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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007
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: 001-33297

VERICHIP CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**06-1637809** (I.R.S. Employer Identification No.)
1690 South Congress Avenue, Suite 200 **Delray Beach, Florida 33445** (Address of principal executive offices, including zip code)	**(561) 805-8008** (Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

The number of shares outstanding of each of the issuer’s classes of common stock as of the close of business on August 7, 2007 is as follows:

Class	Number of Shares
Common Stock: $0.01 Par Value	9,655,999

VERICHIP CORPORATION

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.

VERICHIP CORPORATION
Condensed Consolidated Balance Sheets
(In thousands, except par value)

	June 30, 2007 (unaudited)	December 31, 2006
Assets		
Current Assets:		
Cash	$ 10,271	$ 996
Accounts receivable, net of allowance for doubtful accounts of $144 (2006 - $146)	5,956	4,486
Inventories, net of allowance	2,927	3,698
Prepaid expenses and other current assets	726	567
Deferred tax asset	196	520
Total Current Assets	20,076	10,267
Equipment, net of accumulated depreciation	890	950
Intangible assets, net of accumulated amortization	17,648	18,567
Goodwill	16,025	16,025
Deferred offering costs	—	5,079
	$ 54,639	$ 50,888
Liabilities and Stockholders' Equity		
Current Liabilities:		
Bank indebtedness	$ 1,084	$ 853
Accounts payable	1,745	3,671
Accrued expenses and other current liabilities	4,417	4,968
Note payable to Parent, current portion	1,051	—
Total Current Liabilities	8,297	9,492
Deferred tax liability	5,092	5,415
Note payable to Parent	11,115	13,635
Total Liabilities	24,504	28,542
Commitments and Contingencies		
Stockholders' Equity:		
Capital stock:		
Preferred stock:		
Authorized 5,000 shares of $.001 par value; no shares issued or outstanding	—	—
Common stock:		
Authorized 40,000 shares, of $.01 par value; 9,653 and 6,056 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	97	61
Additional paid-in capital	53,016	39,371
Accumulated deficit	(22,941)	(17,049)
Accumulated other comprehensive loss — foreign currency translation	(37)	(37)
Total Stockholders' Equity	30,135	22,346
	$ 54,639	$ 50,888

VERICHIP CORPORATION
Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Product revenue	$ 7,654	$ 6,563	$ 14,495	$ 12,720
Service revenue	536	413	1,068	806
Total revenue	8,190	6,976	15,563	13,526
Cost of products	3,642	2,643	6,881	5,012
Cost of services	318	231	589	432
Total cost of products and services	3,960	2,874	7,470	5,444
Gross profit	4,230	4,102	8,093	8,082
Operating expenses:				
Selling, general and administrative	5,344	4,225	10,741	8,232
Research and development	956	934	2,363	1,818
Total operating expenses	6,300	5,159	13,104	10,050
Operating loss	(2,070)	(1,057)	(5,011)	(1,968)
Interest income and other expense, net	144	62	83	43
Interest expense	365	154	753	282
Total other expense	509	216	836	325
Loss before income tax provision	(2,579)	(1,273)	(5,847)	(2,293)
(Benefit) provision for income taxes	—	(103)	45	(103)
Net loss	$ (2,579)	$ (1,170)	$ (5,892)	$ (2,190)
Net loss per common share — basic and diluted	$ (0.29)	$ (0.21)	$ (0.73)	$ (0.39)
Weighted average number of shares outstanding — basic and diluted	8,814	5,556	8,050	5,556

VERICHIP CORPORATION
Condensed Consolidated Statement of Stockholders' Equity
For the Six Months Ended June 30, 2007
(In thousands)
(Unaudited)

	Common Shares		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Number	Amount				
Balance December 31, 2006	$ 6,056	$ 61	$ 39,371	$ (17,049)	$ (37)	$ 22,346
Net loss	—	—	—	(5,892)	—	(5,892)
Stock based compensation	—	—	1,302	—	—	1,302
Issuance of shares from option exercises	397	4	268	—	—	272
Issuance of shares in public offering, net of costs of $8,033	3,100	31	12,076	—	—	12,107
Issuance of restricted stock	100	1	(1)	—	—	—
Balance June 30, 2007	$ 9,653	$ 97	$ 53,016	$ (22,941)	$ (37)	$ 30,135

VERICHIP CORPORATION
Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	For the Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net loss	$ (5,892)	$ (2,190)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	1,247	1,172
Stock-based compensation	1,302	32
Accrued interest	738	—
Deferred income tax	—	(143)
Allowance for doubtful accounts	(2)	28
Allowance for inventory excess	395	12
Changes in operating assets and liabilities:		
Increase in accounts receivable	(1,468)	(136)
Decrease (increase) in inventories	376	(477)
Increase in prepaid expenses and other current assets	(159)	(175)
(Decrease) increase in accounts payable and accrued expenses	(748)	363
Net cash used in operating activities	(4,211)	(1,514)
Cash flows from investing activities:		
Payments for equipment	(268)	(351)
Net cash used in investing activities	(268)	(351)
Cash flows from financing activities:		
Short term borrowings, net	231	839
Proceeds from issuance of common shares	272	—
Payments to Parent	(3,500)	—
Borrowings from Parent	1,293	820
Initial public offering costs	(2,879)	(1,087)
Proceeds from initial public offering, net of underwriter fees	18,337	—
Net cash provided by financing activities	13,754	572
Net increase (decrease) in cash	9,275	(1,293)
Cash, beginning of period	996	1,440
Cash, end of period	$ 10,271	$ 147

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business and Basis of Presentation

VeriChip Corporation (the "Company") is a Delaware corporation formed in November 2001. The Company commenced operations in January 2002. On February 14, 2007, the Company completed an initial public offering of its common stock. As of June 30, 2007, Applied Digital Solutions, Inc., Applied Digital, or Parent, owned 57.6% of the Company's stock.

The accompanying unaudited condensed consolidated financial statements of VeriChip Corporation and its subsidiaries (the "Company," "Registrant," "us," "we," or "our") as of June 30, 2007 and December 31, 2006 (the December 31, 2006 financial information included in this report has been extracted from our audited financial statements included in our 2006 Annual Report on Form 10-K), and for three and six-months ended June 30, 2007 and 2006 have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S.") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of our management, all adjustments (including normal recurring adjustments) considered necessary to present fairly the unaudited condensed consolidated financial statements have been made.

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates. Included in these estimates are assumptions about allowances for excess inventory, warranty reserves, bad debt reserves, lives of long lived assets, lives of intangible assets, assumptions used in Black-Scholes valuation models, estimates of the fair value of acquired assets and assumed liabilities, the determination of whether any impairment is to be recognized on goodwill or intangibles, among others.

The unaudited condensed consolidated statements of operations for the three and six-months ended June 30, 2007 and 2006 are not necessarily indicative of the results that may be expected for the entire year. These statements should be read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

The Company develops, markets and sells radio frequency identification, frequently referred to as RFID, systems used for the identification, location and protection of people and assets in the healthcare market. The Company's healthcare security systems utilize external, active RFID tags to locate and protect people and assets. The Company's VeriMed system uses the implantable microchip, a human-implantable passive RFID microchip that is used in patient identification for access to personal health records. Each implantable microchip contains a unique verification number that is read when it is scanned by the Company's scanner. In October 2004, the U.S. Food and Drug Administration, or FDA, cleared the Company's VeriMed system for use in medical applications in the United States.

The Company obtains the implantable microchip from Digital Angel Corporation, Digital Angel, or Affiliate, a majority-owned subsidiary of Applied Digital, under the terms of an amended and restated supply agreement. The supply agreement is discussed in Note 11, "Related Party Transactions." Digital Angel, in turn, obtains the implantable microchip, a component of the VeriChip, from a subsidiary of Raytheon Company, under a separate supply agreement. The technology underlying these systems is covered, in part, by U.S. Patent No. 5,211,129 "Syringe-Implantable Identification Transponders," which the Company refers to as the '129 patent. In 1994, Destron/IDI, Inc., a predecessor company to Digital Angel, granted a co-exclusive license under this patent, other than for certain specified fields of use retained by the predecessor company, to Hughes Aircraft Company, or Hughes, and its then wholly-owned subsidiary, Hughes Identification Devices, Inc., or HID. The specified fields of use retained by the predecessor company do not include human identification or security applications. The rights licensed to Hughes and HID were freely assignable, and the Company does not know which party or parties currently have these rights or whether these rights have been assigned, conveyed or transferred to any third party. Digital Angel sources the implantable microchip indirectly from a subsidiary of Raytheon Company, with which Hughes, then known as HE Holdings, Inc. was merged in 1997. However, the Company has no documentation that establishes its right to use the patented technology for human identification or security applications. Hughes, HID, any of their respective successors in interest, or any party to whom any of the foregoing parties may have assigned its rights under the 1994 license agreement may commence a claim against the Company asserting that the Company is violating its rights.

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The Company is aware that Digital Angel and the successor to HID are in the process of completing a cross-license which includes Digital Angel obtaining a royalty free non-exclusive license to HID's rights to the implantable human applications of the '129 patent, for which it purports certain ownership rights to. That agreement is anticipated to have no cost to the Company. (See Note 9 "Unasserted Claim — Potential Intellectual Property Conflict" and Note 11 "Related Party Transactions").

In April 2007, the Company's wholly-owned subsidiary, VeriChip Corporation, a Canadian company, changed its name to XMARK Corporation, or Xmark.

Initial Public Offering and Underwriting Agreement

On February 14, 2007, the Company completed an initial public offering of its common stock. In connection with the initial public offering, 3,100,000 shares of its common stock were sold. The Company, Applied Digital and Merriman Curhan Ford & Co., as representative of the several underwriters, entered into a underwriting agreement. The initial public offering price was $6.50 per share and the underwriting discounts and commissions were $0.455 per share.

The underwriting agreement required the Company to reimburse the underwriters for their expenses on a non-accountable basis in the amount equal to 1.3% of the aggregate public offering price. In addition, the Company reimbursed the underwriters $150,000 of their legal fees incurred in connection with the offering.

A reconciliation of net proceeds from the initial public offering is provided as follows:

		Amount
Gross proceeds from public offering	$	20,150
Less fees and offering costs:		
Underwriter discounts and fees		1,814
Offering costs paid prior to 2007		3,350
Offering costs paid in 2007		2,879
Net proceeds from public offering	$	12,107

First Amendment to Amended and Restated Supply, License and Development Agreement

On May 9, 2007, the Company and Digital Angel Corporation, or Digital Angel, entered into a First Amendment to Amended and Restated Supply, License and Development Agreement. Under the terms of the amendment, Digital Angel has agreed to extend the minimum purchase requirement due to be purchased by the Company under the agreement by one year and to extend the term of the original agreement by one year. See Note 11 for more information.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board ("FASB") SFAS No. 123 (revised 2004), *Share Based Payment*, or FAS 123R using the modified prospective transition method. Under this method, stock-based compensation expense is recognized using the fair-value based method for all awards granted on or after the date of adoption. Compensation expense for new awards granted after January 1, 2006 is recognized over the requisite service period based on the grant-date fair value of those options. Prior to adoption, the Company used the intrinsic value method under Accounting Principles Board ("APB") 25, and related interpretations and provided the disclosure-only provisions of FAS 123. Under the intrinsic value method, no stock-based compensation had been recognized in our consolidated statement of operations for options granted to the Company's employees and directors because the exercise price of such stock options equaled or exceeded the fair market value of the underlying stock on the dates of grant.

We recorded compensation expense, related to stock options, of approximately $0.1 million and $0.2 million for the three and six-months ended June 30, 2007, respectively, and nil and approximately $31,000 in the three and six months ended June 30, 2006, respectively.

In December 2006, the Company issued 0.5 million shares of its restricted common stock to Scott R. Silverman, its chairman and chief executive officer, which shares are subject to forfeiture in the event that Mr. Silverman terminates his employment or the Company terminates his employment for cause on or before December 31, 2008. The Company determined the value of the stock to be $4.5 million based on the estimated value of its common stock of $9.00 per share on the date of grant. The value of the restricted stock is being amortized as compensation expense over the vesting period. The Company recorded compensation expense of approximately $0.5 million and $1.0 million in the three and six-months ended June 30, 2007 associated with the restricted stock.

In March 2007, the Company issued 0.1 million shares of its restricted common stock to two officers, which will vest on March 2, 2009. The Company determined the value of the stock to be $0.6 million based on the value of its common stock of $5.75 per share on the date of grant. The value of the restricted stock is being amortized as compensation expense over the vesting period. The Company recorded compensation expense of approximately $0.1 million in the three and six-months ended June 30, 2007 associated with this restricted stock.

In August 2007, the Company entered into a consulting agreement with an individual, who was the former Chief Executive Officer of Digital Angel, with respect to identifying, contacting and introducing strategic partners to the Company, identifying potential merger and/or acquisition opportunities for the Company to consider and participating on a committee established for the development of certain products. Under this consulting agreement the Company is issuing 107 thousand common shares. This will result in a non-cash equity compensation charge of approximately $0.7 million during the three months ended September 30, 2007.

Stock-based compensation expense is reflected in the unaudited condensed consolidated statement of operations in selling, general and administrative expense.

The Company's computation of expected life was determined based on the simplified method. The interest rate was based on the U.S. Treasury Yield curve in effect at the time of grant. Prior to its initial public offering, the Company's computation of expected volatility was based on the historical volatility of Applied Digital's common stock. Effective February 9, 2007, the Company's computation of expected volatility is to be based on the historical volatility of the Company's comparable companies' average historical volatility.

2. Principles of Consolidation

The financial statements include the accounts of the Company and its wholly-owned Canadian subsidiaries, VeriChip Holdings Inc., or VHI, and XMARK Corporation. All significant inter-company transactions and balances have been eliminated in consolidation.

3. Inventories

	June 30, 2007	December 31, 2006
Raw materials	$ 1,913	$ 1,489
Work in process	943	1,255
Finished goods	632	1,119
	3,488	3,863
Allowance for excess and obsolescence	(561)	(165)
	$ 2,927	$ 3,698

4. Financing Agreements:

VHI is a party to a credit agreement with the Royal Bank of Canada. The credit facility provides for borrowings up to CDN $1.5 million, or approximately U.S. $1.4 million at June 30, 2007. Approximately USD $1.1 million was outstanding under the credit facility as of June 30, 2007. The annual interest rate on the facility is the Royal Bank of Canada prime rate of interest plus 1%. The borrowing limit is up to 85% of eligible accounts receivable and up to 25% of eligible inventory. Under the terms of the agreement, the Company must comply with certain reporting covenants and requirements. The loan is collateralized by all of the assets of VHI. At June 30, 2007, VHI had aggregate net assets of approximately USD $10.0 million.

The Company's loan agreement with Applied Digital is more fully described in Note 11, "Related Party Transactions."

5. Stockholders' Equity

On February 14, 2007, the Company completed an initial public offering of its common stock. In connection with its initial public offering, the Company sold 3,100,000 shares of its common stock at a price of $6.50 per share. As a result, as of June 30, 2007, Applied Digital owned 57.6% of the Company's stock.

Stock Option Plans

In April 2002, the Company's board of directors approved the VeriChip Corporation 2002 Flexible Stock Plan, or the VeriChip 2002 Plan. Under the VeriChip 2002 Plan, the number of shares for which options, SARs or performance shares, may be granted is approximately 2.0 million. As of June 30, 2007 approximately 1.9 million options and restricted shares, net of forfeitures, have been granted to directors, officers and employees under the VeriChip 2002 Plan, and 1.6 million of the options or shares granted were outstanding as of June 30, 2007. Approximately 1.4 million options are fully vested and expire up to nine years from the vesting date and 0.2 million options vest ratably over three years. As of June 30, 2007, no SARs have been granted and 22,000 shares may still be granted under the VeriChip 2002 Plan.

On April 27, 2005, Applied Digital's board of directors approved the VeriChip Corporation 2005 Flexible Stock Plan, or the VeriChip 2005 Plan. Under the VeriChip 2005 Plan, the number of shares for which options, SARs or performance shares may be granted is approximately 0.3 million. As of June 30, 2007, approximately 0.2 million options have been granted under the VeriChip 2005 Plan. None of the options are fully vested and expire up to nine years from the vesting date and vest ratably over three years. As of June 30, 2007, no SARs have been granted and 0.1 million shares may still be granted under the VeriChip 2005 Plan.

On June 17, 2007, the Company adopted the VeriChip 2007 Stock Incentive Plan, or the VeriChip 2007 Plan. Under the VeriChip 2007 Plan, the number of shares for which options, SARs or performance shares may be granted is 1.0 million. As of June 30, 2007, no options were granted under the VeriChip 2007 Plan.

In addition, as of June 30, 2007, options exercisable for approximately 0.4 million shares of the Company's common stock have been granted outside of the Company's plans, and 0.3 million of the options or shares granted were outstanding as of June 30, 2007. These options were granted at exercise prices ranging from $0.23 to $8.55 per share, are fully vested and are exercisable for a period of up to seven years.

In the six-months ended June 30, 2007, 0.1 million and 0.2 million options have been granted under the 2002 and 2005 VeriChip Plan, respectively. There were no options granted in the three-months ended June 30, 2007. In the six-months ended June 30, 2006, 2,012 options were granted outside of the Company's plans.

A summary of option activity under our option plans as of June 30, 2007, and changes during the six months then ended is presented below (in thousands, except per share amounts):

	Number of Options	Weighted Average Exercise Price Per Share
Outstanding on January 1, 2007	2,099	$ 2.10
Granted[1]	307	5.73
Exercised[2]	(397)	0.69
Forfeited	(22)	5.75
Outstanding on June 30, 2007	1,987	2.91
Exercisable on June 30, 2007[3]	1,652	2.20
Options available on June 30, 2007 for future grants	1,118	

[1] The total compensation expense associated with the options granted in the three and six-months ended June 30, 2007 was approximately $0.1 million. The remaining amount of the compensation expense to be recorded over the remaining vesting period of the options is approximately $0.7 million.

[2] In the three months ended June 30, 2007, 353 and 44 options were exercised under the VeriChip 2002 Plan and outside the Company's plan, respectively. No options were exercised in the first quarter of 2007. The intrinsic value of a stock option is the amount by which the fair value of the underlying stock exceeds the exercise price of the option. Total intrinsic values of options exercised for the VeriChip 2002 Plan and outside of the Company's plan were $1.8 million and $0.2 million for the six-months ended June 30, 2007.

[3] The intrinsic value of a stock option is the amount by which the fair value of the underlying stock exceeds the exercise price of the option. Based upon the Company's closing price on the NASDAQ, the fair value of the underlying stock was $8.59 at June 30, 2007. As of June 30, 2007, the aggregate intrinsic value of all options outstanding was $11.3 million.

The following table summarizes information about stock options at June 30, 2007 (number amounts, except weighted-average amounts):

	Outstanding Stock Options			Exercisable Stock Options	
Range of Exercise Prices	Number	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price Per Share	Number	Weighted-Average Exercise Price Per Share
$0.0000 to $2.0250	1,226	2.8	$ 0.50	1,226	$ 0.50
$4.0501 to $6.0750	349	9.1	5.59	66	5.11
$6.0751 to $8.1000	301	6.1	7.05	298	7.04
$8.1001 to $10.1250	106	7.5	9.23	56	8.55
$18.2251 to $20.2500	6	5.5	20.25	6	20.25
	1,987	4.7	$ 2.91	1,652	$ 2.20

The weighted average per share fair value of grants made in the six months ended June 30, 2007 and 2006 for the Company's incentive plans was $2.93 and $15.77, respectively.

The Black-Scholes model, which the Company used to determine compensation expense, required the Company to make several key judgments including:

- the estimated value of the Company's common stock;
- the expected life of issued stock options;
- the expected volatility of the Company's stock price;
- the expected dividend yield to be realized over the life of the stock options; and
- the risk-free interest rate over the expected life of the stock options.

The Company prepared these estimates based upon its historical experience, the stock price volatility of comparable publicly-traded companies, including Applied Digital, and its best estimation of future conditions.

The fair values of the options granted were estimated on the grant date using the Black-Scholes valuation model based on the following weighted-average assumptions:

	2007	2006
Expected dividend yield	—	—
Expected stock price volatility	50%	60%
Risk-free interest rate	4.51%	4.29%
Expected term (in years)	6.0	5.0

6. Loss per Common Share

A reconciliation of the numerator and denominator of basic and diluted loss per common share is provided as follows (in thousands, except per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Numerator for basic and diluted loss per share:				
Net loss	$ (2,579)	$ (1,170)	$ (5,892)	$ (2,190)
Denominator for basic and diluted loss per share				
Weighted average shares outstanding basic and diluted	8,814	5,556	8,050	5,556
Basic and diluted loss per share	$ (0.29)	$ (0.21)	$ (0.73)	$ (0.39)

The following stock options and warrants outstanding as of June 30, 2007 and 2006 were not included in the computation of dilutive loss per share because the net effect would have been anti-dilutive:

	For the Six Months Ended June 30,	
	2007	2006
Stock options	1,987	2,049
Warrants	444	444
Restricted common stock	600	—
	3,031	2,493

7. Segmented information:

In early 2007, the Company realigned its business into three business segments: healthcare security, implantable, and industrial. This change was made to align the Company's financial reporting with its new operational management structure. All segment information in this Quarterly Report on Form 10-Q has been reclassified to reflect the segment realignment.

Healthcare Security

Utilizing RFID technology, the Company's Healthcare Security segment currently engages in marketing, selling and developing the following products:

- infant protection systems used in hospital maternity wards and birthing centers to prevent infant abduction and mother-baby mismatching;
- wander prevention systems used by long-term care facilities to locate and protect their residents; and
- asset/staff location and identification systems used by hospitals and other healthcare facilities to identify, locate and protect medical staff, patients, visitors and medical equipment.

Implantable

The Company's Implantable segment includes its VeriMed system using the implantable microchip, a human-implantable RFID microchip that is used in patient identification for access to personal health records. Each implantable microchip contains a unique verification number that is read when it is scanned by the Company's scanner. In October 2004, the FDA cleared the Company's VeriMed system for use in medical applications in the United States.

Industrial

The Company's Industrial segment engages in marketing, selling and developing the following products:

- vibration monitoring instruments used by engineering, construction and mining professionals to monitor the effects of human induced vibrations, such as blasting activity; and
- asset management systems that industrial companies use to manage and track their mobile equipment and tools.

The following is the selected segment data as of and for the three months ended June 30:

2007	Healthcare Security	Implantable	Industrial	Corporate	Total
Product revenue	$ 5,708	$ —	$ 1,946	$ —	$ 7,654
Services revenue	155	—	381	—	536
	$ 5,863	$ —	$ 2,327	$ —	$ 8,190
Operating (loss) income	432	(1,309)	366	(1,559)	(2,070)
Depreciation and amortization	433	8	172	8	621
Interest income and other expense, net	183	—	61	(100)	144
Interest expense	9	—	—	356	365
Income (loss) before provision for income taxes	241	(1,309)	305	(1,816)	(2,579)
Segmented assets	$ 35,843	$ 861	$ 9,063	$ 8,872	$ 54,639

2006	Healthcare Security	Implantable	Industrial	Corporate	Total
Product revenue	$ 5,047	$ 11	$ 1,505	$ —	$ 6,563
Services revenue	146	—	267	—	413
	$ 5,193	$ 11	$ 1,772	$ —	$ 6,976
Operating income (loss)	(5)	(927)	432	(557)	(1,057)
Depreciation and amortization	422	10	156	10	598
Interest income and other expense, net	46	—	16	—	62
Interest expense	—	—	—	154	154
Loss (income) before provision for income taxes	(51)	(927)	416	(711)	(1,273)
Segmented assets	$ 35,747	$ 938	$ 9,690	$ 2,290	$ 48,665

The following is the selected segment data as of and for the six months ended June 30:

2007	Healthcare Security	Implantable	Industrial	Corporate	Total
Product revenue	$ 10,907	$ 1	$ 3,587	$ —	$ 14,495
Services revenue	266	—	802	—	1,068
	$ 11,173	$ 1	$ 4,389	$ —	$ 15,563
Operating (loss) income	96	(2,485)	568	(3,190)	(5,011)
Depreciation and amortization	825	20	382	20	1,247
Interest income and other expense, net	183	—	61	(161)	83
Interest expense	17	—	—	736	753
(Loss) income before provision for income taxes	$ (104)	$ (2,485)	$ 507	$ (3,765)	$ (5,847)
Segmented assets	$ 35,843	$ 861	$ 9,063	$ 8,872	$ 54,639

2006	Healthcare Security	Implantable	Industrial	Corporate	Total
Product revenue	$ 9,735	$ 101	$ 2,884	$ —	$ 12,720
Services revenue	215	—	591	—	806
	$ 9,950	$ 101	$ 3,475	$ —	$ 13,526
Operating income (loss)	274	(1,619)	662	(1,285)	(1,968)
Depreciation and amortization	824	19	309	19	1,171
Interest income and other expense, net	33	—	10	—	43
Interest expense	4	—	—	278	282
Income (loss) before provision for income taxes	$ 237	$ (1,619)	$ 652	$ (1,563)	$ (2,293)
Segmented assets	$ 35,747	$ 938	$ 9,690	$ 2,290	$ 48,665

8. Income Taxes

We had an effective tax rate of (0.8)% and (4.5)% for the six months ended June 30, 2007 and 2006, respectively, related to our Canadian-based businesses. We incurred consolidated losses before taxes for the six months ended June 30, 2007 and 2006. However, we have not recorded a tax benefit for the resulting U.S. net operating loss carryforwards, as we have determined that a valuation allowance against our net U.S. deferred tax assets was appropriate based primarily on our historical operating results.

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, ("FIN 48") was issued to clarify the requirements of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, relating to the recognition of income tax benefits.

FIN 48 provides a two-step approach to recognizing and measuring tax benefits when the benefits' realization is uncertain. The first step is to determine whether the benefit is to be recognized, and the second step is to determine the amount to be recognized:

• Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (i.e., a probability of greater than 50 percent) that the tax position would be sustained as filed; and

• If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority.

Effective January 1, 2007, we adopted FIN 48. The implementation of FIN 48 did not result in any adjustment to the Company's beginning tax positions. The Company continues to fully recognize its tax benefits which are offset by a valuation allowance to the extent that it is more likely than not that the deferred tax assets will not be realized.

The Company files federal and provincial income tax returns in Canada and files federal and state income tax returns in the U.S. The Company is generally no longer subject to federal and provincial income tax examinations by Canadian tax authorities for years before 2001 and to federal and state income tax examinations by U.S. tax authorities for years before 2003. Management does not anticipate that adjustments, if any, which may be proposed by the Canadian Revenue Agency would result in a material change to its financial position.

The Company recognizes any interest accrued related to unrecognized tax benefits or exposures in interest expense and penalties in operating expenses. During the six months ended June 30, 2007 and 2006, there was no such interest or penalty.

9. Unasserted Claim—Potential Intellectual Property Conflict

Hughes, HID, any of their respective successors in interest, or any party to whom any of the foregoing parties may have assigned its rights under the 1994 license agreement (see Note 1) may commence a claim against the Company asserting that the Company is violating its rights. If such a claim is successful, sales of the Company's implantable microchip could be enjoined and the Company could be required to cease its efforts to create a market for it implantable microchip until the patent expires in April 2008. In addition, the Company could be required to pay damages, which may be substantial.

If the Company or Digital Angel is denied use of the patented technology in applications involving the identification of human beings, the Company will not be able to purchase or sell any of its products that incorporate the implantable microchip before the patent expires. The Company may be required to pay royalties and other damages to third parties on products it has already purchased or will purchase from Digital Angel.

The Company has been publicly marketing and selling the implantable microchip for human identification and security applications for approximately five years. The Company's supply and development agreement with Digital Angel contains an indemnification provision. To the extent that such an infringement claim is made, the Company believes it is entitled to indemnification pursuant to the supply and development agreement with Digital Angel.

The Company is aware that Digital Angel and the successor to HID are in the process of completing a cross-license which includes Digital Angel obtaining a royalty free non-exclusive license to HID's rights to the implantable human applications of the '129 patent, for which it purports certain ownership rights to. That agreement is anticipated to have no cost to the Company.

Under the circumstances, the accompanying financial statements make no provision with respect to the unasserted claim described above.

10. Legal proceedings

The Company is engaged in certain legal actions and management believes that the ultimate outcome of these actions will not have a material adverse effect on the Company's operating results, liquidity or financial position.

Metro Risk

On January 10, 2005, the Company commenced an action in the Circuit Court for Palm Beach County, Florida, against Metro Risk Management Group, LLC, or Metro Risk. In this suit, the Company has claimed that Metro Risk breached the parties' three international distribution agreements by failing to meet required minimum purchase obligations. On July 1, 2005, Metro Risk asserted a counterclaim against the Company for breach of contract and fraud in the inducement. Specifically, in its claim for breach of contract, Metro Risk alleged that the Company breached the exclusivity provision of the parties' distribution agreements by later signing a different distribution agreement with a large distributor of medical supplies. Metro Risk asserted that the distribution agreement with this other distributor included areas in Europe. Moreover, regarding its claim for fraud in the inducement, Metro Risk alleged that the Company fraudulently induced Metro Risk into signing the distribution agreements by promising millions of dollars in profits and then later signing a different distribution agreement with a large distributor of medical supplies. By virtue of its counterclaim, Metro Risk seeks reliance damages in the amount of $155,000, which represents the amount of money advanced by Metro Risk for the project, lost profits, and attorneys' fees. Given the early stage of the matter and because discovery has recently begun, counsel is currently unable to assess the Company's risk.

Stock Option Plans

The Company has received demand letters from attorneys for several former employees and/or consultants of the Company and our parent company, Applied Digital, asserting claims related to stock options to acquire approximately 540 thousand shares of the Company's common stock that management believes that such employees and/or consultants had forfeited when they ceased their employment or relationship with the Company and/or Applied Digital. The Company believes that all of these potential claims are without merit and intend to vigorously defend them in the event the claims are asserted or litigated.

The Company is a party to various legal actions, as either plaintiff or defendant, including the matter identified above, arising in the ordinary course of business, none of which is expected to have a material adverse effect on our business, financial condition or results of operations.

11. Related Party Transactions

Transition Services Agreement with Applied Digital

During the six months ended June 30, 2007, Applied Digital provided certain general and administrative services to the Company including, accounting, finance, payroll and legal services, telephone, rent and other miscellaneous items. The costs of these services, which are included in the Company's statement of operations in selling, general and administrative expense, were determined based on the Company's use of such services. In determining the estimated use by the Company, Applied Digital and the Company determined the actual cost incurred for each of the services provided and determined the allocation of each of such costs that were attributable to the Company's operations.

The services provided and the basis of allocation was as follows:

- *Accounting, finance and payroll services* — these costs were allocated based upon a percentage of the total labor dollars incurred by Applied Digital's accounting, finance and payroll staff in performing such functions for the Company;
- *Legal services* — the costs were allocated based upon a percentage of Applied Digital's general counsel's salary and benefits based upon the estimated time spent by its general counsel on the Company's legal issues;
- *Accounting fees* — these costs were allocated based upon actual total fees charged by third party accountants and considering the amount of such accounting fees that the Company would have incurred if it was a stand-alone entity;
- *Rent* — the cost was determined based upon the amount of office space square footage used by the Company's employees; and
- *Telephone, office supplies and other costs* — these costs were allocated based upon a percentage of the services or supplies that were deemed to be incurred by the Company.

On December 25, 2005, the Company entered into a transition services agreement with Applied Digital under which Applied Digital agreed to provide the Company with certain administrative transition services. On December 21, 2006, the Company and Applied Digital entered into an amended and restated transition services agreement, which became effective on February 14, 2007, the date of completion of the Company's initial public offering of the Company's common stock. Prior to that time, the initial transition services agreement remained in effect. The term of the amended and restated agreement will continue until such time as the Company requests Applied Digital to cease performing transition services, provided that Applied Digital is not obligated to continue to provide the transition services for more than twenty-four months following the effective date. Except for any request by the Company that Applied Digital cease to perform transition services, subject to certain notice provisions, the agreement may not be terminated by either party except in the event of a material default in Applied Digital's delivery of the transition services or in the Company's payment for those services. The services to be provided by Applied Digital under the amended and restated transition services agreement are the same as those provided under the initial agreement. The estimated monthly charge for the fixed costs allocable to these services was increased to approximately $72,000 per month, primarily as the result of an increased allocation for office space. Effective April 1, 2007, the estimated monthly charge for the fixed costs allocable to these services was reduced to $40,000 per month, primarily as a result of a reduction in allocable accounting fees and accounting and legal services.

The terms of the transition services agreement and the amendment and restatement of the agreement were negotiated between certain of the Company's executive officers and certain executive officers of Applied Digital. The Company's and Applied Digital's executive officers were independent of one another and the terms of the agreement were based upon historical amounts incurred by Applied Digital for payment of such services to third parties. Accordingly, the Company believes that it negotiated the best terms and conditions under the circumstances, however, these costs are not necessarily indicative of the costs which the Company would have incurred as an independent stand alone entity.

Management believes that the fees charged for these services are reasonable and consistent with what the expenses would have been on a stand-alone basis. The costs of these services to the Company were $0.1 million and $0.3 million for the three and six months ended June 30, 2007 and 2006, respectively, and $0.2 million and $0.4 million for the six months ended June 30, 2006, respectively.

Loan Agreement with Applied Digital

Applied Digital has funded and financed the Company's operations since inception, which has resulted in an amount due to Applied Digital totaling $12.2 million and $13.6 million at June 30, 2007 and December 31, 2006, respectively. On December 27, 2005, the Company and Applied Digital converted the amounts due to Applied Digital, including interest accrued, into a revolving line of credit under the terms of a loan agreement, security agreement and a revolving line of credit note.

On October 6, 2006, the Company entered into an amendment to the loan agreement which increased the principal amount available thereunder to $13.0 million, and the Company borrowed an additional $2.0 million under the agreement to make the second purchase price payment with respect to its acquisition of Instantel. In connection with that amendment, the interest rate was also changed to a fixed rate of 12% per annum. Previously, our indebtedness to Applied Digital bore interest at the prevailing prime rate of interest as published from time to time by *The Wall Street Journal*. That amendment further provided that the loan matured in July 2008, but could be extended at the option of Applied Digital through December 27, 2010.

On January 19, 2007, February 8, 2007 and February 13, 2007, the Company entered into further amendments to the loan documents which increased the maximum principal amount of indebtedness that the Company may incur to $14.5 million. A portion of this increase was used to cover approximately $0.7 million of intercompany advances made to the Company by Applied Digital during the first week of January 2007. Upon the consummation of the Company's initial public offering in February 2007, the loan ceased to be a revolving line of credit, and the Company has no ability to incur additional indebtedness under the loan documents. The interest continues to accrue on the outstanding indebtedness at a rate of 12% per annum. On February 14, 2007, the closing date of the Company's initial public offering, the Company was indebted to Applied Digital in the amount of $15.2 million, including $1.0 million of accrued interest and, in accordance with the terms of the loan agreement as most recently amended on February 13, 2007, the Company used $3.5 million of the net proceeds of our initial public offering to repay a portion of its indebtedness to Applied Digital upon consummation of its initial public offering. The Company is not obligated to repay an additional amount of its indebtedness until January 1, 2008. Effective with the payment of the $3.5 million, all interest which accrues on the loan as of the last day of each month, commencing with February 2007, shall be added to the principal amount. Commencing January 1, 2008 through January 1, 2010, the Company is obligated to repay $300,000 on the first day of each month. A final balloon payment equal to the outstanding principal amount then due under the loan plus all accrued and unpaid interest will be due and payable on February 1, 2010.

The loan is collateralized by interests in all property and assets of the Company, including the stock of the Company's subsidiaries, but is not secured by any of the property or assets of the Company's subsidiaries.

Interest expense incurred under the loan for the three and six months ended June 30, 2007 was $0.4 million and $0.7 million, respectively, and $0.1 million and $0.3 million for the three and six months ended June 30, 2006. The previously floating rate of interest negotiated between the parties was based upon the rate that Applied Digital has historically charged to its wholly-owned subsidiaries. On October 6, 2006, the interest rate was modified as discussed above. The modified interest rate was negotiated between the parties and represents the current rate that Applied Digital is incurring on debt owed to its lender. Depending upon the Company's future operating performance, this interest rate may not be comparable to the terms that the Company could obtain from independent third parties.

Supply Agreement with Digital Angel

The Company and Digital Angel executed a supply and development agreement dated March 4, 2002 as amended and restated on December 27, 2005 and as amended on May 9, 2007, or the supply and development agreement. Under this agreement, Digital Angel is the Company's sole supplier of human-implantable microchips and the Company has the exclusive license to the technology related to human-implantable microchips.

The Company's purchases of product under the supply and development agreement were approximately $0.0 million and $0.2 million in the six-months ended June, 2007 and 2006, respectively. Under the terms of the May 9, 2007 amendment, the term of the agreement was extended from March 2013 to March 2014. Also, under the May 9, 2007 amendment, the annual minimum purchase requirements were each extended one year and, accordingly, there is no minimum purchase requirement in 2007. The approximately $0.9 million originally required to be purchased in 2007 is now required to be purchased in 2008, less purchases made in 2006 and 2007. As long as the Company continues to meet minimum purchase requirements, the supply and development agreement will automatically renew annually under its terms until the expiration of the last of the patents covering any of the supplied products. The supply and development agreement may be terminated prior to its stated term under specified events, including as a result of a bankruptcy event of either party or an uncured default. In addition, Digital Angel may sell the microchips to third parties if the Company does not take delivery and pay for a minimum number of microchips as specified in the supply and development agreement. Further, the supply and development agreement provides that Digital Angel shall, at the Company's option, furnish and operate a computer database to provide data collection, storage and related services for the Company's customers for a fee as provided. The Company does not currently utilize this service.

The terms of the original supply and development agreement and each amendment were negotiated by the executive officers of the respective companies and approved by the independent members of each company's board of directors.

Digital Angel relies solely on a production agreement with RME, a subsidiary of Raytheon Company for the manufacture of its human-implantable microchip products. RME utilizes Digital Angel's equipment in the production of the microchips. Digital Angel entered into a new production agreement with RME related to the manufacture and distribution of glass-encapsulated syringe-implantable transponders, including the human-implantable microchip products sold by the Company expiring on June 30, 2010. The technology underlying these systems is covered, in part, by U. S. Patent No. 5,211,129, "Syringe-Implantable Identification Transponders," which the Company refers to as the '129 patent. In 1994, Destron/IDI, Inc., a predecessor company to Digital Angel, granted a co-exclusive license under this patent, other than for certain specified fields of use related to Digital Angel's Animal Applications segment, which were retained by the predecessor company, to Hughes Aircraft Company, or Hughes, and its then wholly owned subsidiary, Hughes Identification Devices, Inc., or HID. The specified fields of use retained by the predecessor company do not include human identification or security applications. The rights licensed to Hughes and HID were freely assignable, and we do not know which party or parties currently have these rights or whether these rights have been assigned, conveyed or transferred to any third party.

The Company does not anticipate generating more than nominal revenue from the sale of its human implantable microchips prior to the expiration of the patent in April 2008. Hughes, HID, any of their respective successors in interest, or any party to whom one of the foregoing parties may have assigned its rights under the 1994 license agreement may commence a claim against the Company asserting that the Company is violating its rights. If such a claim is successful, sales of the Company's human implantable systems could be enjoined, and the Company could be required to cease its efforts to create a market for these systems, until the patent expires in April 2008. In addition, the Company could be required to pay damages, which may be substantial. Regardless of whether any claimant is successful, the Company would face the prospect of the expenditure of funds in litigation, the diversion of management time and resources, damage to its reputation and the potential impairment in the marketability of its systems even after the expiration of the patent, which could harm the Company's business and negatively affect its prospects. (See Note 9 "Unasserted Claim — Potential Intellectual Property Conflict").

The Company is aware that Digital Angel and the successor to HID are in the process of completing a cross-license which includes Digital Angel obtaining a royalty free non-exclusive license to HID's rights to the implantable human applications of the '129 patent, for which it purports certain ownership rights to. That agreement is anticipated to have no cost to the Company. (See Note 9 "Unasserted Claim — Potential Intellectual Property Conflict").

Legal Services

During 2006, the Company deferred legal fees of $0.8 million, respectively, to the Company's legal counsel, Akin Gump Strauss Hauer & Feld LLP, or Akin Gump. Tommy G. Thompson, a partner with Akin Gump, was a member of the Company's board of directors from July 2005 to March 8, 2007, and, as a result of his directorship services, holds fully vested options to purchase 55,556 shares of the Company's common stock.

Pledge Agreement of Applied Digital

On August 24, 2006, Applied Digital pledged 65% of its ownership in the Company's common stock to its lender under the terms of a note and pledge agreement. The note is due in August 2009. This note replaced a previous note issued by Applied Digital which was due in June 2007.

12. Supplementary Cash Flow Information

	For the Six Months Ended June 30,	
	2007	2006
Income taxes paid	$ 105	$ 210
Interest paid	40	4
	$ 145	$ 214

In the six months ended June 30, 2007 and 2006, the Company had the following non-cash investing and financing activities:

	Six Months Ended June 30,	
	2007	2006
Non-cash financing activities:		
Offering costs	$ —	$ 440

13. Exit and Disposal Activity

In November 2006, the Company made the decision to consolidate its healthcare security operations into an existing facility located in Ottawa, Ontario, Canada to eliminate duplicative functions and to improve operating efficiencies. The consolidation entailed the closing of operations in Vancouver, British Columbia. The Company substantially completed the consolidation by March 31, 2007. As a result of the consolidation, for the three and six-months ended June 30, 2007, the Company has recorded charges of nil and $0.3 million, resulting from payroll related charges. Such charges are reflected in the consolidated statement of operations in selling, general and administrative expense and in research and development expenses.

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, without limitation, statements about our market opportunities, our business and growth strategies, our projected revenue and expense levels, possible future consolidated results of operations, the adequacy of our available cash resources, our financing plans, our competitive position and the effects of competition and the projected growth of the industries in which we operate. This Quarterly Report on Form 10-Q also contains forward-looking statements attributed to third parties relating to their estimates regarding the size of the future market for products and systems such as our products and systems, and the assumptions underlying such estimates. Forward-looking statements include all statements that are not historical facts and can be identified by forward-looking statements such as "may," "might," "should," "could," "will," "intends," "estimates," "predicts," "projects," "potential," "continue," "believes," "anticipates," "plans," "expects" and similar expressions. Forward-looking statements are only predictions based on our current expectations and projections, or those of third parties, about future events and involve risks and uncertainties.

Although we believe that the expectations reflected in the forward-looking statements contained in this Quarterly Report on Form 10-Q are based upon reasonable assumptions, no assurance can be given that such expectations will be attained or that any deviations will not be material. In light of these risks, uncertainties and assumptions, the forward-looking statements, events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. Important factors that could cause our actual results, level of performance or achievements to differ materially from those expressed or forecasted in, or implied by, the forward-looking statements we make in this Quarterly Report on Form 10-Q are discussed under "Item 1A. Risk Factors" and elsewhere in our Annual Report on Form 10-K and include:

- our ability to successfully implement our business strategy;
- our expectation that we will incur losses, on a consolidated basis, for the foreseeable future;
- our ability to fund our operations;
- borrowings under our existing bank facility are payable on demand and the facility could be terminated at any time without notice;
- the impact on our success of the relative maturity in the United States, and limited size, of the markets for our infant protection and wander prevention systems and vibration monitoring instruments;
- the degree of success we have in leveraging our brand reputation, reseller network and end-use customer base for our infant protection and wander prevention systems to gain inroads in the emerging market for asset/staff location and identification systems;
- the rate and extent of the U.S. healthcare industry's adoption of radio frequency identification, or RFID, asset/staff location and identification systems;
- the relative degree of market acceptance of our zonal, or cell identification, active RFID systems compared to competing technologies, such as lower power Ultra Wide Band-based location technologies, 802.11 and Zigbee-based location and wireless networking technologies;
- our ability to complete our efforts to introduce new vibration monitoring instrumentation products;
- uncertainty as to whether we will be able to increase our sales of infant protection and wander prevention systems outside of North America;
- our reliance on third-party dealers to successfully market and sell our products;
- we may become subject to costly product liability claims and claims that our products infringe the intellectual property rights of others;
- our ability to comply with current and future regulations relating to our businesses;
- uncertainty as to whether a market for our VeriMed and Evitrace systems will develop and whether we will be able to generate more than a nominal level of revenue from the sale of these systems;

- the potential for patent infringement claims to be brought against us asserting that we hold no rights for the use of the implantable microchip technology and that we are violating another party's intellectual property rights. If such a claim is successful, we could be enjoined from engaging in activities to market the systems that utilize the implantable microchip and be required to pay substantial damages;
- market acceptance of our VeriMed system, which will depend in large part on the future availability of insurance reimbursement for the VeriMed system microchip implant procedure from government and private insurers, and the timing of such reimbursement, if it, in fact, occurs;
- a potential disruption to our business, loss of sales and higher expense if we are unable to obtain the implantable microchip used in our VeriMed and Evitrace systems from our sister company Digital Angel and other risks related to our supply agreement with Digital Angel;
- our ability to provide uninterrupted, secure access to the VeriMed database;
- conflict of interest risks related to our continued affiliation with Digital Angel and our parent company, Applied Digital; and
- our ability to establish and maintain proper and effective internal accounting and financial controls.

You should not place undue reliance on any forward-looking statements. In addition, past financial or operating performance is not necessarily a reliable indicator of future performance, and you should not use our historical performance to anticipate future results or future period trends. Except as otherwise required by federal securities laws, we disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained in this Quarterly Report on Form 10-Q to reflect any change in our expectations or any change in events, conditions or circumstances on which any such statement is based. All forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements included in this Quarterly Report on Form 10-Q.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and related notes included in Item 1 of this Quarterly Report on the Form 10-Q as well as our 2006 Annual Report on Form 10-K for the year ended December 31, 2006.

We develop, market, and sell radio frequency identification, frequently referred to as RFID, systems used for the identification, location and protection of people and assets in the healthcare market. In early 2007, we realigned our business into three business segments: healthcare security, implantable, and industrial. This change was made to align our financial reporting with our new operational management structure. All segment information in this Quarterly Report on Form10-Q has been reclassified to reflect the segment realignment.

Our healthcare security segment encompasses the development, marketing and sale of our healthcare security and location systems, specifically: (i) infant protection systems used in hospital maternity wards and birthing centers to prevent infant abduction and mother-baby mismatching; (ii) wander prevention systems used by long-term care facilities to locate and protect their residents; and (iii) asset/staff location and identification systems used by hospitals and other healthcare facilities to identify, locate and protect medical staff, patients, visitors and medical equipment.

The principal offering of our implantable segment is our VeriMed system using the implantable microchip, a FDA cleared human-implantable RFID microchip that is used in patient identification for access to personal health records.

Our industrial segment encompasses the sale of vibration monitoring instruments used by engineering, construction and mining professionals to monitor the effects of human induced vibrations, such as blasting activity.

Our industrial segment also encompasses the sale of asset management systems used by industrial companies to manage and track their mobile equipment and tools.

Highlights for our second quarter ended June 30, 2007, included:

- The Company sold its 1,300th infant protection system and continues to be the leading provider of infant protection systems in North America.
- The Company added 78 new hospitals to its VeriMed Patient Identification System network at the Emergency Department Practice Management Association's conference in May.
- 25 Alzheimer's patients and caregivers received the VeriMed RFID implantable microchip at the Alzheimer's Educational Conference in June.
- The number of hospitals enrolled in the VeriMed network increased by 24.3% from 515 at the end of the 2007 first quarter to 640 at the end of the 2007 second quarter. The number of protocol-adopted hospitals (included in the aforementioned hospitals) increased by 45% from 109 at the end of the 2007 first quarter to 158 at the end of the 2007 second quarter.

Results of Operations

The table below sets forth data from our consolidated statements of operations for the three and six months ended June 30, 2007 and 2006, expressed as a percentage of total revenue. To date, substantially all of our revenue consists of revenue from our Canadian-based healthcare security and industrial businesses, which were acquired in the first half of 2005.

Through June 30, 2007, we have recorded nominal revenue from sales of our VeriMed system. Over time, we expect that sales of our VeriMed system will become a significant part of our revenue, although there can be no assurance that they will.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Product revenue	93.5%	94.1%	93.1%	94.0%
Service revenue	6.5	5.9	6.9	6.0
Total revenue	100.0%	100.0%	100.0%	100.0%
Cost of products sold	44.5	37.9	44.2	37.1
Cost of services sold	3.9	3.3	3.8	3.2
Gross profit	51.6	58.8	52.0	59.7
Selling, general and administrative expense	65.2	60.5	69.0	60.9
Research and development	11.6	13.4	15.2	13.4
Other expense	1.8	0.9	0.5	0.3
Interest expense	4.5	2.2	4.8	2.1
Loss before provision for income taxes	(31.5)	(18.2)	(37.6)	(17.0)
Provision for income taxes	0.0	(1.4)	(0.3)	(0.8)
Net loss attributable to common stockholder	(31.5)%	(16.8)%	(37.9)%	(16.2)%

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

The table below presents unaudited condensed statement of operations data by segment and in total for the three months ended June 30, 2007 and 2006.

	2007				
	Healthcare Security	Implantable	Industrial	Corporate	Total
			(in thousands)		
Product revenue	$ 5,708	$ —	$ 1,946	$ —	$ 7,654
Service revenue	155	—	381	—	536
Total revenue	5,863	—	2,327	—	8,190
Gross profit	3,043	—	1,187	—	4,230
Selling, general and administrative	2,053	1,211	521	1,559	5,344
Research and development	558	98	300	—	956
Total operating expenses	2,611	1,309	821	1,559	6,300
Operating (loss) income	$ 432	$ (1,309)	$ 366	$ (1,559)	$ (2,070)

	2006				
	Healthcare Security	Implantable	Industrial	Corporate	Total
			(in thousands)		
Product revenue	$ 5,047	$ 11	$ 1,505	$ —	$ 6,563
Service revenue	146	—	267	—	413
Total revenue	5,193	11	1,772	—	6,976
Gross profit	2,972	1	1,129	—	4,102
Selling, general and administrative	2,252	928	488	557	4,225
Research and development	725	—	209	—	934
Total operating expenses	2,977	928	697	557	5,159
Operating income (loss)	$ (5)	$ (927)	$ 432	$ (557)	$ (1,057)

Revenue

Revenue for the three months ended June 30, 2007 was $8.2 million, an increase of $1.2 million, or 17.4%, compared to the comparable period of the prior year.

Our healthcare security segment's revenue was $5.9 million for the three months ended June 30, 2007 compared to $5.2 million for the three months ended June 30, 2006. The $0.7 million increase in revenue in our healthcare security segment is primarily attributable to increased sales of infant protection systems reflecting increased sales volumes generated by our key dealers for both new systems and the sale of RFID tags and other consumables to our installed base. Revenue from the sale of our wander prevention products also increased for the three months ended June 30, 2007 compared to the three months ended June 30, 2006.

Our industrial segment's revenue was $2.3 million for the three months ended June 30, 2007 compared to $1.8 million for the three months ended June 30, 2006. The $0.5 million increase in revenue in our industrial segment reflects continued strong demand in the worldwide construction market for our vibration monitoring systems. The strength or weakness of the worldwide construction market has historically had a significant influence on the sales volumes of our vibration monitoring instruments.

Our implantable segment revenue was nil for the three months ended June 30, 2007 compared to $11,000 for the three months ended June 30, 2006. This decrease is attributable to the sale of access security systems in early 2006 prior to the shift in our sales and marketing efforts to the build out of our VeriMed business.

Gross Profit and Gross Profit Margin

Our cost of products consists of component parts, direct labor and finished goods. Component parts and finished goods are purchased from contract manufacturers, including our implantable microchip and scanners used in our VeriMed system, which are purchased as finished goods under the terms of our agreement with Digital Angel Corporation, or Digital Angel. Moreover, included in our cost of products is amortization of intangible assets acquired in the acquisitions of Instantel Corporation and EXI Wireless Inc., during the first half of 2005. Such amortization amounted to $0.5 million for the three months ended June 30, 2007 and 2006.

Cost of services consists primarily of third-party installation services in connection with direct sales to healthcare customers. In addition, cost of services sold in our industrial segment consists of servicing our existing systems, principally the calibration services we provide for our vibration monitoring instruments.

Gross profit for the three months ended June 30, 2007 was $4.2 million compared to $4.1 million for the three months ended June 30, 2006. As a percentage of revenue, our gross profit margin was 51.6% and 58.8% for the three months ended June 30, 2007 and 2006, respectively.

Our healthcare security segment's gross profit was $3.0 million for the three months ended June 30, 2007 and 2006. Our healthcare security segment's gross profit margin decreased to 51.9% in the three months ended June 30, 2007 compared to 57.2% in the three months ended June 30, 2006. The decline in gross profit margin is the result of increased warranty costs related to our former Vancouver operations. We have implemented a process to reduce these costs and management believes that the process will result in gross margins increasing by the end of 2007.

Our industrial segment's gross profit for the three months ended June 30, 2007 was $1.2 million compared to $1.1 million for the three months ended June 30, 2006. Our industrial segment's gross profit margin decreased to 51.0% in the three months ended June 30, 2007 compared to 63.7% in the three months ended June 30, 2006. The decline in gross profit margin resulted from increased inventory reserves for slower moving inventory and due to increased revenues from tool management products compared to the three months ended June 30, 2006, which have a lower gross margin that our vibration monitoring products.

Selling, General and Administrative Expense

Selling, general and administrative expense consists primarily of compensation for employees in executive, sales, marketing and operational functions, including finance and accounting, and corporate development. Other significant costs include depreciation and amortization, professional fees for accounting and legal services, consulting fees and facilities costs.

Selling, general and administrative expense increased $1.1 million to $5.3 million for the three months ended June 30, 2007 as compared to $4.2 million for the three months ended June 30, 2006. As a percentage of revenue, selling, general and administrative expense was 65.3% and 60.6% for the three months ended June 30, 2007 and 2006, respectively.

During the three months ended June 30, 2007 and 2006, we incurred stock-based compensation expense of $0.6 million and $31,000, respectively.

Included in selling, general and administrative expense was $0.1 and $0.2 million of certain general and administrative services provided to us by Applied Digital, including accounting, finance and legal services, insurance, telephone, rent and other miscellaneous items in both the three months ended June 30, 2007 and 2006.

Selling, general and administrative expense included depreciation and amortization expense of approximately $0.6 million for the three months ended June 30, 2007 and 2006.

Our healthcare security segment's selling, general and administrative expense was $2.1 million in the three months ended June 30, 2007 as compared to $2.3 million in the three months ended June 30, 2006. The decrease of $0.2 million is a result of cost savings from the close of our Vancouver operations which was completed in the first quarter of 2007. As a percentage of our healthcare security segment's revenue, selling, general and administrative expense was 35.0% and 43.4% for the three months ended June 30, 2007 and 2006, respectively.

Our industrial segment's selling, general and administrative expense remained constant at approximately $0.5 million for the three months ended June 30, 2007 and 2006. As a percentage of our industrial segment's revenue, selling, general and administrative expense was 22.4% and 27.5% for the three months ended June 30, 2007 compared to the three months ended June 30, 2006, respectively. We attribute the decrease in selling, general, and administrative expense as a percentage of segment revenue primarily to revenue growth in our vibration monitoring business and the fixed nature of our general and administrative expenses.

Our implantable segment's selling, general and administrative expense increased to $1.2 million from $0.9 million for the three months ended June 30, 2007 compared to the three months ended June 30, 2006. The increase was due to our increased sales and marketing expenses associated with the build out of our VeriMed business, primarily through increased sales staff and fees related to our market development efforts.

Our corporate segment's selling, general and administrative expense increased from $0.6 million to $1.6 million in three months ended June 30, 2007 compared to the three months ended June 30, 2006. This increase was due primarily to the additional costs resulting from equity based compensation and increased costs related to becoming a public entity during the three months ended June 30, 2007.

Research and Development

Our research and development expense consists primarily of payroll costs for engineering personnel and costs associated with various projects, including testing, developing prototypes and related expenses. Research and development expenses are incurred only in our healthcare security and industrial segments.

Research and development expense was $1.0 million for the three months ended June 30, 2007 compared to $0.9 million for the three months ended June 30, 2006. As a percentage of revenue, research and development expense was 11.7% and 13.4% for the three months ended June 30, 2007 and 2006, respectively.

Our healthcare security segment's research and development expense decreased from $0.7 million to approximately $0.6 million for the three months ended June 30, 2006. This decrease is attributable to the savings realized from the consolidation of our R&D efforts from Vancouver to Ottawa, which was completed in the first quarter of 2007.

Our industrial segment's research and development expense was approximately $0.3 million for the three months ended June 30, 2007 as compared to $0.2 in the three months ended June 30, 2006.

Interest Expense

Interest expense was $0.4 million and $0.2 million for the three months ended June 30, 2007 and 2006, respectively. The increase in interest expense was due to the increased amount owed and increased interest rate under our loan agreement with Applied Digital, and our increased borrowings under our revolving credit facility with the Royal Bank of Canada. We used a portion of the proceeds from our initial public offering to repay $3.5 million of outstanding indebtedness owed to Applied Digital at the closing of our initial public offering. During the three months ended June 30, 2007 and 2006, the interest rate under our loan agreement with Applied Digital was 12% and 7% per annum, respectively.

Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

The table below presents statement of operations data by segment and in total for the six months ended June 30, 2007 and 2006.

	2007				
	Healthcare Security	Implantable	Industrial	Corporate	Total
			(in thousands)		
Product revenue	$ 10,907	$ 1	$ 3,587	$ —	$ 14,495
Service revenue	266	—	802	—	1,068
Total revenue	11,173	1	4,389	—	15,563
Gross profit	5,766	1	2,326	—	8,093
Selling, general and administrative	4,046	2,388	1,117	3,190	10,741
Research and development	1,624	98	641	—	2,363
Total operating expenses	5,670	2,486	1,758	3,190	13,104
Operating (loss) income	$ 96	$ (2,485)	$ 568	$ (3,190)	$ (5,011)

	2006				
	Healthcare Security	Implantable	Industrial	Corporate	Total
			(in thousands)		
Product revenue	$ 9,735	$ 101	$ 2,884	$ —	$ 12,720
Service revenue	215	—	591	—	806
Total revenue	9,950	101	3,475	—	13,526
Gross profit	5,868	46	2,168	—	8,082
Selling, general and administrative	4,289	1,665	993	1,285	8,232
Research and development	1,305	—	513	—	1,818
Total operating expenses	5,594	1,665	1,506	1,285	10,050
Operating income (loss)	$ 274	$ (1,619)	$ 662	$ (1,285)	$ (1,968)

Revenue

Revenue for the six months ended June 30, 2007 was $15.6 million, an increase of $13.5 million, or 15.1%, compared to the comparable period of the prior year.

Our healthcare security segment's revenue was $11.2 million for the six months ended June 30, 2007 compared to $10.0 million for the six months ended June 30, 2006. The $1.2 million increase in revenue in our healthcare security segment is primarily attributable to increased sales of infant protection systems reflecting increased sales volumes generated by our key dealers for both new systems and the sale of RFID tags and other consumables to our installed base. Revenue from the sale of our wander prevention products also increased for the six months ended June 30, 2007 compared to the six months ended June 30, 2006.

Our industrial segment's revenue was $4.4 million for the six months ended June 30, 2007 compared to $3.5 million for the six months ended June 30, 2006. The $0.9 million increase in revenue in our industrial segment reflects continued strong demand in the worldwide construction market for our vibration monitoring systems. The strength or weakness of the worldwide construction market has historically had a significant influence on the sales volumes of our vibration monitoring instruments.

Our implantable segment's revenue was $1,000 for the six months ended June 30, 2007 compared to $101,000 for the six months ended June 30, 2006. This decrease is attributable to the sale of access security systems to several international distributors in the first three months of 2006 prior to the shift in our sales and marketing efforts to the build out of our VeriMed business.

Gross Profit and Gross Profit Margin

Our cost of products consists of component parts, direct labor and finished goods. Component parts and finished goods are purchased from contract manufacturers, including our implantable microchip and scanners used in our VeriMed system, which are purchased as finished goods under the terms of our agreement with Digital Angel Corporation, or Digital Angel. Moreover, included in our cost of products is amortization of intangible assets acquired in the acquisitions of Instantel Corporation and EXI Wireless Inc., during the first half of 2005. Such amortization amounted to $0.9 million for the six months ended June 30, 2007 and 2006.

Cost of services consists primarily of third-party installation services in connection with direct sales to healthcare customers. In addition, cost of services sold in our industrial segment consists of servicing our existing systems, principally the calibration services we provide for our vibration monitoring instruments.

Gross profit for the six months ended June 30, 2007 was $8.1 million for the six months ended June 30, 2007 and 2006. As a percentage of revenue, our gross profit margin was 52.0% and 59.8% for the six months ended June 30, 2007 and 2006, respectively.

Our healthcare security segment's gross profit for the six months ended June 30, 2007 was $5.8 million compared to $5.9 million for the six months ended June 30, 2006. Comparing the same six month periods, gross profit margin decreased from 59.0% in the six months ended June 30, 2006 to 51.6% in the six months ended June 30, 2006. The decline in gross profit margin is the result of increased warranty costs related to our former Vancouver operations. We have implemented a process to reduce these costs and management believes that the process will result in gross margins increasing by the end of 2007.

Our industrial segment's gross profit for the six months ended June 30, 2007 was $2.3 million compared to $2.2 million for the six months ended June 30, 2006. Our industrial segment's gross profit margin decreased to 53.0% in the six months ended June 30, 2007 compared to 62.4% in the six months ended June 30, 2006. The decline in gross profit margin resulted from increased inventory reserves for slower moving inventory and due to increased revenues from tool management products compared to the six months ended June 30, 2006, which have a lower gross margin that our vibration monitoring products.

Our implantable segment's gross profit decreased from $46,000 for the six months ended June 30, 2006 to $1,000 for the six months ended June 30, 2007. The $45,000 decrease resulted from the decrease in revenue resulting from the shift of our sales and marketing strategy in early 2006 to focus of the build out of our VeriMed business. In the first three months of 2006 we sold a number of access control systems to international distribution partners.

Selling, General and Administrative Expense

Selling, general and administrative expense consists primarily of compensation for employees in executive, sales, marketing and operational functions, including finance and accounting, and corporate development. Other significant costs include depreciation and amortization, professional fees for accounting and legal services, consulting fees and facilities costs.

Selling, general and administrative expense increased $2.5 million to $10.7 million for the six months ended June 30, 2007 as compared to $8.2 million for the six months ended June 30, 2006. As a percentage of revenue, selling, general and administrative expense was 69.0% and 60.9% for the six months ended June 30, 2007 and 2006, respectively. We expect the increased year over year selling, general and administrative expense to continue as a result of the build out of our Verimed business, the cost resulting from equity based compensation, and the cost related to becoming a public entity.

During the six months ended June 30, 2007 and 2006, we incurred stock-based compensation expense of $1.3 million and $31,000, respectively.

Included in selling, general and administrative expense was $0.2 million of certain general and administrative services provided to us by Applied Digital, including accounting, finance and legal services, insurance, telephone, rent and other miscellaneous items in both the six months ended June 30, 2007 and 2006.

Selling, general and administrative expense included depreciation and amortization expense of approximately $1.2 million for both the six months ended June 30, 2007 and 2006.

Our healthcare security segment's selling, general and administrative expense was $4.0 million and $4.3 million in the six months ended June 30, 2007 and 2006, respectively. As a percentage of our healthcare security segment's revenue, selling, general and administrative expense was 36.2% and 43.1% for the six months ended June 30, 2007 and 2006, respectively. The decrease of $0.3 million is a result of cost savings from the closing of our Vancouver operations in the first quarter of 2007. We expect to realize additional cost savings year over year from the closing of our Vancouver operations.

Our industrial segment's selling, general and administrative expense decreased approximately $0.9 million to $1.1 million for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. As a percentage of our industrial segment's revenue, selling, general and administrative expense was 25.5% and 28.6% for the six months ended June 30, 2007 compared to the six months ended June 30, 2006, respectively. We attribute the decrease in selling, general, and administrative expense as a percentage of segment revenue primarily to revenue growth in our vibration monitoring business and the fixed nature of our general and administrative expenses.

Our implantable segment's selling, general and administrative expense increased $0.7 million to $2.4 million for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. The increase was due to our increased sales and marketing expenses associated with the build out of our VeriMed business, primarily through increased sales staff and fees related to our market development efforts.

Our corporate segment's selling, general and administrative expense increased $1.9 million to $3.2 million in six months ended June 30, 2007 compared to the six months ended June 30, 2006. This increase was due primarily to the additional costs resulting from equity based compensation and increased costs related to becoming a public entity during the six months ended June 30, 2007. We expect the increased year over year selling, general and administrative expense to continue as a result of the costs of equity based compensation and costs related to becoming a public entity.

Research and Development

Our research and development expense consists primarily of payroll costs for engineering personnel and costs associated with various projects, including testing, developing prototypes and related expenses. Research and development expenses are incurred only in our healthcare security and industrial segments.

Research and development expense was $2.4 million for the six months ended June 30, 2007 compared to $1.8 million for the six months ended June 30, 2006. As a percentage of revenue, research and development expense was 15.2% and 13.4% for the six months ended June 30, 2007 and 2006, respectively.

Our healthcare security segment's research and development expense increased $0.3 million to approximately $1.6 million for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. The increase in our healthcare security segment's research and development expense was due to the costs of duplicative staffing during the period that we were closing our Vancouver facility in early 2007.

Our industrial segment's research and development expense was approximately $0.6 million and $0.5 million for the six months ended June 30, 2007 and 2006, respectively.

Interest Expense

Interest expense was $0.8 million and $0.3 million for the six months ended June 30, 2007 and 2006, respectively. The increase in interest expense was due to the increased amount owed and increased interest rate under our loan agreement with Applied Digital, and our increased borrowings under our revolving credit facility with the Royal Bank of Canada. We used a portion of the proceeds from our initial public offering to repay $3.5 million of outstanding indebtedness owed to Applied Digital at the closing of our initial public offering. During the six months ended June 30, 2007 and 2006, the interest rate under our loan agreement with Applied Digital was 12% and 7% per annum, respectively.

Liquidity and Capital Resources

As of June 30, 2007, cash totaled $10.3 million compared to cash of approximately $1.0 million at December 31, 2006.

Cash Flows Used in Operating Activities

Net cash used in operating activities totaled $4.2 million and $1.5 million during the six months ended June 30, 2007 and 2006, respectively. For each of the periods presented, cash was used primarily to fund operating losses, accounts receivable, and payments of accounts payable and accrued expenses.

Since our acquisitions of our Canadian-based businesses in the first half of 2005, we have generated operating cash flows from such operations that have partially funded our efforts to create a market for our VeriMed system. We expect to continue to generate significant net cash operating outflows for the foreseeable future in our VeriMed business as a result of our continuing investment in marketing and sales efforts related to our VeriMed business. We expect that these net cash operating outflows will continue to be funded through cash flows generated by our Canadian-based operations, as well as from the net proceeds of our initial public offering. As a result, we expect that our consolidated statements of cash flows will reflect significant cash flows used in operating activities for at least the next 12-24 months.

The components of our VeriMed system (i.e., scanners, insertion kits and the implantable microchips) are purchased as finished goods under the terms of our agreement with Digital Angel. The agreement imposes minimum purchase requirements as follows: $0 million in 2007; $0.5 million in 2008, net of $0.4 million of purchases in 2006 and less purchases made in 2007; $1.8 million in 2009; $2.5 million in 2010; $3.8 million in 2011; and $3.8 million in each year thereafter, subject to the parties reaching agreement on a different amount. Under the terms of the agreement, Digital Angel may not supply human implantable microchips to other parties if we meet the minimum purchase requirements. If sales of the implantable microchip do not materialize or do not reach the level of the applicable minimum purchase requirement in any year, we intend to satisfy the minimum purchase requirements nonetheless. In such event, our inventory of implantable microchips will increase. We believe that we will have sufficient liquidity to meet the minimum purchase requirements under the agreement for the next few years.

Cash Flows from Investing Activities

Investing activities used cash of $0.3 million and $0.4 million during the six months ended June 30, 2007 and 2006, respectively, which was used to purchase equipment.

Cash Flows from Financing Activities

Financing activities provided cash of $13.8 million and $0.6 million during the six months ended June 30, 2007 and 2006, respectively. In the six months ended June 30, 2007 and 2006, cash of $0.2 million and $0.8 million was provided from net borrowings under our credit agreement with the Royal Bank of Canada and cash of $(3.5) million was paid to Applied Digital in the six months ended June 30, 2007. During the six months ended June 30, 2007 and 2006, borrowing of $1.3 million and $0.8 million were made from Applied Digital. During the six months ended June 30, 2007, cash of $15.5 million was provided from our initial public offering, net of underwriting fees and offering costs.

Credit Facilities

Prior to the date of our initial public offering, which was consummated on February 14, 2007, we financed a significant portion of our operations and investing activities primarily through funds that Applied Digital provided. As of June 30, 2007, we were indebted to Applied Digital in the amount of $12.2 million.

Through October 5, 2006, our loan with Applied Digital bore interest at the prevailing prime rate of interest as published by *The Wall Street Journal*, which as of September 30, 2006 was 8.25% per annum. On October 6, 2006, we entered into an amendment to the loan agreement which increased the principal amount available thereunder to $13.0 million and we borrowed an additional $2.0 million under the agreement to make the second purchase price payment with respect to our acquisition of Instantel Inc. In connection with that amendment, the interest rate was also changed to a fixed rate of 12% per annum. That amendment further provided that the loan matured on July 1, 2008, but could be extended at the option of Applied Digital through December 27, 2010.

On January 19, 2007, February 8, 2007 and February 13, 2007, we entered into further amendments to the loan documents which increased the maximum principal amount of indebtedness that we may incur to $14.5 million. A portion of this increase was used to cover approximately $0.7 million of intercompany advances made to us by Applied Digital during the first week of January 2007. Upon the consummation of our initial public offering in February 2007, the loan ceased to be a revolving line of credit, and we have no ability to incur additional indebtedness under the loan documents. The interest continues to accrue on the outstanding indebtedness at a rate of 12% per annum. On February 14, 2007, the closing date of our initial public offering, we were indebted to Applied Digital in the amount of $15.1 million, including $1.0 million of accrued interest and, in accordance with the terms of the loan agreement as most recently amended on February 13, 2007, we used $3.5 million of the net proceeds of our initial public offering to repay a portion of our indebtedness to Applied Digital upon consummation of our initial public offering. We are not obligated to repay an additional amount of our indebtedness until January 1, 2008. Effective with the payment of the $3.5 million, all interest which accrues on the loan as of the last day of each month, commencing with February 2007, is added to the principal amount. Commencing January 1, 2008 through January 1, 2010, we are obligated to repay $300,000 on the first day of each month. A final balloon payment equal to the outstanding principal amount then due under the loan plus all accrued and unpaid interest will be due and payable on February 1, 2010. We amended the repayment terms of the loan to allow us to retain a greater portion of the net proceeds of our initial public offering for use in our business, thereby improving our liquidity for at least the next 12 to 18 months.

Our subsidiary, VeriChip Holdings Inc., or VHI, has entered into a credit facility dated March 15, 2006 with the Royal Bank of Canada, or RBC, providing for up to CDN$1.5 million, or approximately $1.4 million based on the exchange rate as of June 30, 2007, of revolving credit loans, provided that outstanding borrowings under the facility may not exceed at any time an amount determined by reference to eligible accounts receivable plus eligible inventory, in each case as defined in the agreement, of VHI, or CDN$3.8 million at June 30, 2007. At June 30, 2007, $1.1 million was outstanding under the facility. The facility is not a committed facility as it provides that loans are made available to VHI at the sole discretion of RBC and that RBC may cancel or restrict the availability or any unutilized portion thereof at any time or from time to time. Borrowings may be made in either Canadian or U.S. dollars, are repayable on demand, as a result of which outstanding borrowings under the facility are reflected as current liabilities in our consolidated financial statements, and bear interest at a floating rate per annum equal to the Canadian or U.S. dollar prime rate, as applicable, announced by RBC from time to time, plus in each case 1%. The facility also provides for letters of credit and letters of guarantee denominated in Canadian dollars. Borrowings, letters of credit and letters of guarantee under the facility are secured by all of the assets of VHI and its subsidiary, and is guaranteed by VHI's subsidiary in the amount of CDN$2.0 million. The loan agreements contain customary representations and warranties and events of default for loan arrangements of this type. In addition, the loan agreements contain customary covenants restricting VHI's ability to, among other things, merge or enter into business combinations, create liens, or sell or otherwise transfer assets. The foregoing is a summary of the material terms of the credit facility and related agreements, and is qualified in its entirety by reference to the terms and provisions of those agreements.

Financial Condition

As of June 30, 2007, we had working capital of approximately $11.8 million and an accumulated deficit of $23.0 million compared to a working capital of approximately $0.8 million and an accumulated deficit of approximately $17.0 million as of December 31, 2006. The increase in working capital was primarily due to proceeds from our initial public offering completed on February 14, 2007, net of offering costs and underwriter fees, on February 14, 2007.

We believe that with the remaining net proceeds of our initial public offering, together with the cash we have on hand, our expected borrowing capacity under current or new bank facilities and operating cash flows we expect to generate, we will have sufficient funds available to cover our cash requirements, including capital expenditures, debt service requirements and the minimum purchase obligations under our supply agreement with Digital Angel, for at least the next twenty four months. However, a decrease in operating cash flows from our healthcare security and industrial businesses, or our inability to enter into a larger, committed bank credit facility, or failure to control or, as necessary, reduce costs related to our continuing investment in our VeriMed business, would have a material adverse effect on our planned business operations, financial condition, results of operations and liquidity.

Impact of Recently Issued Accounting Standards

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159"), including an amendment of FAS 115. This statement provides companies with an option to report selected financial assets and liabilities at fair value. This statement is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. We are currently assessing the impact that the adoption of FAS 159 could have on results of operations or financial position, if any.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We presently do not use any derivative financial instruments to hedge our exposure to adverse fluctuations in interest rates, foreign exchange rates, fluctuations in commodity prices or other market risks, nor do we invest in speculative financial instruments. Our line of credit with the Royal Bank of Canada bears interest at the Bank of Canada prime rate plus 1%. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since our investments are short-term.

Due to the nature of our short-term investments, we have concluded that there is no material market risk exposure and, therefore, no quantitative tabular disclosures are required. Due to the minimal amounts of foreign currency exchange gains and losses and translation adjustments during the six months ended June 30, 2007, a sensitivity analysis of fluctuations in foreign currency exchange rates is not required. During the three and six months ended June 30, 2007, we incurred $0.2 million in foreign exchange loss primarily from the fluctuation of Canadian dollar exchange related RBC credit facility and other Canadian denominated liabilities.

The table below presents the principal amount, including accrued interest, and weighted-average interest rate for our debt portfolio:

	June 30, 2007 (dollars in thousands)
Loan due Applied Digital	$ 12,167
Credit agreement with Royal Bank of Canada	$ 1,084
Weighted-average interest rate for the six months ended June 30, 2007	11.2%

Based upon the average variable rate debt outstanding during the three months ended June 30, 2007, a 1% change in our variable interest rates would have a de minimis affect on our loss before income taxes.

The estimated fair value of our indebtedness to Applied Digital is not reasonably determinable due to the related party nature of the instrument.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Evaluation of Disclosure Controls. We evaluated the effectiveness of the design and operation of our “disclosure controls and procedures” as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) as of June 30, 2007. This evaluation (the “disclosure controls evaluation”) was done under the supervision and with the participation of management, including our chief executive officer (“CEO”) and chief financial officer (“CFO”). Rules adopted by the SEC require that in this section of our Quarterly Report on Form 10-Q we present the conclusions of the CEO and CFO about the effectiveness of our disclosure controls and procedures as of June 30, 2007 based on the disclosure controls evaluation.

Objective of Controls. Our disclosure controls and procedures are designed so that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Our disclosure controls and procedures are also intended to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures.

Conclusion. Based upon the disclosure controls evaluation, our CEO and CFO have concluded that, as of June 30, 2007, our disclosure controls and procedures were effective to provide reasonable assurance that the foregoing objectives are achieved.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act that occurred during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

The Company has received demand letters from attorneys for several former employees and/or consultants of the Company and our parent company, Applied Digital, asserting claims related to stock options to acquire approximately 540 thousand shares of the Company’s common stock that management believes that such employees and/or consultants had forfeited when they ceased their employment or relationship with the Company and/or Applied Digital. The Company believes that all of these potential claims are without merit and intend to vigorously defend them in the event the claims are asserted or litigated.

The Company is a party to various legal actions, as either plaintiff or defendant, including the matter identified above, arising in the ordinary course of business, none of which is expected to have a material adverse effect on our business, financial condition or results of operations.

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

An annual meeting of our shareholders was held on June 14, 2007 to:

(1) Elect five directors to hold office until the 2008 Annual Meeting of Stockholders and until their successors have been duly elected and qualified. The results of the vote to elect five directors were as follows:

Name of Director	For	Withheld
Scott R. Silverman	7,274,252	417,210
Jeffrey S. Cobb	7,674,283	17,179
Paul C. Green	7,674,273	17,189
Daniel E. Penni	7,674,283	17,179
Constance K. Weaver	7,674,330	17,133

(2) To ratify the appointment of Eisner LLP as independent auditors of the Company for the year ending December 31, 2007. The proposal received 7,684,613 votes for,5,275 votes against, 1,575 abstentions and no broker non-votes;

(3) To approve and adopt the Company's 2007 Stock Incentive Plan. The proposal received 6,083,417 votes for, 264,235 votes against, 5,740 abstentions and 1,338,071 broker non-votes.

Each of the three proposals was approved by the Company's stockholders.

Item 5. Other Information.

On August 8, 2007, the Company entered into a consulting agreement with Randolph K. Geissler. Mr. Geissler, who is the former Chief Executive Officer of Digital Angel, possesses considerable industry knowledge and experience, has agreed to perform consulting work with respect to identifying, contacting and introducing strategic partners to the Company, identifying potential merger and/or acquisition opportunities for the Company to consider and participating on a committee established for the development of certain products (the "Services"). Under the terms of the consulting agreement, Mr. Geissler will receive 107,000 shares of the Company's common stock and will be reimbursed for all actual reasonable and necessary expenses, which are directly related to the Services, provided that the Company grants prior approval of any expenditure. The term of the agreement is for one year.

Item 6. Exhibits.

Exhibit Number	Description
2.1	Acquisition Agreement dated as of January 25, 2005 between Applied Digital Solutions, Inc. and EXI Wireless Inc.(1)
2.2	Amendment to Acquisition Agreement dated as of March 11, 2005 between Applied Digital Solutions, Inc. and EXI Wireless Systems Inc.(1)
2.3	Exchange Agreement dated as of June 9, 2005 between Applied Digital Solutions, Inc. and VeriChip Corporation(1)
2.4	Waiver and Release between Applied Digital Solutions, Inc. and VeriChip Corporation(1)
2.5	Share Purchase Agreement dated as of June 10, 2005 by and among Instantel Inc., Instantel Holding Company s.ár.l., Perceptis, L.P., VeriChip Inc., Applied Digital Solutions, Inc. and VeriChip Corporation (1)
2.6	Letter Agreement dated as of December 21, 2005, by and among VeriChip Corporation, VeriChip Inc., and Applied Digital Solutions, Inc.(1)
2.7	Registration Rights Agreement dated as of June 10, 2005 between VeriChip Corporation and Perceptis, L.P.(1)
3.1	Second Amended and Restated Certificate of Incorporation of VeriChip Corporation filed with the Secretary of State of Delaware on December 18, 2006(1)
3.2	Amended and Restated By-laws of VeriChip Corporation adopted as of December 12, 2005(1)
4.1	Warrant Agreement dated as of August 21, 2002 between VeriChip Corporation and IBM Credit Corporation (1)
4.2	Form of Specimen Common Stock Certificate(1)
4.3	Form of Warrant to Purchase Common Stock of VeriChip Corporation(1)
10.1*	Form of Non-Qualified Option Award Agreement under the VeriChip Corporation 2007 Stock Incentive Plan
10.2*	Consulting Agreement dated as of August 8, 2007 between VeriChip Corporation and Randolph K. Geissler
10.3	VeriChip Corporation Executive Management Incentive Plan dated April 2, 2007(2)
10.4	First Amendment to Amended and Restated Supply, License and Development Agreement dated as of May 9, 2007 between the Registrant and Digital Angel Corporation (3)
10.5	VeriChip Corporation 2007 Stock Incentive Plan, adopted as of June 14, 2007(4)
31.1*	Certification by Scott R. Silverman, Chief Executive Officer, pursuant to Exchange Act Rules 13A-14(a) and 15d-14(a)
31.2*	Certification by William J. Caragol, Chief Financial Officer, pursuant to Exchange Act Rules 13A-14(a) and 15d-14(a)
32.1*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

(1) Incorporated by reference to the Registration Statement on Form S-1 previously filed by VeriChip Corporation (Registration No. 333-130754).

(2) Incorporated by reference to the Annual Report on Form 10-K previously filed by VeriChip Corporation on April 2, 2007.

(3) Incorporated by reference to the Quarterly Report on Form 10-Q previously filed by VeriChip Corporation on May 15, 2007.

(4) Incorporated by reference to the Form 8-K previously filed by VeriChip Corporation on June 20, 2007.

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SIGNATURES

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

VERICHIP CORPORATION
(Registrant)

Date: August 8, 2007

By: /s/ William J. Caragol
William J. Caragol
President, Chief Financial Officer, Treasurer and Secretary

Exhibit Index

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32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 10.1

NON-QUALIFIED STOCK OPTION AWARD GRANTED UNDER THE VERICHIP CORPORATION 2007 STOCK INCENTIVE PLAN

Name of Option Recipient: [insert name of Grantee]

On [insert applicable date], the Company awarded you a stock option. You were granted an option to buy [insert applicable number] Shares of the Common Stock at the price of $[insert applicable amount] per Share on or after [insert vesting date], and on or before [insert expiration date]. [*Where the option award is to vest in tranches, use the following sentence as a replacement for the one immediately prior:* You were granted an option to buy [insert applicable number] Shares of the Common Stock at the price of $[insert applicable amount] per Share on or after the following dates—[insert number for first tranche] on [insert first vesting date]; [insert number for second tranche] on [insert second vesting date]; and [insert number for third tranche] on [insert third vesting date] —and no later than [insert expiration date]. *If to vest over more than, or less than, three tranches, customize as necessary.*]

IMPORTANT: By signing below, you agree to be bound by, and acknowledge receipt of, the attached Terms and Conditions of this Non-Qualified Stock Option Award and the VeriChip Corporation 2007 Stock Incentive Plan.

VeriChip Corporation

By:

Read and agreed to this
_________ day of ___________________________, 200_.

____
[insert name of Grantee]

TERMS AND CONDITIONS

NON-QUALIFIED STOCK OPTION AWARD GRANTED UNDER

VERICHIP CORPORATION

2007 STOCK INCENTIVE PLAN

1. Definitions

(a)	Committee	The Committee (or, in certain cases, its designees) who administers the Stock Option Plan
(b)	Company	VeriChip Corporation, a Delaware corporation
(c)	Grantee	The recipient of an Option Award
(d)	Option	The option granted by the Option Award
(e)	Option Award	The Non-Qualified Stock Option Award to which the Terms and Conditions are attached together with, except where the context requires otherwise, these Terms and Conditions
(f)	Stock Option Plan	VeriChip Corporation 2007 Stock Incentive Plan, as amended

All capitalized terms not otherwise defined herein shall have the meanings given to such terms by the Stock Option Plan.

2. Evidence of Option Grant and Option not an Incentive Stock Option

The Option Award evidences a grant to the Grantee of an Option to purchase that number of Shares ("Optioned Shares") of the Common Stock of the Company ("Stock") set forth on the Option Award. The Grantee may exercise the Option as shown on the Option Award. In no event shall the Option or any part of the Option be exercisable after [insert expiration date] (the "Option Expiration Date"). The Option shall not be treated as an "Incentive Stock Option," as defined in Section 422 of the Internal Code of 1986, as amended ("Code").

3. Exercise of Option

The Option shall be exercised by the Grantee delivering a written notice of exercise to the Company's corporate headquarters at 1690 S. Congress Ave., Suite 200, Delray Beach, Florida 33445. This notice shall specify the number of Optioned Shares the Grantee then desires to purchase.

4. Payment of Option Price

Payment for the Shares purchased under the Option shall be made to the Company in cash (including cashier's check, bank draft or money order).

In addition to the foregoing methods of payment, payment of the Option price may, at the discretion of the Committee, be made in whole or in part in other property, rights and credits, including the Grantee's promissory note.

5. Form of Notice of Exercise

The Grantee's notice as required by Section 3 shall be signed by the Grantee and shall be in substantially the following form:

"I hereby exercise my Option to purchase _________ Shares in accordance with my Option Award dated __________________, _________, granted under the Company's 2007 Stock Incentive Plan.

The aggregate Option price of the Shares I am purchasing is $_________. I hereby tender in payment of such price, my cashier's check, bank draft or money order made payable to the Company in the amount of $_________.

If the Shares purchased have not been registered under the Securities Act of 1933, I hereby further represent to the Company that I am acquiring the _________ Shares that I am purchasing solely for investment and solely for my own account and that I have no present intention of selling or offering for sale any of such Shares to any other person or persons."

6. Stock Certificates

Upon the exercise of the Option solely for cash or cash and property, rights and/or credits specifically permitted by the Committee, the Grantee shall be entitled to a certificate evidencing the Shares acquired upon exercise.

7. Legends on Certificates

The certificate or certificates to be issued under Section 6 shall be issued as soon as practicable. Such certificate or certificates shall contain thereon a legend in substantially the following form if the Shares evidenced by such certificate have not been registered under the Securities Act of 1933, as amended:

"The shares represented by this certificate have not been registered under the Securities Act of 1933 or any applicable state law. They may not be offered for sale, sold, transferred or pledged without (1) registration under the Securities Act of 1933 and any applicable state law, or (2) at holder's expense, an opinion (satisfactory to the Company) that registration is not required."

The certificates shall also contain such other legends as may be appropriate or required by law, such as a legend relating to any stockholders' agreement that may apply to the Shares.

8. Termination of Employment; Nonassignability

8.1 Voluntary Termination or Termination for Cause.

a. If the Grantee's Continuous Status as an Employee or Consultant voluntarily terminates prior to attainment of age 65, the Grantee will have a thirty (30) day period beginning on the date of termination during which the Grantee may exercise the Option, but only to the extent the Option is vested and exercisable on the date of termination. Any Option not exercised within such period shall terminate and the Grantee's rights thereunder shall cease.

b. If the Grantee's Continuous Status as an Employee or Consultant is terminated by the Employer for "Cause", as defined below, then the Grantee's full interest in the Option shall terminate on the date of such termination of employment and all rights thereunder shall cease whether or not the Option is then exercisable.

I. Whether a Grantee's Continuous Status as an Employee or Consultant is terminated for Cause shall be determined by the Committee.

II. Cause shall mean gross negligence, willful misconduct, flagrant or repeated violations of the Employer's policies, rules or ethics, a material breach by the Grantee of any employment agreement between the Grantee and the Employer, intoxication, substance abuse, sexual or other unlawful harassment, disclosure of confidential or proprietary information, engaging in a business competitive with the Employer, or dishonest, illegal or immoral conduct.

8.2 Other Termination.

a. Death, Disability or Retirement. If the Grantee's Continuous Status as an Employee or Consultant is terminated for disability (as such term is defined in Section 22(e)(3) of the Code), death, or voluntary termination by the Grantee after attainment of age 65 ("Retirement"), such termination shall have no effect on his or her rights under the Option, regardless of whether the Option is then exercisable. The Option shall continue to vest and remain outstanding and exercisable until it expires by its terms.

b. Termination by the Employer without Cause. If the Grantee's Continuous Status as an Employee or Consultant is be terminated by the Employer without Cause, such termination shall have no effect on his or her rights under the Option, regardless of whether the Option is then exercisable. The Option shall continue to vest and remain outstanding and exercisable until it expires by its terms. The Grantee's service as a Director shall be deemed to have been terminated without Cause if the Grantee ceases to serve in such a position solely due to the failure to be reelected or reappointed, as the case may be, and such failure is not a result of an act or omission which would constitute Cause.

8.3 Non-Transferability of Rights; Designation of Beneficiaries. The Option shall not be transferable by the Grantee otherwise than by will or the laws of descent and distribution or as provided in this Section 8.3. During the lifetime of the Grantee the Option shall be exercisable only by the Grantee. The Grantee, however, may file with the Company a written designation of a beneficiary or beneficiaries to exercise, in the event of death of the Grantee, the Option granted hereunder, subject to all of the provisions of this Section 8. A Grantee may from time to time revoke or change any such designation of beneficiary and any designation of beneficiary under the Plan shall be controlling over any other disposition, testamentary or otherwise; provided, however, that if the Committee shall be in doubt as to the right of any such beneficiary to exercise the Option, the Committee may determine to recognize only an exercise by the personal representative of the estate of the Grantee, in which case the Company, the Committee and the members thereof shall not be under any further liability to anyone.

8.4 Deemed Termination of Employment and Transfer. If the Employer that employs the Grantee (or of which the Grantee is a Director) ceases to be an Employer, the Grantee's Continuous Status as an Employee or Consultant shall be deemed to have been terminated by such Employer without Cause as of the date that it ceases to be an Employer. The transfer of a Grantee's employment (or a Director's service as a Director) from one Employer to another Employer shall not be deemed a termination of Continuous Status as an Employee or Consultant.

9. Withholding

The Company or any Affiliate that employs the Grantee shall have the right to deduct any sums that federal, state or local tax law requires to be withheld with respect to the exercise of the Option, or as otherwise may be required by such laws. The Company or any such Affiliate may require as a condition to issuing Stock upon the exercise of the Option that the Grantee or other person exercising the Option pay to the Company any sum that federal, state or local tax law requires to be withheld with respect to such exercise or at 1690 S. Congress Avenue, Suite 200, Delray Beach, Florida 33445, prior to or concurrently with exercise. In the alternative, the Grantee or other person exercising the Option, may elect to have the necessary number of shares withheld, equal to the amount of the amount of tax required to be withheld. There is no obligation that the Grantee be advised of the existence of the tax or the amount which the employer corporation will be so required to withhold.

10. Right to Exercise Acceleration

On or before the Option Expiration Date, the Option shall be immediately exercisable in full (if not already exercisable) upon a Change of Control.

11. Stock Option Plan Controls

The Option Award and these Terms and Conditions are subject to all terms and provisions of the Stock Option Plan which is incorporated herein by reference. In the event of any conflict, the Stock Option Plan shall control over the Option Award and these Terms and Conditions.

Exhibit 10.2

CONSULTING AGREEMENT.

THIS CONSULTING AGREEMENT (the "Agreement") is made effective this 8th day of August, 2007, between Randolph K. Geissler, whose address is 410 Brookwood Dr., Hudson, WI 54016, (the "Consultant"), and VeriChip Corporation, a Delaware corporation, whose principal place of business is located at 1690 South Congress Avenue, Suite 200, Delray Beach, Florida 33445 (the "Company").

WHEREAS, the Company is in need of assistance in connection with identifying business opportunities with respect to growing the Company;

WHEREAS, the Consultant possesses considerable industry knowledge and experience that is valuable to the Company; and

WHEREAS, the Consultant has agreed to perform consulting work for the Company with respect to identifying, contacting, and introducing potential strategic partners to the Company, identifying potential medical device merger and/or acquisition opportunities for the Company to consider, and participating on a committee established to develop the glucose sensing chip (collectively, the "Services").

NOW, THEREFORE, the parties hereby agree as follows:

ARTICLE 1 — SCOPE OF WORK.

1.1 Services — The Company shall engage the Consultant to provide the Services related to the human implantable RFID business on the terms and conditions that follow.

1.2 Time and Availability — The Consultant shall perform the Services and provide advice and analysis with respect to the Services as the Company may reasonably require. The Services shall be performed at such place or places as the Consultant deems reasonable giving due regard to the needs of the Company's business. Consultant shall devote such of his time and business efforts to the performance of the Services as Consultant deems reasonable and necessary to discharge his responsibilities and obligations hereunder.

1.3 Confidentiality — In order for the Consultant to perform the Services, it may be necessary for the Company to provide the Consultant with Confidential Information (as defined below) regarding the Company's business and products. The Consultant agrees to be bound by the terms of Article 5 hereof.

1.4 Standard of Conduct — In rendering the Services under this Agreement, the Consultant shall conform to high professional standards of work and business ethics. The Consultant shall not use time, materials, or equipment of the Company without the prior written consent of the Company.

1.5 Outside Services — The Consultant shall not use the service of any other person, entity or organization in the performance of the Consultant's duties without the prior written consent of the Company. Should the Company consent to the use by the Consultant of the services of any other person, entity or organization, no information regarding the Services to be performed under this Agreement shall be disclosed to that person, entity or organization until such person, entity or organization has executed an agreement to protect the confidentiality of the Company's Confidential Information (as defined below) and the Company's absolute and complete ownership of all right, title and interest in the work performed under this Agreement.

1.6 Reports — The Consultant shall, periodically and when specifically requested by the Company, provide the Company with written reports of his observations and conclusions regarding the Services. Upon the termination of this Agreement, the Consultant shall, upon the request of Company, prepare a final report of the Consultant's activities.

ARTICLE 2 — INDEPENDENT CONTRACTOR.

2.1 Independent Contractor — The Consultant is an independent contractor and is not an employee, partner, or co-venturer of, or in any other service relationship with, the Company. The Consultant is not authorized to speak for, represent, or obligate the Company in any manner without the prior express written authorization from an officer of the Company.

2.2 Defense and Indemnification

(a) The Company agrees, at its sole expense, to defend the Consultant against, and to indemnify and hold the Consultant harmless from, any claims or suits by a third party against the Consultant's acts or omissions or any liabilities or judgments based thereon, arising form the Consultant's performance of the Services at the Company's direction under this Agreement.

(b) The Consultant agrees to indemnify, defend and hold harmless the Company, its directors, officers, employees and agents with respect to claim, demand, cause of action, debt or liability, including reasonable attorneys' fees, to the extent that such an action arises out of the negligence or misconduct of the Consultant.

2.3 Taxes — The Consultant shall be responsible for all taxes arising from compensation as per Section 3.1 below under this Agreement, and shall be responsible for all payroll taxes and fringe benefits of the Consultant's employees. Neither federal, nor state, nor local income tax, nor payroll tax of any kind, shall be withheld or paid by the Company on behalf of the Consultant or its employees. The Consultant understands that it is required to pay, according to law, the Consultant's taxes and the Consultant shall, when requested by the Company, properly document to the Company that any and all federal and state taxes have been paid. All reimbursements as per Section 3.2 are not and shall not be reported to the IRS as taxable income.

2.4 Benefits — The Consultant and the Consultant's employees will not be eligible for, and shall not participate in, any employee pension, health, welfare, or other fringe benefit plan, of the Company. No workers' compensation insurance shall be obtained by the Company covering the Consultant or the Consultant's employees.

ARTICLE 3 — COMPENSATION FOR CONSULTING SERVICES.

3.1 Compensation — In consideration of Consultant performing the Services, the Consultant shall be granted 107,000 (one hundred seven thousand) shares of the Company's common stock (the "Shares") pursuant to any combination of the Company's 2005 Flexible Stock Plan and/or the 2007 Stock Incentive Plan, at the Company's discretion. The Company shall issue the Shares to the Consultant as soon as administratively practicable following the effective date of this Agreement. The Consultant shall not be entitled to any other compensation by the Company for any services rendered by the Consultant without the express written approval of the Company.

3.2 Reimbursement — The Company agrees to reimburse the Consultant for all actual reasonable and necessary expenditures, which are directly related to the Services. Expenses will only be reimbursed if the Company had given prior approval of the expenditure. Expenses incurred by the Consultant will be reimbursed by the Company within thirty (30) days of the Consultant's proper written request for reimbursement which includes all proper documentation.

ARTICLE 4 — TERM AND TERMINATION.

4.1 Term — This Agreement shall be effective as of August 6, 2007, and shall continue in full force and effect for 12 consecutive months. The Company and the Consultant may negotiate to extend the term of this Agreement and the terms and conditions under which the relationship shall continue. The Company may cancel this agreement on thirty (30) days notice to Consultant, as per section 9.9 below.

4.2 Termination — The Company may immediately terminate this Agreement for "Cause," after giving the Consultant written notice of the reason. Cause means: (1) the Consultant has breached the provisions of Article 5 or 7 of this Agreement in any respect; (2) the Consultant has breached any other provision of this Agreement and the breach continues for 15 days following receipt of a notice from the Company; (3) the Consultant has committed fraud, a misappropriation or embezzlement in connection with the Company' s business or the Consultant's Services; (4) the Consultant has been convicted of a felony, or (5) the Consultant's use of narcotics, liquor or illicit drugs has a detrimental effect on the performance of her employment responsibilities, as determined by the Company.

4.3 Responsibility upon Termination — Any equipment provided by the Company to the Consultant in connection with or furtherance of Consultant's Services under this Agreement, including, but not limited to, computers, laptops, and personal management tools, shall, immediately upon the termination of this Agreement, be returned to the Company.

4.4 Survival — The provisions of Articles 5, 6, 7 and 8 of this Agreement shall survive the termination of this Agreement and remain in full force and effect thereafter.

ARTICLE 5 — CONFIDENTIAL INFORMATION.

5.1 Obligation of Confidentiality — In performing the Services under this Agreement, the Consultant may be exposed to and will be required to use certain “Confidential Information” (as hereinafter defined) of the Company. The Consultant agrees that the Consultant will not and the Consultant’s employees, agents or representatives will not, use, directly or indirectly, such Confidential Information for any purpose other than providing the Services and will not use for the benefit of any person, entity or organization other than the Company, or disclose such Confidential Information without the written authorization of the Company, either during or after the term of this Agreement, for as long as such information retains the characteristics of Confidential Information.

5.2 Definition — “Confidential Information” means information, not generally known, and proprietary to the Company or to a third party for whom the Company is performing work, including, without limitation, information concerning any patents or trade secrets, confidential or secret designs, processes, formulae, source codes, plans, devices or material, research and development, proprietary software, analysis, techniques, materials or designs (whether or not patented or patentable), directly or indirectly useful in any aspect of the business of the Company, any vendor names, customer and supplier lists, databases, management systems and sales and marketing plans of the Company, any confidential secret development or research work of the Company, or any other confidential information or proprietary aspects of the business of the Company. All information which Consultant acquires or becomes acquainted with during the period of this Agreement, whether developed by Consultant or by others, which Consultant has a reasonable basis to believe to be Confidential Information, or which is treated by the Company as being Confidential Information, shall be presumed to be Confidential Information. Confidential Information does not include information that (i) is or later becomes available to the public through no breach of this Agreement by the recipient; (ii) is obtained by the recipient from a third party who had the legal right to disclose the information to the recipient; (iii) is already in the possession of the recipient on the date this Agreement becomes effective; or (iv) is required to be disclosed by law, government regulation, or court order.

5.3 Property of the Company — The Consultant agrees that all plans, manuals and specific materials developed by the Consultant on behalf of the Company in connection with the Services rendered under this Agreement, are and shall remain the exclusive property of the Company. Promptly upon the expiration or termination of this Agreement, or upon the request of the Company, the Consultant shall return to the Company all documents and tangible items, including samples, provided to Consultant or created by Consultant for use in connection with services to be rendered hereunder, including without limitation all Confidential Information, together with all copies and abstracts thereof. This clause shall not apply to services performed by the President of the Consultant related to Receptors LLC. In the event of a conflict, property developed that is related to an agreement with Receptors LLC shall be governed first by any agreement between the Company and Receptors LLC, and if no such agreement exists, by this Agreement.

5.4 Intellectual Property — Title to all inventions and discoveries made by the Consultant resulting from the work performed hereunder shall reside in the Company as related to the human RFID implantable products and business; title to all inventions and discoveries made by the Company resulting from the research performed hereunder shall reside in the Company; title to all inventions and discoveries made jointly by the Consultant and Company resulting from the consultancy hereunder shall reside with the Company solely. The Consultant reserves the right to give notice to the Company and use, apply and profit from the above if the Company elects not to use or put into practice or outside the store fixture industry. Title to all inventions and discoveries made by the Consultant prior to this agreement shall reside with the Consultant.

ARTICLE 6 —DATA.

6.1 Data — All drawings, models, designs, formulas, methods, documents and tangible items prepared for and submitted to the Company by the Consultant in connection with the services rendered under this Agreement shall belong exclusively to the Company and shall be deemed to be works made for hire (the "Deliverable Items"). To the extent that any of the Deliverable Items may not, by operation of law, be works made for hire, the Consultant hereby assigns to the Company the ownership of copyright or mask work in the Deliverable Items, and the Company shall have the right to obtain and hold in its own name any trademark, copyright, or mask work registration, and any other registrations and similar protection which may be available in the Deliverable Items. The Consultant agrees to give the Company or its designees all assistance reasonably required to perfect such rights.

ARTICLE 7 — CONFLICT OF INTEREST AND NON— SOLICITATION.

7.1 Conflict of Interest — The Consultant covenants and agrees not to consult or provide any services in any manner or capacity to a direct competitor of the Company during the duration of this Agreement unless express written authorization to do so is given by the Company. A direct competitor of the Company for purposes of this Agreement is defined as any individual, partnership, corporation and/or other business entity that engages in the business of the Company.

7.2 Non-Solicitation — The Consultant covenants and agrees that during the term of this Agreement, the Consultant will not, directly or indirectly, through an existing corporation, unincorporated business, affiliated party, successor employer, or otherwise, solicit, hire for employment or work with, on a part-time, consulting, advising or any other basis, other than on behalf of the Company, any customer or client of, or any employee or independent contractor employed by, the Company while the Consultant is performing the Services for the Company.

ARTICLE 8 — RIGHT TO INJUNCTIVE RELIEF.

The Consultant acknowledges that the terms of Articles 5, 6, and 7 of this Agreement are reasonably necessary to protect the legitimate interests of the Company, are reasonable in scope and duration, and are not unduly restrictive. The Consultant further acknowledges that a breach of any of the terms of Articles 5, 6, or 7 of this Agreement will render irreparable harm to the Company, and that a remedy at law for breach of the Agreement is inadequate, and that the Company shall therefore be entitled to seek any and all equitable relief, including, but not limited to, injunctive relief, and to any other remedy that may be available under any applicable law or agreement between the parties. The Consultant acknowledges that an award of damages to the Company does not preclude a court from ordering injunctive relief. Both damages and injunctive relief shall be proper modes of relief and are not to be considered as alternative remedies.

ARTICLE 9 — GENERAL PROVISIONS.

9.1 Construction of Terms — If any provision of this Agreement is held unenforceable by a court of competent jurisdiction, that provision shall be severed and shall not affect the validity or enforceability of the remaining provisions.

9.2 Governing Law — This Agreement shall be governed by and construed in accordance with the internal laws (and not the laws of conflicts) of the State of Florida.

9.3 Complete Agreement — This Agreement constitutes the complete agreement and sets forth the entire understanding and agreement of the parties as to the subject matter of this Agreement and supersedes all prior discussions and understandings in respect to the subject of this Agreement, whether written or oral.

9.4 Jurisdiction and Venue — The parties acknowledge that all of the negotiations, anticipated performance and execution of this Agreement occurred or shall occur in the State of Florida, and that, therefore, without limiting the jurisdiction or venue of any other federal or state courts, each of the parties irrevocably and unconditionally (a) agrees that any suit, action or legal proceeding arising out of or relating to this Agreement may be brought in the state or federal courts of record of the State of Florida in Palm Beach County; (b) consents to the jurisdiction of each such court in any suit, action or proceeding; (c) waives any objection which it may have to the laying of venue of any such suit, action or proceeding in any of such courts; and (d) agrees that service of any court paper may be effected on such party by mail, as provided in this Agreement, or in such other manner as may be provided under applicable laws or court rules in said state.

9.5 Modification — No modification, termination or attempted waiver of this Agreement, or any provision thereof, shall be valid unless in writing signed by the party against whom the same is sought to be enforced.

9.6 Waiver of Breach — The waiver by a party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any other or subsequent breach by the party in breach.

9.7 Successors and Assigns — This Agreement may not be assigned by either party without the prior written consent of the other party; provided, however, that the Agreement shall be assignable by the Company without the Consultant's consent in the event the Company is acquired by or merged into another corporation or business entity.

The benefits and obligations of this Agreement shall be binding upon and inure to the parties hereto, their successors and assigns.

9.8 No Conflict — The Consultant warrants that the Consultant has not previously assumed any obligations inconsistent with those undertaken by the Consultant under this Agreement.

9.9 Notices — Any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient upon delivery, when delivered personally or by overnight courier or sent by fax (upon customary confirmation of receipt), or 48 hours after being deposited in the U.S. mail, as certified or registered mail, with postage prepaid, addressed to the party to be notified at such party's address as set forth above.

9.10 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original and all of which together shall constitute one instrument. Delivery of an executed counterpart of this Agreement via facsimile transmission shall be effective as delivery of a manually executed counterpart of this Agreement.

IN WITNESS WHEREOF, this Agreement is executed as of the date set forth above.

VeriChip Corporation

By: /s/ William J. Caragol
Name: William J. Caragol
Title: President and Chief Financial Officer

/s/ Randolph K. Geissler
Randolph K. Geissler

Exhibit 31.1

VERICHIP CORPORATION
CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Scott R. Silverman, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VeriChip Corporation;

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 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) [reserved];

c) 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

d) 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.

5. The registrant's other certifying officer 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: August 8, 2007

/s/ Scott R. Silverman

Scott R. Silverman
Chairman of the Board and Chief Executive Officer

Exhibit 31.2

VERICHIP CORPORATION
CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, William J. Caragol, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of VeriChip Corporation;

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 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) [reserved];

c) 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

d) 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.

5. The registrant's other certifying officer 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: August 8, 2007

/s/ William J. Caragol

William J. Caragol
President, Chief Financial Officer, Treasurer
and Secretary

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of VeriChip Corporation (the "Company") on Form 10-Q for the period ended June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott R. Silverman, Chairman of the Board and Chief Executive Officer of the Company, and I, William J. Caragol, President, Chief Financial Officer, Treasurer and Secretary of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Scott R. Silverman

Scott R. Silverman
Chairman of the Board and Chief Executive Officer
Date: August 8, 2007

/s/ William J. Caragol

William J. Caragol
President, Chief Financial Officer, Treasurer and Secretary
Date: August 8, 2007

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