



Recent Highlights

We've been holding regular monthly meetings with NXT-ID to more closely track their progress since things are moving much faster now that the Wocket is in production. Here are some recent highlights:

Production ramp: NXT-ID is currently shipping their Wocket in steadily increasing numbers. Revenues are growing rapidly on a sequential basis - from \$100K in Q2 to \$400K in Q3 with a solid Q4 expected. The company continues to track very closely to **our IV model projections which suggest a stock price of \$7.47**. Our unit sales estimates for 2016 and beyond appear to be low but we will re-evaluate those numbers as we exit 2015.

Expanded distribution: NXT started working with [Touch of Modern](#) which is a kind of high-style-geek batch sale site. NXTD also announced¹ that they would be available on **Amazon** taking advantage of Amazon stocking and shipping services. These new outlets are a measured expansion intended to line up with the ability to build and ship units. As manufacturing capacity expands we can expect to see more distribution arrangements. We still love the idea of using QVC where the value proposition and audience seem like a very good fit.

Influential advisors: Bill Fields has joined with NXT-ID as a senior advisor to help oversee market strategy and distribution. **Mr. Fields brings 25 years of experience from Wal-Mart** where he rose to position of President and CEO of the Wal-Mart Stores Division. This will bring greater access and expertise in retail distribution. We also like the demonstration of a high standard of corporate governance despite the small size of the company.

Product pipeline: NXTD has released an App that provides customers with tools to update and manage their Wocket via the smartphones. They are also working on EMV-compatible designs for release later this year. Since they have solved what we view as the harder problem in smart wallets they are in a good position to do an easier one like a smart credit card linked to your phone. (This is what many others like Stratos have done.) It's less secure but it is convenient. The Wocket card works at far more points of sale than the others they company will release a phone/card solution that expands their TAM and probably put's a dent in the opportunity for Stratos and that ilk of product. **Card issuers believe they will still be issuing twice as many conventional cards versus EMV in 2019.**

Possible bluebird: We haven't focused too much on the biometric side of the NXT-ID business due to all the excitement around the Wocket. However the 3D-ID business is part of the company and has been working with Battelle as a subcontractor on some major military initiatives. Specifically 3D-ID has been selected as the technology to be used for 3D facial recognition. This probably amounts to an incremental \$150K to \$200K of high margin revenue so it's not dramatic (but is high margin.) However having military-grade biometric technology is an asset in digital wallets and payments. We recount some of the important NXT-ID biometric technology below.

¹ <http://www.prnewswire.com/news-releases/nxt-ids-rocket-smart-wallet-accepted-by-amazon-launchpad-for-retail-sales-expected-to-add-to-continued-sales-growth-528166361.html>

NXT-ID Long Term Positioning

It's easy to get caught up in the moment around digital wallets and smartphones. However the long-term positioning for NXT-ID is far more interesting. Payments is a single use case for a general need which is to 1) store your personal information securely and allow you to manage it and 2) transmit that information (again securely) to some third party.

In the case of payments that's just a credit card and a POS terminal. Not very complicated. Extend this to electronic medical records, contracts and other types of information and financial assets and the generalized ability to manage your "vault" and deliver securely on demand to a specific end-point is really a platform.

NXT-ID core assets are in biometric security and the ability to securely exchange information with any device.

We're only in the first or second inning of a long ball game here. The Wocket can be also be viewed as a reference platform for the combination of consumer-managed privacy and credentials and flexible secure online data exchange.

Even with respect to the "simple" shift to EMV it will take quite some time to play out. One of the leading card issuers, CPI Card Group (PMTS), is out marketing their IPO right now.

the cost

graph portion you factor by 2019 stripe

about 1B magnetic 90% of

replacement cards due to expiration, card loss and churn.)



EMV is a major near-term driver for them and of an EMV card is 5 to 10 times that of a traditional magnetic stripe card. But as the below indicates even by 2019 a significant portion of their business will still not be EMV.² When in the prices of the cards the picture is stark – there will still be twice as many magnetic cards issued as EMV cards. That amounts to EMV cards in 2019 but a little over 2B stripe cards. (It's also important to know that the volume is not new accounts but

How can this be so? It's because there are really two sides to the shift to EMV. What we are seeing now is the corporate side – merchants and credit card companies. They basically have a gun to their head and have to move to EMV as fast as they can. But EMV is an incremental new payment method, not a replacement. With the bulk of consumers carrying traditional cards merchants will need to continue to accept them. Since consumers will continue to enjoy broad acceptance of whatever card they are less motivated to switch to EMV. In some cases their card companies are sending them a new EMV card whether they like it or not but many issuers are not. As of the October 1st "deadline" somewhere between 20% and 40% of consumers have received a new EMV credit card from their issuer.³

Some consumers will elect to improve the security of all their cards with a secure wallet like the Wocket. The Wocket card works almost everywhere today and will be upgraded to work with EMV systems. But if managed the right way will give Wocket an even stronger positioning post-EMV with a device that brings the same level of security to all your cards (traditional or EMV) and works with both older style POS systems and the newer EMV and contactless payment methods.

The main point we see is that NXT-ID will be expanding their range of secure consumer-based systems while the industry has their hands full upgrading infrastructure. The combination of secure information management and the ability to securely transmit to any endpoint will be key requirements for the next decade at least.

² Graphic is from the CPI Card Group IPO roadshow with the source cited as Annapolis Industry Research (May 2015).

³ The 20% figure from Visa as of mid-September and the 40% number from a creditcard.com survey.

The NXT-ID Biometric Advantage

Biometric authentication is already becoming a mainstream method for eliminating the flawed password/PIN model in use today. Even so-called multi-factor is limited due to the inconvenience. Humans offer several readily available methods to authenticate who they are and we'll see these biometric factors become the norm.

When you approach your new Tesla X and it opens the door automatically for you it's not going to be based on shouting out a password or typing a code into your phone. You also don't want anyone with your phone to be able to open and drive your car. Your face, your eye, your fingerprint, maybe your voice, can all be used to know it's you. As important as biometrics are they don't often make for a great stand-alone business. That's why NXT-ID is leveraging their proprietary technology with products like the Wocket.

Although they don't tout it, NXT-ID's expertise in biometrics, along with its growing patent portfolio gives the company a solid foundation upon which to participate in the new biometric-focused security world.

The genesis of NXT-ID goes back to the days when the founders were an integral part of the senior management teams at Technest Holdings, Inc., and its subsidiary, Genex Technologies. Genex Technologies was launched in the mid-1990s to develop and commercialize the unique Rainbow[®] method of capturing 3D data. The Rainbow method utilizes structured light to capture 3D data.⁴

Genex has developed innovative technologies and products for all aspects of imaging, including capture, processing, display, and enhancement. The company's products range from 3D cameras to surveillance algorithms to integrated facial recognition systems. Genex and Technest have won awards from the U.S. Department of Defense, NIH, NIST and NSF, amounting to over \$30 million in support of the technology. NXT-ID has licensed (exclusively in many markets) all the Technest /Genex technology. This technology is an important piece of the foundation upon which NXT-ID is developing its products.

Additionally, NXT-ID has also licensed, on a non-exclusive basis, distribution, manufacturing rights and know-how from Geometrix, Inc., a leading 3D imaging company using a different technical approach from Technest. This technology performed very favorably at the Face Recognition Vendor Test conducted by the National Institute of Science and Technology (NIST). NXT-ID also has key scientific and engineering personnel that have had key roles in the development of these technologies and have an important intellectual knowledge base that the company intends to leverage.

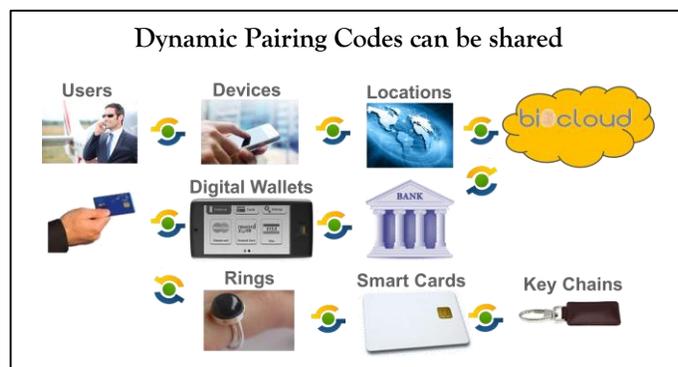
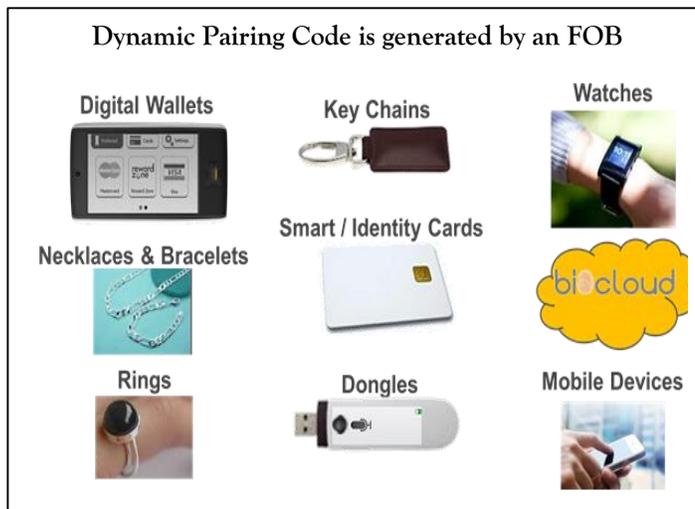
NXT-ID's technology also includes the acquired assets of 3D-ID, LLC, which is comprised of 22 licensed patents in the field of 3D facial recognition. NXT-ID is in the process of building out its extensive IP portfolio further by vigorously pursuing new patents associated with its new Mobile-Bio technologies, which includes The Wocket, The Mobile-Bio Sensor and FaceMatch products.

Another technology in development that figures prominently in the evolution of NXT-ID's biometric security paradigm is Dynamic Pairing Codes (DPC). DPC are a new, proprietary method to secure users, devices, accounts, locations and servers over any communication media by sharing key identifiers, including biometric-enabled identifiers, between end-points by passing dynamic pairing codes (random numbers) between end-points to establish sessions and/or transactions without exposing identifiers or keys.

⁴ Structured light is the process of projecting a known pattern of pixels (often grids or horizontal bars) onto a scene. The way that these deform when striking surfaces allows vision systems to calculate the depth and surface information of the objects in the scene. Structured light is used by a number of police forces for the purpose of photographing fingerprints in a 3D scene.

Under Dynamic Pairing, any two or more entities can share specific information, or *identifiers*, between themselves in order to establish recognition for a one time communication session or transaction. These identifiers and keys are unique to specific factors that include but are not limited to users, manufacturers, devices, accounts, locations and/or sessions (or transactions). Internal keys are derived from the identifiers so that all points have common information that “binds” or “pairs” the devices together (so that they have a means to recognize one another).

The way Dynamic Pairing works is for an entity to pass a randomly generated number to all the other entities to be “paired” together (see figure below). Authentication is performed when one entity passes a random code to another entity, which thereby sends a second pseudo-random number back to the first. The second pseudo-random number response is derived by generating a new pseudo-random number from a combination of the received random number and internal identifiers.



The combination of which identifiers are used to generate the Dynamic Pairing Code is also dynamic, chosen by every point in the communication by NXT-ID's proprietary algorithm. Other inputs may also be used for key generation including a random number generator, temporary keys, and data from external sources to further customize the internal Dynamic Pairing Codes.

From the beginning NXT-ID envisioned a complete platform they call Mobile-Bio™. The components include:

1. **Mobile-Bio FaceMatch™** – 2D, 3D and pseudo-3D methods to perform facial recognition. Additionally, NXT-ID seeking to incorporate its patent pending “FacePassword” as a method to add multi-factor face and face movement to Dynamic Pairing Codes using a simple low-power embedded processor on an external device (biosensor), such as a Wocket, that then connects to other end-points using Dynamic Pairing Codes. The non-Mobile version of FaceMatch is currently on the market and being used by various law enforcement agencies to provide identity authentication.
2. **Biometrically secure mobile devices** like The Wocket™ designed to replace the traditional wallet.
3. **Mobile-Bio Sensors™** – a simple, web-enabled, biometric-enabled external devices used for local authentication and remote authentication with the BioCloud and/or remote servers.
4. **VoiceMatch™** – a way to add biometric identifiers (both speech and speaker recognition) to Dynamic Pairing Codes using a simple low-power embedded processor on an external device (e.g., BioSensor), such as a Wocket, that then connects to other end-points using NXT-ID's Dynamic Pairing Codes.
5. **Mobile BioCloud™** – a cloud-based end-point (authentication service) to authenticate any “end-point” along a communication path, including external biosensors such as the Wocket and/or other PCs or servers along the path. A

dynamic pairing code is sent to the BioCloud where it is combined with other “identifiers” (e.g., device serial number, master key, wallet key, dynamic pairing keys, Firmware key) dynamically (per NXT-ID’s proprietary algorithm that selects which identifiers are used when) to issue a response, which is then compared by each end-point.

While we don’t model the biometric portion of their assets as a business there are some “bluebird” opportunities as we noted in the highlights. The real advantage though is in the fact that strong biometric technology will be integral to nearly every new technology product over time.

Stock Conclusion

With the shares now all the way to their IPO price of \$1 despite the company now in the early commercial stages of growth the stock looks oversold with multiple catalysts coming in the next few months.

Our IV estimate of \$7.47 suggests a potential 7-fold return as the existing Wocket continues to ship and upgraded and new versions debut with expanded distribution in Q4 and into 2016.

As we mentioned at the start of the note, the risk/return from the current stock level is very attractive. Longer-term investors will also note that our IV for 2016 doubles, so if NXT-ID exits 2015 with good momentum there is quite a bit of additional upside.

NXT-ID	Price	\$0.79				
NXTD	IV	\$7.47				
5-Oct-15	Delta	846%				

NXT-ID	2015	2016	2017	2018	2019	2020
Wocket Units (K)	40	120	300	600	975	1500
Wocket Price	\$150	\$150	\$150	\$150	\$150	\$150
Wocket Services	\$600	\$1,800	\$4,500	\$9,000	\$14,625	\$22,500
Sales	\$6,600	\$19,800	\$49,500	\$99,000	\$160,875	\$247,500
YoY Growth	NA	200.0%	150.0%	100.0%	62.5%	53.8%
Gross Margin%	60.0%	60.0%	60.0%	60.0%	60.0%	60.0%
Gross Profits	\$3,960	\$11,880	\$29,700	\$59,400	\$96,525	\$148,500
SGA %	90.9%	60.6%	50.5%	45.5%	37.3%	32.3%
SGA \$	\$6,000	\$12,000	\$25,000	\$45,000	\$60,000	\$80,000
Net Operating Margin	-30.9%	-0.6%	9.5%	14.5%	22.7%	27.7%
Operating Income	-\$2,040	-\$120	\$4,700	\$14,400	\$36,525	\$68,500
Taxed Operating Income	-\$1,326	-\$78	\$3,055	\$9,360	\$23,741	\$44,525
Market Value Using P/E	-\$19,890	-\$1,170	\$45,825	\$140,400	\$356,119	\$667,875
Cash Position	\$0	-\$78	\$2,977	\$12,337	\$36,078	\$80,603
Shares (K)	30,000	30,600	31,212	31,836	32,473	33,122
Period Share Price	-\$1	\$0	\$1	\$4	\$11	\$20
PV of MV 4 Years Out	\$203,612	\$381,860				
PV of Cash 4 Years Out	\$20,628	\$46,085				
PV MV + Cash	\$224,240	\$427,945				
PV Value Per Share	\$7.47	\$13.99				

NXTD	Ticker
NASDAQ	Exchange
113%	Rev Growth
\$0.79	Current Price
30,000	Shares Out
2%	Avg. Dilution
\$0	Debt
35%	Tax Rate
15	P/E Multiple
15%	Discount Rate
\$24	Cap (M)
\$0	Cash
\$7.47	Intrinsic Value
846%	Up/Downside

Editor's Note: This article covers one or more stocks trading at less than \$1 per share and/or with less than a \$100 million market cap. Please be aware of the risks associated with these stocks.

Disclosures

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