



One Park Plaza, Suite 600  
Irvine, CA. 92614  
tel: 949-441-5152 fax: 949-441-5099  
[www.T11Capital.com](http://www.T11Capital.com)

email: [mail@T11Capital.com](mailto:mail@T11Capital.com)

## IWSY: A TRANSITIONED BUSINESS MODEL THAT SHOULD BE EMBRACED BY INVESTORS

\*Originally published on March 1, 2013.

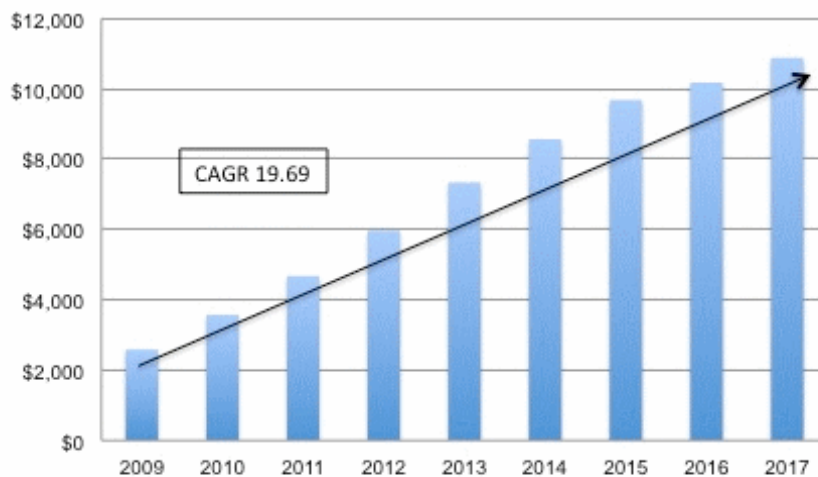
### The Background

On May 8th of 2012, a research report was posted to Zenpenny detailing the opportunity in a biometric security company that specialized in the mobile space. The report was titled, "**AUTH Presents A Substantial Opportunity In The Wireless Sector.**" When the report was posted to the site AUTH was trading in the \$3 range. A little more than two months later AAPL bought AUTH in the \$8 range, making AUTH one of the big portfolio winners from last year. I was drawn to AUTH as an investment for two reasons:

1. It was flying completely under the radar, while dramatically improving fundamental aspects of the company that had caused the stock to fall from a post- IPO (spinoff from Harris) high of near \$20 per share.
2. They were making great strides in an area of mobile security that is going to become standard in the wireless space over the next several years – biometric user identification.

AAPL, seeing the light, decided to seize the opportunity while it was still undervalued, gobbling the company up at bargain prices. AUTH deserved a valuation in the teens. AAPL got it cheap.

**Biometric Industry Revenues**  
(US Millions)



©Acuity Market Intelligence

This article citing data from Goode Intelligence, a British market research firm, describes the opportunity in the biometric market:

<http://www.securityweek.com/analyst-biometrics-will-become-must-have-all-mobile-devices>

A British market research firm, Goode Intelligence, says that biometrics for mobile devices will be an essential feature before the decade is out. Their claims come from previous forecasts that point to a market growth of nearly

39 million users by 2015.

Smart Mobile Devices (SMDs) are now the personal device of choice, Goode notes, with sales outpacing PCs. The BYOD trend is accelerating the need for enhanced security as SMDs are being used more often for consumer and business-sensitive activities.

“Last year, we forecasted that the mobile biometric security market would grow to 39 million users by 2015” said Alan Goode, founder and Managing Director of Goode Intelligence.

“This was based on the expectation that initial growth would come from two biometric modalities; embedded fingerprint sensors and voice biometrics. The news that **Apple is buying fingerprint sensor specialist AuthenTec** further supports the evidence for this exciting trend.”

Apple did make a move to acquire the biometric security company last week, and will pay roughly \$356 million for the firm which creates embedded fingerprint scanners and other IDM software. Moreover, AuthenTec also creates DRM software. The fact that IDM and DRM are both coming from the company makes them a decent buy for Apple. While the speculation is that iDevices (iPhones, iPads, etc.) will get biometrics, Apple hasn't confirmed anything.

Goode says that mobile biometric security “will become a standard feature in SMDs as these devices become the prime computer in both our personal and business life. Whether it is for protecting the physical device or for providing strong authentication and identity verification for a remote service, such as NFC-based [mobile payments](#), mobile phone-based biometrics can offer a wide variety of solutions – the third factor in the palm of your hand.”

### [IWSY History](#)

IWSY is not new to the technology market by any stretch of the imagination. The company has been around since 1987, originally involved in digital imaging. In 1999, the focus of IWSY switched to the biometric field. The original model for IWSY included and has grown to the following biometric applications. This from the company website:

- Our **innovative, patented, multi-modal biometric software platform** manages millions of identities for a wide range of customers from the U.S. Veterans Administration and the Mexican Ministry of Foreign Affairs to the Canadian Air Transport Security Authority (CATSA).
- Our **advanced credentialing software** has issued tens of millions of identity cards, drivers' licenses, passports and visas in dozens of countries across the globe.
- More than 100 law enforcement agencies worldwide, including the Las Vegas Metro Police Department, the Arizona Department of Public Safety and the New South Wales Police in Australia trust ImageWare software to digitally capture, store and retrieve images and data for booking, investigative and identification purposes.
- The Pill Phone®**, enabled by our **IWS Interactive Messaging System** push application platform, is FDA cleared and the only mobile health management application secured by biometrics.

The original model the company pursued and still pursues to this day involves more governmental and police contracts. A revenue model that depends on governments and municipalities tends to be lumpy in nature. IWSY recognized this early on but did not have an organic means of shifting their business away from such a lumpy revenue model. The proverbial light bulb seem to have clicked on in 2012, as I will detail later in this report.

What should be encouraging to investors is the profile of the corporate executives. This is not a newly formed executive team brought in to facilitate growth in an industry that is foreign to them. This is an executive team that not only possesses tremendous industry experience, but has been loyal to IWSY for some years:

Jim Miller – Chairman & CEO

Jim Miller has served as CEO and as a Director since 1990.

Wayne Wetherell – SVP of Administration and CFO

Joined the company in 1996.

Chuck AuBuchon – VP, Business Development

Chuck AuBuchon joined ImageWare Systems in 2003.

And then there is the experienced group of directors the company has put together recently. I will also get to that part later. IWSY is a well-established company in the biometric field with an experienced, dedicated management team. Often

times, experienced and dedicated leads to traditional operators of a company that leads to very little in the way of innovation. The dynamics necessary to stay on the cutting edge of the technology cycle seem to disappear with experience and dedication. IWSY seems to be bucking this trend, with some extremely interesting developments over the past 12 months that have gone without notice, thereby creating the investment opportunity.

### Recent Developments Make The Opportunity Great

If IWSY was a company involved only in airport and police biometrics, the opportunity would be no greater than the bevy of biometric security companies that exist in the public marketplace. A lumpy revenue model, with little in the ways of growth opportunity except during periods of terrorist inspired hysteria that brings security to the forefront of the collective consciousness for a period of months.

IWSY is a lot more than the typical biometric company. During the middle of 2012 the company started aggressively transitioning itself into a provider of mobile and cloud biometrics. This allows the company to curtail the lumpy revenue model that has led share price nowhere over the past several years, transitioning to a revenue model that will be recurring and reliable.

Since undertaking these efforts the market has rewarded IWSY by creating no growth in share price whatsoever. Fairly typical behavior in a marketplace that is overwhelmed with myopic focus on story stocks that have perceived safety brought by the camaraderie of group think. This dynamic allows for companies like IWSY to languish for months while the company makes progress that creates exciting growth possibilities.

The clues about the future intentions of IWSY came to light in late June when the company acquired four wireless technology patents from Vocol in exchange for warrants and royalty payments.

**<http://www.iwsinc.com/about-iws/news-and-events-weblink/press-releases/imageware-acquires-four-wireless-technology-patents>**

SAN DIEGO, CA – June 28, 2012 – ImageWare Systems, Inc. (OTCQB: IWSY), a leader in multimodal biometric security solutions, has acquired from a private company four U.S. patents related to wireless technology. These patents, combined with ImageWare Systems' existing foundational patents in the areas of biometric identification, verification, enrollment and fusion, provide a unique and protected foundation on which to build interactive mobile applications that are secured using biometrics.

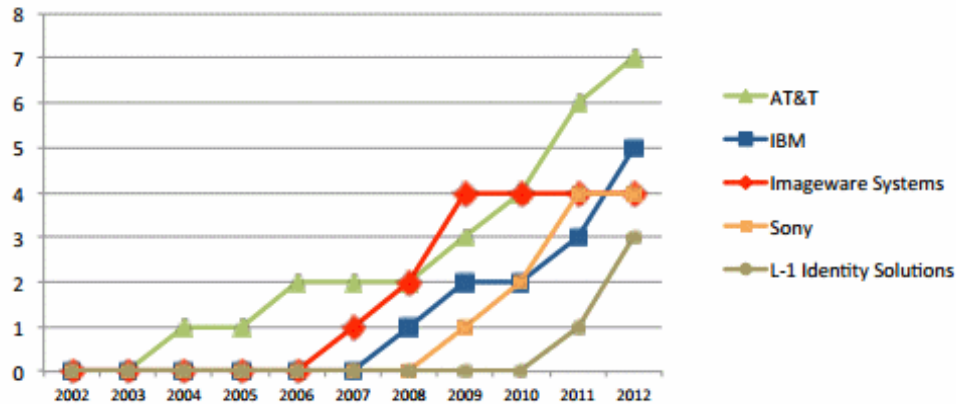
Securing these patents is expected to accelerate and strengthen ImageWare's entry into the mobile transaction marketplace for industries like healthcare, law enforcement, banking, and retail—or for any organization requiring highly-reliable and flexible identity verification of their mobile users.

“The addition of these patents to our IP portfolio significantly strengthens our market position as we continue our entrance into the mobile marketplace,” said Jim Miller, ImageWare Systems chairman and CEO. “Combining the technology underlying these patents with ImageWare's biometric solutions provides the missing security link facing a growing number of enterprises and government agencies using mobile platforms to transact business or interact with their users.”

“We believe securing these patents also provides yet another substantial competitive barrier to entry, as we work to roll out related mobile security enhancements to our products before the end of the year,” added Miller.

Including these newly acquired patents, ImageWare Systems now holds nine patents with eight patent applications pending. In addition to these patents, the company also announced during 2012 that it planned on acquiring between 30-40 additional patents, indicating an aggressive posture towards growth. More importantly, it indicates the company fully intends on making mobile and cloud biometric technology the future of IWSY. A complete shift of company focus that will impact their revenue model in ways that the market has yet to factor in.

Figure 11: Top 5 patent holders in "multimodal biometrics"



Courtesy: MDB Capital Group

Here is the CEO Jim Miller describing the progress made in 2012 to an industry publication:  
<http://findbiometrics.com/assets/findBIOMETRICS-Year-in-Review-2012.pdf>

2012 was a good year for Imageware. We strengthened our balance sheet and retired all of our debtenabling us to move forward with aggressive product development and market entry.

We released version 2.0 of our flagship product, the patented Biometric Engine(R), an evolutionary leap in biometric data management including new features such as a patent pending capability for anonymous biometric identity management. The Biometric Engine was selected by Fujitsu as the multi-biometric data management solution for their NuVola Private Cloud platform to be sold worldwide

We introduced IWS CloudID(R), our next generation, cloud-ready suite of identity solutions.

We were selected by Los Angeles World Airports to provide biometric identity management for LAX and Ontario Airports as well as the government of Ecuador to provide a biometric identity system for all seaports.

We finalized development of our new mobile platform which will bring patented biometric security to the mobile world in tandem with patented wireless push messaging technology.

b. The exciting entry into the mobile market with multiple biometric products designed for retail, financial and healthcare industries.

The emergence of the patented Biometric Engine as the worlds premier biometric database manager.

The partnership announced with Fujitsu in 2012 provides legitimacy to their cloud based offering very early during this transition. Security in the cloud is a daunting issue for large corporations. It is an issue that will be solved by moving away from passwords that will become a figment of yesterday's technology over the next several years.

Here is the view from an industry publication regarding Fujitsu choosing IWSY to provide cloud security:

<http://www.businesscloud9.com/content/fujitsu-adds-imageware-biometrics-private-clouds/11719>

One of the important trends in delivering security for Cloud services is the switch from attempting to defend individual devices with anti-virus and anti-malware tools to defending the entire infrastructure on the basis of operational policy control.

Basically, if a process or individual staff member steps across a policy 'line' in what they are doing or when they are doing it, the system can spot it – and terminate it with extreme prejudice.

When it comes to staff members this approach can be critical, though it does carry with it one important proviso – the need to accurately authenticate that the individual concerns is who they claim to be. Everyone knows that the most common form of authentication – the password – is one of the worst single points of failure in any security plan, and for many businesses much stronger tools are needed.

The partnership means that ImageWare now gets a foothold in the private cloud-based marketplace, while Fujitsu gains some real bragging rights on the strength and capabilities it can provide its private cloud customers as an integral part of the package. In addition, the ability of ImageWare's BE to integrate with most of the existing suites of security and security management tools will help many enterprises IT departments.

The ability to integrate directly with security tools they are already using should remove one significant problem area if they are looking to move to private clouds and pondering the user authentication issues.

The Fujitsu partnership creates recognition of IWSY's ability in the industry. Keep in mind, AUTH made an announcement of a partnership with Samsung just a short while before AAPL announced their buyout. It is partnerships of this nature that make other technology companies take notice of a previously unknown player. While I do not expect something as dramatic as a buyout to take place as a result of this initial announcement, it is early validation of IWSY's efforts to transition the company into a mobile and cloud company, from a governmental and municipal security company. And again, the market is not taking notice....at all.

### What Is With All the Sudden Activity?

While it is nice to hear positive words coming from management with respect to the future possibilities that IWSY possesses as a result of their recent transition, it can be more beneficial to look at what they are actually doing to give investors more substantive clues:

1. IWSY had their first conference call in 5+ years on November 14th, 2012. Your first thought is probably, "big deal, companies have conference calls all the time." Let's look at the psychology and intentions behind such an act. First of all, to have the desire to speak to investors and analysts after a period of years suggests that corporate executives are excited enough with the prospects of the company that they deem it necessary to start making the investment community aware of what is going on. The last thing an experienced CEO of nearly 25 years would do is to come out from his hiding place, face the analyst community and then fall flat on his face for all to see. Secondly, management realizes that once you go into conference call mode, you can't suddenly go back into hiding. There is anticipation of greater consistency with management that is expressed through this act.

2. During 2012 three substantial appointments to the board of the company were made. Perhaps the most substantial additions in company history:

- February 2012 – John Cronin – Managing Director and Chairman of ipCG, the largest intellectual property strategy consulting team in the world, serving over 500 companies since 1998.
- August 2012 – Neal Goldman – President of Goldman Capital Management. Largest IWSY shareholder. More on him later.
- September 2012 – Charles Crocker – CEO of Crocker Capital, a private investment firm with particular interest in early stage companies.

Judging by this mix of human capital, the company is squarely focused on strengthening its IP portfolio, while having access to the resources needed to fulfill the growth possibilities ahead. This mix of competent and experienced board members goes a long ways towards securing the future of IWSY.

3. Let's not forget to mention the growth of the patent portfolio in 2012. As mentioned before, very deliberate steps are being taken to position the company in the mobile and cloud biometric marketplace. This patent portfolio that IWSY is putting together positions them to potentially be leader in the space, as well as potentially being a prime candidate for acquisition.

### Why Has Goldman Capital Management Made IWSY Its Largest Position, By Far?

Over 20% of Goldman's portfolio is invested in IWSY. An enormous position for such a large, well established fund. It is his largest position by far. Goldman has been accumulating the position since 2008 through common stock and warrants. What does Neal Goldman see in IWSY that has caused him to make it almost triple in size to the next largest portfolio investment?

Goldman is an industry veteran, having run Goldman Capital Management since the 1980s. It is difficult to get much in the way of information regarding his thought process. However, I did come across this interview he gave in 1998. You can expect that his thought process is much the same now as it was then. Here are some interesting tidbits from that interview that may explain his extremely favorable opinions of IWSY:

**<http://www.twst.com/interview/1256>**

- Our philosophy is a value-oriented approach with preservation of capital as key. I look for a catalyst in a company that will change the earnings power of that company. The catalyst could be either a demographic factor, a new product, a change in management, a divestiture or an acquisition. We are looking at companies that typically have strong balance sheets, seasoned management and quality of earnings. The preservation aspect is where we are looking for limited downside, but when the catalyst comes along that can really change the earnings power positively, then I can get significant capital appreciation.

- Sometimes you will find an industry like that, and look for companies in the industry that you don't feel have been recognized or aren't followed, and that might lead to an opportunity. Or, again, it's just finding a company that is completely

ignored by the marketplace because of either disappointing earnings, or where some short-term problem occurred and investors have walked away from the stock.

- I mean, what I'm buying is the flexibility of management. If I buy the right people, I am buying their ability to maximize shareholder value, and sometimes it's making an acquisition of a product line, or a product extension, or oftentimes they become an acquisition candidate for some other company.

In IWSY it is rather obvious what Goldman sees: An experienced management team. Zero debt. Earnings set to accelerate as a result of company being at the forefront of technology. The catalyst is the recent changes to the revenue model that the company has undertaken through their cloud and mobile to consumer and enterprise offerings.

### [Risk Has Become Clearly Defined](#)

Contrary to most research reports that attempt to dissect earnings, margins and potential liabilities to the nth degree, I will spare you this cavalcade of buffoonery. It is simply impossible to even estimate where IWSY is headed with its potential offerings. There is no forward guidance. This is essentially a brand new revenue model we are dealing with.

Most importantly, what has occurred with this restructuring of their revenue model is that risk has become extremely well-defined. How so, you may ask?

We know that their lumpy business model that sold to governments and municipalities remains intact. That business model since 2011 has created maximum downside in share price of .50 cents per share. Approximately 50% from current levels of .95 cents.

What does the addition of a consumer and enterprise driven cloud and mobile offering do to that risk model? We know we have the government and municipal aspect in place. That is established. We now have the addition of cloud and mobile that seems to be occurring with minimal capital outlay as a result of payment in future considerations. This essentially creates a leveraged model of sorts in an extremely high growth area of the technology marketplace.

An extremely accommodating risk profile takes shape from this point forward. The key fact with IWSY is that all of these positive developments are taking place without any appreciation whatsoever in share price. The marketplace is basically approaching the company as if its revenue model is going to be built on scanning the sausage fingers of port workers in Latin America for the foreseeable future.

The company has transformed itself into a mobile and cloud offering to a chorus of crickets. Downside has been negligible from some months now.

For a much more clear look at downside, see the chart below.

### [A Technical Look](#)

Market Cap: 72 million

Avg Vol: 65,000

Float: 45 million

Cash: 5.3 million

Debt: 0

click chart to enlarge





# LEGAL DISCLAIMER

*As of the publication date of this report, T11 CAPITAL MANAGEMENT LLC and its affiliates (collectively "T11"), others that contributed research to this report and others that we have shared our research with (collectively, the "Authors") have long positions in the stock of the company covered herein and stand to realize gains in the event that the price of the stock increases.*

*Following publication of the report, the Authors may transact in the securities of the company covered herein. All content in this report represent the opinions of T11. The Authors have obtained all information herein from sources they believe to be accurate and reliable. However, such information is presented "as is", without warranty of any kind – whether express or implied. The Authors make no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results obtained from its use. All expressions of opinion are subject to change without notice, and the Authors do not undertake to update or supplement this report or any information contained herein.*

*This document is for informational purposes only and it is not intended as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. The information included in this document is based upon selected public market data and reflects prevailing conditions and the Authors' views as of this date, all of which are accordingly subject to change. The Authors' opinions and estimates constitute a best efforts judgment and should be regarded as indicative, preliminary and for illustrative purposes only.*

*Any investment involves substantial risks, including, but not limited to, pricing volatility, inadequate liquidity, and the potential complete loss of principal. This report's estimated fundamental value only represents a best efforts estimate of the potential fundamental valuation of a specific security, and is not expressed as, or implied as, assessments of the quality of a security, a summary of past performance, or an actionable investment strategy for an investor. This document does not in any way constitute an offer or solicitation of an offer to buy or sell any investment, security, or commodity discussed herein or of any of the affiliates of the Authors. Also, this document does not in any way constitute an offer or solicitation of an offer to buy or sell any security in any jurisdiction in which such an offer would be unlawful under the securities laws of such jurisdiction. To the best of the Authors' abilities and beliefs, all information contained herein is accurate and reliable. The Authors reserve the rights for their affiliates, officers, and employees to hold cash or derivative positions in any company discussed in this document at any time. As of the original publication date of this document, investors should assume that the Authors are long shares of the company and stand to potentially realize gains in the event that the market valuation of the company's common equity is higher than prior to the original publication date. These affiliates, officers, and individuals shall have no obligation to inform any investor about their historical, current, and future trading activities. In addition, the Authors may benefit from any change in the valuation of any other companies, securities, or commodities discussed in this document. The compensation structure for the Authors' analysts is generally a derivative of their effectiveness in generating and communicating new investment ideas and the performance of recommended strategies for the Authors. This could represent a potential conflict of interest in the statements and opinions in the Authors' documents.*

*The information contained in this document may include, or incorporate by reference, forward looking statements, which would include any statements that are not statements of historical fact. Any or all of the Authors' forward-looking assumptions, expectations, projections, intentions or beliefs about future events may turn out to be wrong. These forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks, uncertainties and other factors, most of which are beyond the Authors' control. Investors should conduct independent due diligence, with assistance from professional financial, legal and tax experts, on all securities, companies, and commodities discussed in this document and develop a stand-alone judgment of the relevant markets prior to making any investment decision.*

