

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, 1998

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 333-35563

VASCO Data Security International, Inc.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE 36-4169320
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

1901 South Meyers Road, Suite 210
Oakbrook Terrace, Illinois 60181
(Address of Principal Executive Offices)(Zip Code)

Registrant's telephone number, including area code: (630) 932-8844

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

As of August 7, 1998, 20,331,057 shares of the Company's Common Stock, \$.001 par value per share ("Common Stock"), were outstanding.

VASCO Data Security International, Inc.
Form 10-Q
For The Three and Six Months Ended June 30, 1998

Table of Contents

PART I. FINANCIAL INFORMATION	Page No.
Item 1...Consolidated Financial Statements:	
Consolidated Balance Sheets as of December 31, 1997 and June 30, 1998 (Unaudited)	3
Consolidated Statements of Operations (Unaudited) for the three and six months ended June 30, 1997 and 1998.....	4
Consolidated Statements of Comprehensive Income (Unaudited) for the three and six months ended June 30, 1997 and 1998.....	5
Consolidated Statements of Cash Flows (Unaudited) for the six months ended June 30, 1997 and 1998.....	6
Notes to Consolidated Financial Statements.....	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	7

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.....10

SIGNATURES.....13

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

VASCO Data Security International, Inc.
Consolidated Balance Sheets

	December 31, 1997	June 30, 1998 (Unaudited)
	-----	-----
ASSETS		
Current assets:		
Cash	\$ 1,897,666	\$ 2,245,602
Accounts receivable, net of allowance for doubtful accounts of \$429,000 and \$69,000 in 1997 and 1998	2,458,451	2,185,590
Inventories, net	1,001,294	1,554,531
Prepaid expenses	86,426	660,160
Deferred income taxes	83,000	83,000
Other current assets	221,572	341,084
	-----	-----
Total current assets	5,748,409	7,069,967
	-----	-----
Property and equipment:		
Furniture and fixtures	488,338	554,383
Office equipment	322,434	414,800
	-----	-----
	810,772	969,183
Accumulated depreciation	(497,381)	(586,145)
	-----	-----
	313,391	383,038
Goodwill, net of accumulated amortization of \$198,000 and \$263,000 in 1997 and 1998		
	704,124	639,667
Other assets	1,609,901	1,269,756
	-----	-----
Total assets	\$ 8,375,825	\$ 9,362,428
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:

Current maturities of long-term debt	\$	3,185,400	\$	2,633,163
Accounts payable		1,083,965		716,408
Customer deposits		426,914		429,356
Other accrued expenses		1,606,810		1,865,707
		-----		-----
Total current liabilities		6,303,089		5,644,634

Long-term debt, including stockholder note

of \$5,000,000 in 1997 and 1998		8,442,946		11,470,524
Common stock subject to redemption		494,668		-

Stockholders' equity (deficit):

Common stock, \$.001 par value - 75,000,000 shares authorized; 20,132,968 shares issued and outstanding in 1997; 20,331,057 shares issued and outstanding in 1998		20,133		20,331
Additional paid-in capital		9,186,726		9,796,543
Accumulated deficit		(15,901,575)		(17,504,394)
Accumulated other comprehensive income- cumulative translation adjustment		(170,162)		(65,210)
		-----		-----

Total stockholders' equity (deficit)		(6,864,878)		(7,752,730)
		-----		-----

Total liabilities and stockholders' equity (deficit)	\$	8,375,825	\$	9,362,428
		=====		=====

See accompanying notes to consolidated financial statements.

VASCO Data Security International, Inc.
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1998	1997	1998
	----	----	----	----
Revenues -				
data security products	\$ 3,043,485	\$ 3,524,762	\$ 6,591,694	\$ 6,137,729
Cost of goods sold	1,373,676	1,655,593	3,296,091	2,877,416
	-----	-----	-----	-----
Gross profit	1,669,809	1,869,169	3,295,603	3,260,313
	-----	-----	-----	-----
Operating costs:				
Sales and marketing	871,554	1,046,527	1,603,009	1,929,140
Research and development	265,414	390,532	537,338	827,966
General and administrative	963,068	418,153	1,802,343	993,942
	-----	-----	-----	-----
Total operating costs	2,100,036	1,855,212	3,942,690	3,751,048
	-----	-----	-----	-----
Operating income (loss)	(430,227)	13,957	(647,087)	(490,735)
Interest expense	(282,052)	(670,015)	(460,137)	(879,585)
Other expense, net	(29,714)	(86,693)	(72,750)	(101,155)
	-----	-----	-----	-----
Loss before income taxes	(741,993)	(742,751)	(1,179,974)	(1,471,475)
Provision for income taxes	57,136	121,969	57,171	131,343
	-----	-----	-----	-----
Net loss	(799,129)	(864,720)	(1,237,145)	(1,602,818)
Preferred stock dividends	(27,000)	-	(54,000)	-
	-----	-----	-----	-----
Net loss available to common stockholders	\$ (826,129)	\$ (864,720)	\$ (1,291,145)	\$ (1,602,818)
	=====	=====	=====	=====
Basic loss per common share \$	(0.04)	(0.04)	(0.07)	(0.08)
	=====	=====	=====	=====
Shares used to compute basic loss per common share	18,526,938	20,322,151	18,495,858	20,363,002
	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

VASCO Data Security International, Inc.
 Consolidated Statements of Comprehensive Income
 (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	1997	1998	1997	1998
	----	----	----	----
Comprehensive income:				
Net loss	\$(799,129)	\$(864,720)	\$(1,237,145)	\$(1,602,818)
Other comprehensive income-cumulative translation adj.	(146,952)	275,195	(86,470)	104,952
	-----	-----	-----	-----
Comprehensive loss	\$(946,081)	\$(589,525)	\$(1,323,615)	\$(1,497,866)
	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

VASCO Data Security International, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
	1997	1998
	----	----
Cash flows from operating activities:		
Net loss	\$ (1,237,145)	\$ (1,602,818)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	528,939	494,719
Interest paid in shares of common stock	193,196	-
Changes in current assets and current liabilities:		
Accounts receivable, net	470,472	272,861
Inventories, net	305,836	(553,237)
Other current assets	85,422	(693,246)
Accounts payable	(1,084,972)	(367,557)
Customer deposits	(564,158)	2,442
Other accrued expenses	123,050	258,897
	-----	-----
Net cash used in operations	(1,179,360)	(2,187,939)
	-----	-----
Cash flows from investing activities - additions to property and equipment	(39,870)	(159,765)
	-----	-----
Net cash used in investing activities	(39,870)	(159,765)
	-----	-----
Cash flows from financing activities:		
Series B preferred stock dividends	(54,000)	-
Net proceeds from sales of common stock	(56,895)	115,347
Proceeds from exercise of stock options	28,938	-
Redemption of common stock	(247,261)	-
Proceeds from issuance of debt	2,716,141	3,027,578
Repayment of debt	(32,126)	(552,237)
	-----	-----
Net cash provided by financing activities	2,354,797	2,590,688
	-----	-----
Effect of exchange rate changes on cash	(86,470)	104,952
	-----	-----
Net increase in cash	1,049,097	347,936
Cash, beginning of period	1,813,593	1,897,666
	-----	-----
Cash, end of period	\$ 2,862,690	\$ 2,245,602
	=====	=====
Supplemental disclosure of cash flow information:		
Interest paid	\$ 106,411	\$ 175,901
	=====	=====
Income taxes paid	\$ -	\$ 133,014
	=====	=====

See accompanying notes to consolidated financial statements.

VASCO Data Security International, Inc.
Notes to Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its subsidiaries (collectively, the "Company") and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 1997.

In the opinion of management, the accompanying unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements, and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for a full year.

Note 2 - Exchange Offer

VASCO Data Security International, Inc. ("VDSI Inc.") was organized in 1997 as a subsidiary of VASCO Corp., a Delaware corporation ("VASCO Corp."). Pursuant to an exchange offer ("Exchange Offer") by VDSI Inc. for securities of VASCO Corp. that was completed March 11, 1998, VDSI Inc. acquired 97.7% of the outstanding common stock of VASCO Corp. Consequently, VASCO Corp. became a subsidiary of VDSI Inc., with certain VASCO Corp. shareholders holding the remaining 2.3% of the VASCO Corp. common stock representing a minority interest. The impact of the minority interest is not material to the Company's consolidated financial statements. The December 31, 1997 financial statements have been restated to account for the Exchange Offer as a transaction between entities under common control in a manner similar to a pooling of interests.

The assets and liabilities of VASCO Corp. were recorded by VDSI Inc. at their historical carrying values.

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

The Company designs, develops, markets and supports open standards-based hardware and software security systems which manage and secure access to data.

The following discussion is based upon the Company's consolidated results of operations for the three and six months ended June 30, 1998 as compared to VASCO Corp.'s consolidated results of operations for the three and six months ended June 30, 1997. See "Note 2 - Exchange Offer."

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q, including the "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 concerning, among other things, the prospects, developments and business strategies for the Company and its operations, including the development and marketing of certain new products and the anticipated future growth in certain markets in which the Company currently markets and sells its products or anticipates selling and marketing its products in the future. These forward-looking statements (i) are identified by their use of such terms and phrases as "expected," "expects," "believe," "believes," "will," "anticipated," "emerging," "intends," "plans," "could," "may," "estimates," "should," "objective," and "goals" and (ii) are subject to risks and uncertainties and represent the Company's present expectations or beliefs concerning future events. The Company cautions that the forward-looking statements are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, including (a) risks of general market conditions, including demand for the Company's products and services, competition and price levels and the Company's historical dependence on relatively few products, certain suppliers and certain key customers, and (b) risks inherent to the computer and network security industry, including rapidly changing technology, evolving industry standards, increasing numbers of patent infringement claims, changes in customer requirements, price competitive bidding, changing government regulations and potential competition from more established firms and others. Therefore, results actually achieved may differ materially from expected results included in, or implied by these statements.

Comparison of Three and Six Months Ended June 30, 1997 and June 30, 1998

The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements for the three and six months ended June 30, 1997 and 1998.

Revenues

Revenues for the three months ended June 30, 1998 were \$3,525,000, an increase of \$481,000, or 16%, as compared to the three months ended June 30, 1997. This increase can be attributed to increased demand related to the Company's newest product, Digipass 300, as well as follow-on orders received from current customers.

For the six months ended June 30, 1998, revenues decreased 7% to \$6,138,000 from \$6,592,000 in 1997. This decrease can be attributed, in part, to the introduction of the Digipass 300 during the first quarter of 1998. Due to the anticipated release of this product, management believes that many customers held off ordering existing products, thus curtailing revenue until the shipment of Digipass 300, which began mid-way through the first quarter of 1998. In addition, this decrease was due to a reduction in shipments to Concord-Eracom Nederland BV, the Company's largest customer, during the three months ended March 31, 1998. However, during 1998, Concord-Eracom Nederland BV has placed additional orders of approximately \$3,750,000. These orders are expected to be shipped during the second half of 1998 and 1999.

Cost of Goods Sold

Cost of goods sold for the three months ended June 30, 1998 was \$1,656,000, an increase of \$282,000, or 21%, as compared to the three months ended June 30, 1997. This increase is consistent with the increase in revenues for the same period.

For the six months ended June 30, 1998, cost of goods sold decreased 13% to \$2,877,000 from \$3,296,000 in 1997. This decrease is consistent with the decrease in revenues for the same period. The cost of goods sold for security products, however, decreased as a percentage of revenues at a quicker pace than revenues for security products due to efficiencies realized in the manufacture of the products.

Gross Profit

The Company's gross profit for the three months ended June 30, 1998 was \$1,869,000, an increase of \$199,000, or 12%, as compared to the three months ended June 30, 1997. This represents a gross margin of 53% as compared to 55% for the same period in 1997. The decrease reflects the increased involvement of the Company's indirect channel during the second quarter of 1998, which results in a slightly lower margin.

For the six months ended June 30, 1998, gross profit was \$3,260,000, a decrease of \$35,000, or 1%, as compared to 1997. This represents a gross margin of 53% as compared to 50% for the same period in 1997. Margins have remained steady during 1998. With the introduction of the Digipass 300 during the first quarter of 1998, the Company anticipates improved gross margins as acceptance of the Digipass 300 increases.

Sales and Marketing Expenses

Sales and marketing expenses for the three months ended June 30, 1998 were \$1,047,000, an increase of \$175,000, or 20%, over the three months ended June 30, 1997. Selling and marketing expenses also increased 20% in the first six months of 1998 to \$1,929,000 from \$1,603,000 in the first six months of 1997. The increases are attributed to increased sales efforts including, in part, increased travel costs and an increase in marketing activities, including the development of a company-wide marketing program and other efforts.

Research and Development

Research and development costs for the three months ended June 30, 1998 were \$391,000, an increase of \$125,000, or 47%, as compared to the three months ended June 30, 1997. Research and development costs increased 54% in the first six months of 1998 to \$828,000 from \$537,000 in the first six months of 1997. The increases are due to the addition of R&D personnel, in both the U.S. and Europe.

General and Administrative Expenses

General and administrative expenses for the three months ended June 30, 1998 were \$418,000, a decrease of \$545,000, or 57%, compared to the three months ended June 30, 1997. General and administrative expenses decreased 45% in the first six months of 1998 to \$994,000 from \$1,802,000 in the first six months of 1997. The decreases were due to economies of scale being realized as a result of the combination of the operations of Lintel Security and VDS during 1997, as well as a favorable experience with regard to bad debt recovery and the recovery of legal fees associated with the Exchange Offer. In addition, the Company was preparing for the Exchange Offer during 1997, thus generating significant legal and accounting expenses.

Interest Expense

Interest expense for the three months ended June 30, 1998 was \$670,000, compared to \$282,000, an increase of 138% over the same period of 1997. Interest expense increased 91% in the first six months of 1998 to \$880,000 from \$460,000 in the first six months of 1997. The increases can be attributed to an increased borrowing base during 1998.

Operating Income (Loss)

The Company's operating income for the three months ended June 30, 1998 was \$14,000, compared to an operating loss of \$430,000 for the three months ended June 30, 1997. The Company had an operating loss of \$491,000 for the first six months of 1998, as compared to \$647,000 for the first six months of 1997, a decrease of 24%.

Liquidity and Capital Resources

Since inception, the Company has financed its operations through a combination of the issuance of equity securities, private borrowings, short-term commercial borrowings, cash flow from operations, and loans from Mr. T. Kendall Hunt, its Chief Executive Officer and one of the stockholders of the Company's original corporate predecessor.

The Company's cash and cash equivalents were \$2,246,000 at June 30, 1998, which is an increase of approximately \$348,000 from \$1,898,000 at December 31, 1997. As of June 30, 1998, the Company had working capital of \$1,425,000.

Capital expenditures during the first six months of 1998 were \$160,000 and consisted primarily of computer equipment and office furniture and fixtures.

The Company intends to seek acquisitions of businesses, products and technologies that are complementary or additive to those of the Company. While from time to time the Company engages in discussions with respect to potential acquisitions, the Company has no present plans, commitments or agreements with respect to any such acquisitions as of the date of this Form 10-Q and currently does not have excess cash for use in making acquisitions. There can be no assurance that any such acquisitions will or will not be made.

The Company believes that its current cash balances and anticipated cash generated from operations will be sufficient to meet its anticipated cash needs through December 31, 1998. Continuance of the Company's operations beyond December 31, 1998, however, will depend on the Company's ability to obtain adequate financing. In March 1998, the Company entered into a loan agreement in the amount of \$3 million with Lernout & Hauspie Speech Products N.V. ("L&H"); the funding of this occurred in April 1998. The loan bears interest at the prime rate plus 1%, payable quarterly, and matures on January 4, 1999.

The Company has previously entered into engagement letters with Banque Paribas S.A. and Generale Bank dated June 20, 1997 and June 26, 1997, respectively, for a possible future public offering. Further, the Company has had preliminary discussions regarding other possible debt or equity financing. There can be no assurance, however, that the Company will be successful in effecting a public offering or obtaining other additional financing.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

a) The following exhibits are filed with this Form 10-Q or incorporated by reference as set forth below:

Exhibit Number	Description
27	Financial Data Schedule.

b) Reports on Form 8-K

No reports on Form 8-K have been filed by the Registrant during the quarter ended June 30, 1998.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on August 7, 1998.

VASCO Data Security International, Inc.

/s/ T. Kendall Hunt

T. Kendall Hunt
Chairman of the Board, Chief Executive
Officer and President

/s/ Gregory T. Apple

Gregory T. Apple
Vice President and Treasurer
(Principal Financial Officer and
Principal Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
27	Financial Data Schedule.

6-MOS	DEC-31-1998	
	JUN-30-1998	
		2,245,602
		0
		2,254,590
		69,000
		1,554,531
		7,069,967
		969,183
		586,145
		9,362,428
		5,644,634
		0
		0
		0
		20,331
		(7,642,641)
9,362,428		
		6,137,729
		6,137,729
		2,877,416
		3,751,048
		101,155
		0
		879,585
		(1,471,475)
		131,343
		(1,602,818)
		0
		0
		0
		(1,602,818)
		(0.08)
		(0.07)