanding as of December 31, 2004	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2004	Weighted average exercise price of options exercisable
\$ 0.8 - 1.2	1,511,814	4.77	\$ 0.91	539,846	\$ 0.96
\$ 1.45 - 1.61	<u>243,000</u>	<u>3.00</u>	<u>\$ 1.52</u>	<u>153,996</u>	<u>\$ 1.52</u>
	<u>1,754,814</u>	<u>4.6</u>	<u>\$ 1.09</u>	<u>693,842</u>	<u>\$ 1.07</u>

No compensation expenses were recognized by the Company for the years ended December 31, 2004 and 2003.

Weighted average fair value and weighted average exercise prices of options granted during the years ended December 31, 2004 and 2003 whose exercise price is equal to or exceeds the market price of the shares at the date of grant, are as follows:

	Year ended December 31,			
	2004		2003	
	Weighted average fair value	Weighted average exercise price	Weighted average fair value	Weighted average exercise price
Equals market price at date of grant	<u>\$ 0.81</u>	<u>\$ 1.05</u>	<u>\$ 1.42</u>	<u>\$ 1.45</u>
Exceeds market price at date of grant	<u>\$ 0.38</u>	<u>\$ 2.17</u>	<u>\$ -</u>	<u>\$ -</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share data)

NOTE 8:- STOCK CAPITAL (Cont.)

d. Stock warrants:

The Company has issued warrants, as follows:

<u>Issuance date</u>	<u>Outstanding as of December 31, 2004</u>	<u>Exercise price</u>	<u>Exercisable as of December 31, 2004</u>	<u>Exercisable through</u>
July 2002 (1)	1,347,831	\$ 2.17	1,347,831	July 2007
September 2002 (1)	108,695	\$ 2.17	108,695	September 2007
September 2002 (2)	550,933	\$ 1.61	550,933	September 2007
April 2004 (3)	<u>1,904,412</u>	\$ 1.00	<u>1,904,412</u>	April 2009
	<u>3,911,871</u>		<u>3,911,871</u>	

- (1) Issued to investors in the 2002 private placement.
- (2) Issued to underwriters of the 2002 private placement.
- (3) Issued to investors in the 2004 private placement.

e. Dividends:

In the event that dividends are declared in the future, such dividends will be paid in U.S. dollars.

The Company does not intend to pay cash dividends in the foreseeable future.

NOTE 9:- TAXES ON INCOME

a. Measurement of taxable income under the Income Tax Law (Inflationary Adjustments), 1985:

The results for tax purposes of the Israeli subsidiary are measured in terms of earnings in NIS, after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are measured in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities at the Israeli subsidiary.

b. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

NOTE 9:- TAXES ON INCOME (Cont.)

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Net operating loss carryforward	\$ 1,994	\$ 1,529
Other deductions for tax purposes	1,084	1,975
	<hr/>	<hr/>
Net deferred tax asset before valuation allowance	3,078	3,504
Valuation allowance	(3,078)	(3,504)
	<hr/>	<hr/>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforward and other temporary differences. Management currently believes that since the Company has a history of losses it is more likely than not that the deferred tax regarding the loss carryforward and other temporary differences will not be realized in the foreseeable future. During fiscal 2004, the Company decreased its valuation allowance by \$ 426 to \$ 3,078.

Net loss consists of the following:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Domestic	\$ (1,043)	\$ (1,299)
Foreign	(1,018)	(1,666)
	<hr/>	<hr/>
	<u>\$ (2,061)</u>	<u>\$ (2,965)</u>

- c. On July 24, 2002, Amendment 132 to the Israeli Income Tax Ordinance ("the Amendment") was approved by the Israeli parliament and came into effect on January 1, 2003. The principal objectives of the Amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employees income.

The material consequences of the Amendment applicable to the Israeli subsidiary include, among other things, imposing tax upon all income of Israel residents, individuals and corporations, regardless of the territorial source of income and certain modifications in the qualified taxation tracks of employee stock options.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 9:- TAXES ON INCOME (Cont.)

d. Tax loss carryforwards:

Net operating loss carryforwards as of December 31, 2004 are as follows:

Israel	\$	2,454
United States *)		<u>3,698</u>
		<u><u>\$ 6,152</u></u>

Net operating losses in Israel may be carried forward indefinitely. Net operating losses in the U.S. are available through 2024.

*) Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

e. The main reconciling items between the statutory rate of the Company and the effective tax rate are the non-recognition of tax benefits from the accumulated net operating losses carryforward among the two subsidiaries due to the uncertainty of the realization of such tax benefits.

f. Reduction in corporate tax rate:

In June 2004, the Israeli Parliament approved an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision) (the "Amendment"), which progressively reduces the regular corporate tax rate from 36% to 35% in 2004, 34% in 2005, 32% in 2006 and to a rate of 30% in 2007. The amendment was signed and published in July 2004 and is, therefore, considered enacted in July 2004.

NOTE 10:- FINANCIAL INCOME, NET

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Interest, bank charges and fees	\$ 5	\$ 44
Foreign currency translation differences	(4)	(9)
	<u>\$ 1</u>	<u>\$ 35</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 11:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

The Company manages its business on a basis of one reported operating segment: Security Solutions (see Note 1 for a brief description of the Company's business). Total revenues are attributed to geographic areas based on the location of the end customers. This data is presented in accordance with Statement of Financial Accounting Standards No.131, "Disclosure About Segments of an Enterprise and Related Information" ("SFAS No. 131").

The following data presents total revenue for the years ended December 31, 2004 and 2003, based on the customer's location and long-lived assets as of December 31, 2004 and 2003:

	2004		2003	
	Total revenues	Long-lived assets	Total revenues	Long-lived assets
United States	\$ 619	\$ 312	\$ -	\$ 384
Export:				
Israel	-	259	-	265
Turkey	237	-	464	-
Netherlands	-	-	77	-
Other	99	-	67	-
	\$ 955	\$ 571	\$ 608	\$ 649

Major customer data as a percentage of total revenues, is as follows:

	Year ended December 31,	
	2004	2003
Customer A	*)	76%
Customer B	63%	-
Customer C	25%	*)
Customer D	*)	11%

*) Represent a percentage lower than 10%
