

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

DOCUMENT SECURITY SYSTEMS INC

Form: 10-Q

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2019

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

For the transition period from _____ to _____.

001-32146

Commission file number



DOCUMENT SECURITY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

New York

(State or other Jurisdiction of
incorporation- or Organization)

16-1229730

(IRS Employer
Identification No.)

200 Canal View Boulevard, Suite 300
Rochester, NY 14623

(Address of principal executive offices)

(585) 325-3610

(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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Title of each class	Ticker symbol(s)	Name of each exchange on which registered
Common Stock, \$0.02 par value per share	DSS	The NYSE American LLC

As of August 13, 2019, there were 29,721,907 shares of the registrant's common stock, \$0.02 par value, outstanding.

DOCUMENT SECURITY SYSTEMS, INC.
FORM 10-Q
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PART I – FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

As of
(unaudited)

	June 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,321,344	\$ 2,317,659
Restricted cash	50,266	130,326
Accounts receivable, net of \$50,000 allowance for doubtful accounts	2,564,178	2,217,877
Inventory	1,272,111	1,563,593
Prepaid expenses and other current assets	256,048	285,580
	9,463,947	6,515,035
Total current assets	9,463,947	6,515,035
Property, plant and equipment, net	4,854,786	5,014,494
Investment	324,930	324,930
Other assets	90,319	90,319
Right-of-use assets	1,313,742	-
Goodwill	2,453,597	2,453,597
Other intangible assets, net	1,166,310	881,411
	19,667,631	15,279,786
Total assets	\$ 19,667,631	\$ 15,279,786
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,563,986	\$ 1,347,491
Accrued expenses and deferred revenue	818,773	1,106,346
Other current liabilities	1,473,163	2,255,942
Current portion of long-term debt, net	348,574	713,427
Current portion of lease liability	332,883	-
	4,537,379	5,423,206
Total current liabilities	4,537,379	5,423,206
Long-term debt, net	1,965,829	1,721,936
Lease liability	1,005,222	-
Other long-term liabilities	329,348	391,325
Deferred tax liability, net	168,986	168,986
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock, \$.02 par value; 200,000,000 shares authorized, 29,202,721 shares issued and outstanding (17,425,858 on December 31, 2018)	584,054	348,517
Additional paid-in capital	112,972,366	107,624,666
Accumulated other comprehensive loss	(22,483)	(7,052)
Accumulated deficit	(101,873,070)	(100,391,798)
	11,660,867	7,574,333
Total stockholders' equity	11,660,867	7,574,333
Total liabilities and stockholders' equity	\$ 19,667,631	\$ 15,279,786

See accompanying notes to the condensed consolidated financial statements.

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income (Loss)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2019	2018	2019	2018
Revenue:				
Printed products	\$ 3,623,191	\$ 3,724,980	\$ 7,989,245	\$ 7,648,259
Technology sales, services and licensing	483,638	362,081	926,504	816,356
Total revenue	4,106,829	4,087,061	8,915,749	8,464,615
Costs and expenses:				
Cost of revenue, exclusive of depreciation and amortization	2,897,674	2,756,447	6,057,225	5,338,062
Selling, general and administrative (including stock based compensation)	1,864,685	1,802,096	3,641,500	3,584,664
Depreciation and amortization	336,740	346,816	631,147	692,483
Total costs and expenses	5,099,099	4,905,359	10,329,872	9,615,209
Operating loss	(992,270)	(818,298)	(1,414,123)	(1,150,594)
Other income (expense):				
Interest income	2,524	3,033	4,192	6,107
Interest expense	(40,476)	(33,768)	(70,141)	(82,906)
Amortization of deferred financing costs and debt discount	(600)	(6,168)	(1,200)	(33,899)
Gain on extinguishment of liabilities, net	-	3,532,659	-	3,532,659
Income (loss) before income taxes	(1,030,822)	2,677,458	(1,481,272)	2,271,367
Income tax expense (benefit)	-	-	-	-
Net income (loss)	\$ (1,030,822)	\$ 2,677,458	\$ (1,481,272)	\$ 2,271,367
Other comprehensive income (loss):				
Interest rate swap gain (loss)	(14,653)	6,963	(15,431)	21,852
Comprehensive income (loss):	\$ (1,045,475)	\$ 2,684,421	\$ (1,496,703)	\$ 2,293,219
Earnings (loss) per common share:				
Basic	\$ (0.05)	\$ 0.16	\$ (0.07)	\$ 0.14
Diluted	\$ (0.05)	\$ 0.16	\$ (0.07)	\$ 0.13
Shares used in computing earnings (loss) per common share:				
Basic	21,907,308	16,599,327	19,911,679	16,599,327
Diluted	21,907,308	16,842,204	19,911,679	16,882,450

See accompanying notes to condensed consolidated financial statements.

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Six Months Ended June 30,
(unaudited)

	2019	2018
Cash flows from operating activities:		
Net income (loss)	\$ (1,481,272)	\$ 2,271,367
Adjustments to reconcile net income (loss) to net cash used by operating activities:		
Depreciation and amortization	631,147	692,483
Stock based compensation	58,610	86,173
Paid in-kind interest	-	12,000
Amortization of deferred financing costs and debt discount	600	33,899
Gain on extinguishment of liabilities, net	-	(3,532,659)
Decrease (increase) in assets:		
Accounts receivable	(346,301)	118,491
Inventory	291,482	289,513
Prepaid expenses and other current assets	53,895	(27,771)
Increase (decrease) in liabilities:		
Accounts payable	216,496	303,907
Accrued expenses	(249,903)	(90,318)
Other liabilities	(897,858)	(606,928)
Net cash used by operating activities	(1,723,104)	(449,843)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(261,555)	(311,402)
Purchase of intangible assets	(350,000)	(20,137)
Net cash used by investing activities	(611,555)	(331,539)
Cash flows from financing activities:		
Payments of long-term debt	(121,560)	(758,302)
Borrowings from convertible note	500,000	-
Issuances of common stock, net of issuance costs	4,879,844	-
Receipt of subscription receivable, net of issuance costs	-	288,000
Net cash provided (used) by financing activities	5,258,284	(470,302)
Net increase (decrease) in cash and cash equivalents	2,923,625	(1,251,684)
Cash and restricted cash at beginning of period	2,447,985	4,444,628
Cash and restricted cash at end of period	\$ 5,371,610	\$ 3,192,944

See accompanying notes to the condensed consolidated financial statements.

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Shares	Amount				
Balance, December 31, 2018	17,425,858	\$ 348,517	\$ 107,624,666	\$ (7,052)	\$ (100,391,798)	\$ 7,574,333
Issuance of common stock, net	576,863	11,537	626,453	-	-	637,990
Stock based payments, net of tax effect	-	-	30,701	-	-	30,701
Other comprehensive loss	-	-	-	(778)	-	(778)
Net loss	-	-	-	-	(450,450)	(450,450)
Balance, March 31, 2019	18,002,721	\$ 360,054	\$ 108,281,820	\$ (7,830)	\$ (100,842,248)	\$ 7,791,796
Issuance of common stock, net	11,200,000	224,000	4,662,637	-	-	4,886,637
Stock based payments, net of tax effect	-	-	27,909	-	-	27,909
Other comprehensive loss	-	-	-	(14,653)	-	(14,653)
Net loss	-	-	-	-	(1,030,822)	(1,030,822)
Balance, June 30, 2019	29,202,721	\$ 584,054	\$ 112,972,366	\$ (22,483)	\$ (101,873,070)	\$ 11,660,867

	Common Stock		Additional Paid-in Capital	Subscription Receivable	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Shares	Amount					
Balance, December 31, 2017	16,599,327	\$ 331,987	\$ 106,633,708	\$ (300,000)	\$ (23,069)	\$ (101,856,767)	\$ 4,785,859
Issuance of common stock, net	-	-	(12,000)	300,000	-	-	288,000
Stock based payments, net of tax effect	-	-	1,251	-	-	-	1,251
Other comprehensive gain	-	-	-	-	14,889	-	14,889
Net loss	-	-	-	-	-	(406,091)	(406,091)
Balance, March 31, 2018	16,599,327	\$ 331,987	\$ 106,622,959	\$ -	\$ (8,180)	\$ (102,262,858)	\$ 4,683,908
Stock based payments, net of tax effect	-	-	84,922	-	-	-	84,922
Other comprehensive gain	-	-	-	-	6,963	-	6,963
Net income	-	-	-	-	-	2,677,458	2,677,458
Balance, June 30, 2018	16,599,327	\$ 331,987	\$ 106,707,881	\$ -	\$ (1,217)	\$ (99,585,400)	\$ 7,453,251

See accompanying notes to the condensed consolidated financial statements.

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Document Security Systems, Inc. (the "Company"), through two of its subsidiaries, Premier Packaging Corporation, which operates under the assumed name of DSS Packaging Group, and Plastic Printing Professionals, Inc., which operates under the name of DSS Plastics Group, operates in the security and commercial printing, packaging and plastic ID markets. The Company develops, markets, manufactures and sells paper and plastic products designed to protect valuable information from unauthorized scanning, copying, and digital imaging. The Company's subsidiary, DSS Digital Inc., which also operates under the name of DSS Digital Group, develops, markets and sells digital information services, including data hosting, disaster recovery and data back-up and security services. The Company's subsidiary, DSS Technology Management ("DSSTM"), Inc., manages, licenses and acquires intellectual property ("IP") assets for the purpose of monetizing these assets through a variety of value-enhancing initiatives, including, but not limited to, investments in the development and commercialization of patented technologies, licensing, strategic partnerships and commercial litigation. In 2018, the Company commenced operations in the Asia Pacific market through its subsidiary DSS Asia Limited, which was formed in 2017.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 8.03 of Regulation S-X for smaller reporting companies. Accordingly, these statements do not include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, the accompanying balance sheets and related interim statements of operations and comprehensive loss and cash flows include all adjustments considered necessary for their fair presentation in accordance with U.S. GAAP. All significant intercompany transactions have been eliminated in consolidation.

Interim results are not necessarily indicative of results expected for the full year. For further information regarding the Company's accounting policies, refer to the audited consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the fiscal year ended December 31, 2018.

Principles of Consolidation - The consolidated financial statements include the accounts of Document Security Systems and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable, inventory, fair values of investments, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of options and warrants to purchase the Company's common stock, deferred revenue and income taxes, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Restricted Cash - As of June 30, 2019, cash of \$50,266 (\$130,326 - December 31, 2018) is restricted for payments of costs and expenses associated with one of the Company's IP monetization programs.

	<u>June 30, 2019</u>	<u>December 31, 2018</u>
Cash and cash equivalents	\$ 5,321,344	\$ 2,317,659
Restricted Cash	50,266	130,326
Total	\$ 5,371,610	\$ 2,447,985

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Cash and cash equivalents	\$ 3,051,593	\$ 4,188,623
Restricted Cash	141,351	256,005
Total	\$ 3,192,944	\$ 4,444,628

Investment – In accordance with ASC 325-20, the Company records its investment in common stock of Singapore eDevelopment Limited at cost as the fair market value of the investment is not readily determinable. The Company evaluates investment for indications of impairment at least annually.

Fair Value of Financial Instruments - Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value Measurement Topic of the FASB ASC establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The carrying amounts reported in the balance sheet of cash, accounts receivable, prepaids, accounts payable and accrued expenses approximate fair value because of the immediate or short-term maturity of these financial instruments. The fair value of revolving credit lines notes payable and long-term debt approximates their carrying value as the stated or discounted rates of the debt reflect recent market conditions. Derivative instruments, as discussed below, are recorded as assets and liabilities at estimated fair value based on available market information. The fair value of investments carried at cost, less impairment however, the fair value is not considered readily determinable based on the lack of liquidity for the shares owned.

Derivative Instruments - The Company maintains an overall interest rate risk management strategy that incorporates the use of interest rate swap contracts to minimize significant fluctuations in earnings that are caused by interest rate volatility. The Company has an interest rate swap that changes variable rates into fixed rates on one Citizens Bank term loan relating to the Company's subsidiary, Premier Packaging. This swap qualifies as a Level 2 fair value financial instrument. This swap agreement is not held for trading purposes and the Company does not intend to sell this derivative swap financial instrument. The Company records the interest swap agreement on the balance sheet at fair value because the agreement qualifies as a cash flow hedge under accounting principles generally accepted in the United States of America. Gains and losses on these instruments are recorded in other comprehensive loss until the underlying transaction is recorded in earnings. When the hedged item is realized, gains or losses are reclassified from accumulated other comprehensive loss ("AOCI") to the consolidated statement of operations on the same line item as the underlying transaction. The valuations of the interest rate swaps have been derived from proprietary models of Citizens Bank, N.A (Citizens), based upon recognized financial principles and reasonable estimates about relevant future market conditions and may reflect certain other financial factors such as anticipated profit or hedging, transactional, and other costs. The notional amounts of the swaps decrease over the life of the agreements. The Company is exposed to a credit loss in the event of nonperformance by the counter parties to the interest rate swap agreements. However, the Company does not anticipate non-performance by the counter parties. The cumulative net loss attributable to this cash flow hedge recorded in accumulated other comprehensive loss and other liabilities as of June 30, 2019 was approximately \$22,000 (\$7,000 - December 31, 2018).

On June 27, 2019, the Promissory Note associated with this swap agreement was refinanced (see Note 6) at fixed rate of interest. As of June 30, 2019, the Company had not settled the swap agreement with Citizens. The fixed and variable rate at June 30, 2019 was 5.87% and 5.58% respectively.

Impairment of Long-Lived Assets and Goodwill - The Company monitors the carrying value of long-lived assets for potential impairment and tests the recoverability of such assets whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. If a change in circumstance occurs, the Company performs a test of recoverability by comparing the carrying value of the asset or asset group to its undiscounted expected future cash flows. If cash flows cannot be separately and independently identified for a single asset, the Company will determine whether impairment has occurred for the group of assets for which the Company can identify the projected cash flows. If the carrying values are in excess of undiscounted expected future cash flows, the Company measures any impairment by comparing the fair value of the asset or asset group to its carrying value.

Contingent Legal Expenses - Contingent legal fees are expensed in the consolidated statements of operations in the period that the related revenues are recognized. In instances where there are no recoveries from potential infringers, no contingent legal fees are paid; however, the Company may be liable for certain out of pocket legal costs incurred pursuant to the underlying legal services agreement that will be paid out from the proceeds from settlements or licenses that arise pursuant to an enforcement action, which will be expensed as legal fees in the period in which the payment of such fees is probable. Any unamortized patent acquisition costs will be expensed in the period a conclusion is reached in an enforcement action that does not yield future royalties potential.

Earnings Per Common Share - The Company presents basic and diluted earnings per share. Basic earnings per share reflect the actual weighted average of shares issued and outstanding during the period. Diluted earnings per share are computed including the number of additional shares that would have been outstanding if dilutive potential shares had been issued and is calculated utilizing the treasury stock method. In a loss period, the calculation for basic and diluted earnings per share is the same, as the impact of potential common shares is anti-dilutive.

For the three and six months ended June 30, 2019, common stock equivalents were excluded from the calculation of diluted earnings per share as the Company had a net loss, since their inclusion would have been anti-dilutive. For the six-months ended June 30, 2018, based on the average market price of the Company's common stock during that period of \$1.41, 283,123 common stock equivalents were added to the basic shares outstanding to calculate dilutive earnings per share. For the three-months ended June 30, 2018, based on the average market price of the Company's common stock during that period of \$1.33, 242,877 common stock equivalents were added to the basic shares outstanding to calculate dilutive earnings per share.

Concentration of Credit Risk - The Company maintains its cash in bank deposit accounts, which at times may exceed federally insured limits. The Company believes it is not exposed to any significant credit risk as a result of any non-performance by the financial institutions.

During the six months ended June 30, 2019, two customers accounted for approximately 36% and 12%, respectively, of the Company's consolidated revenue and accounted for 55% and 5%, respectively, of the Company's accounts receivable balance as of June 30, 2019. During the six months ended June 30, 2018, these two customers accounted for 24% and 14%, respectively, of the Company's consolidated revenue and accounted for 25% and 5%, respectively, of the Company's accounts receivable balance as of June 30, 2018. The risk with respect to accounts receivables is mitigated by credit evaluations the Company performs on its customers, the short duration of its payment terms for most of its customer contracts and by the diversification of its customer base.

Income Taxes - The Company recognizes estimated income taxes payable or refundable on income tax returns for the current year and for the estimated future tax effect attributable to temporary differences and carry-forwards. Measurement of deferred income items is based on enacted tax laws including tax rates, with the measurement of deferred income tax assets being reduced by available tax benefits not expected to be realized. We recognize penalties and accrued interest related to unrecognized tax benefits in income tax expense.

Recently Adopted Accounting Pronouncements - In February 2016, the FASB issued ASU No. 2016-02 and its related amendments which introduced Leases (Topic 842, or "ASC 842"), a new comprehensive lease accounting model that supersedes the current lease guidance under Leases (Topic 840). The new accounting standard requires lessees to recognize right-of-use ("ROU") assets and corresponding lease liabilities for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. In July 2018, the FASB added a transition option for implementation that allows companies to continue to use the legacy guidance in ASC 840, Leases, including its disclosure requirements, in the comparative periods presented in the year of adoption. The Company adopted the guidance effective January 1, 2019. The Company elected the transition package of three practical expedients permitted under the transition guidance and elected the optional transition method that allows for a cumulative-effect adjustment in the period of adoption, without a restatement of prior periods. Further, the Company elected a short-term lease exception policy, permitting the Company to not apply the recognition requirements of this standard to short-term leases (i.e. leases with terms of 12 months or less) and an accounting policy to account for lease and non-lease components as a single component for certain classes of assets. As a result of the adoption, the Company adjusted its beginning balance as of January 1, 2019 by recording operating lease ROU asset and liabilities through a cumulative-effect adjustment. The adoption impacted the accompanying consolidated balance sheet, but did not have an impact on the consolidated statements of operations and comprehensive income (loss).

At the inception of a contractual arrangement, the Company determines whether the contract contains a lease by assessing whether there is an identified asset and whether the contract conveys the right to control the use of the identified asset in exchange for consideration over a period of time. If both criteria are met, the Company calculates the associated lease liability and corresponding ROU assets upon lease commencement using a discount rate based on a credit-adjusted secured borrowing rate commensurate with the term of the lease. The Company records lease liabilities within current or noncurrent liabilities based upon the length of time associated with the lease payments. The operating lease ROU assets includes any lease payments made and excludes lease incentives and initial direct costs incurred, if any, and are recorded as noncurrent assets. Lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Leases with an initial term of 12 months or less are not recorded on the accompanying consolidated balance sheet. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

The impact of the adoption of ASC 842 on the accompanying consolidated balance sheet as of January 1, 2019 was a right-of-use asset and a lease liability of \$1,489,156.

Continuing Operations and Going Concern – The accompanying consolidated financial statements have been prepared assuming that we will continue as a going concern. This basis of accounting contemplates the recovery of our assets and the satisfaction of liabilities in the normal course of business. These consolidated financial statements do not include any adjustments to the specific amounts and classifications of assets and liabilities, which might be necessary should we be unable to continue as a going concern. While the Company has approximately \$ 5.3 million in cash, and a positive working capital position of approximately \$4.9 million as of June 30, 2019, the Company has incurred negative cash flows from operating and investing activities over the past two years and has projected that the Company will likely incur negative cash flows from operations in 2019. To continue as a going concern, on June 5, 2019, the Company entered into an underwriting agreement with Aegis Capital Corp., acting as a representative of several underwriters, which provided for the issuance and sale by the Company in an underwritten public offering (the “Offering”) of 11,200,000 shares of the Company’s common stock. The Company also granted the Underwriters a 45-day option to purchase up to 1,680,000 additional shares of the Company’s common stock on the same terms and conditions for the purpose of covering any over-allotments in connection with the Offering (519,186 shares were exercised on July 18, 2019.) The net offering proceeds to the Company was approximately \$5.2 million, inclusive of the July 18, 2019 transaction and after deducting underwriting discounts, commissions and other offering expenses.

The expected use of cash for operations in 2019 will be primarily for funding operating losses, working capital, legal expenses associated with its intellectual property related litigation, and the costs associated with the global roll-out of the Company’s AuthentiGuard product line.

The Company’s management intends to take actions necessary to continue as a going concern. Management’s plans concerning these matters includes, among other things, continued growth among our operating segments including international expansion of our AuthentiGuard product, and tightly controlling operating costs and reducing spending growth rates wherever possible to return to profitability.

We believe that our \$5.7 million in aggregate cash and equivalents and restricted cash as of June 30, 2019 will allow us to fund our current and planned operations through 2020. However, we may seek additional capital through the sale of debt or equity securities, if necessary, especially in conjunction with opportunistic acquisitions or licensing arrangements. Based on this, we have concluded that substantial doubt of our ability to continue as a going concern has been alleviated.

Recent Accounting Pronouncements – In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350) – Simplifying the Test for Goodwill Impairment”, which eliminates the two-step process that required identification of potential impairment and a separate measure of the actual impairment. The annual assessment of goodwill impairment will be determined by using the difference between the carrying amount and the fair value of the reporting unit. The standards update is effective for goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company is currently assessing the impact that adopting this new accounting standard will have on its Consolidated Financial Statements.

2. Revenue

Effective January 1, 2018, the Company adopted Topic 606 using the modified retrospective approach and applied the guidance to those contracts which were not completed as of January 1, 2018. Adoption of Topic 606 did not impact the timing of revenue recognition in the Company’s Consolidated Financial Statements for the current or prior interim or annual periods. Accordingly, no adjustments have been made to opening retained earnings or prior period amounts.

Revenue Recognition

The Company sells printed products including packaging printing and fabrication, commercial and security printing and plastic cards and badges, including cards and badges integrated with technology such as RFID and smart chips. The Company also provides information technology services and digital authentication products and services to its customers. The Company recognizes its products and services revenue based on when the title passes to the customer or when the service is completed and accepted by the customer. Revenue is measured as the amount of consideration the Company expects to receive in exchange for shipped product or service provided. Sales and other taxes billed and collected from customers are excluded from revenue. Customers, including distributors, do not have a general right of return. The Company also derives revenue from royalties from third parties which are typically based on licensees' net sales of products that utilize the Company's technology, or on a per item usage of the technology on the customers' printed products. The Company recognizes license revenue at the time it is reported by the licensee. From time to time, the Company generates license revenues through litigation settlements. For these, the Company recognizes revenue upon the execution of the agreement, when collectability is reasonably assured, or upon receipt of the minimum upfront fee for term agreement renewals, and when all other revenue recognition criteria have been met.

As of June 30, 2019, the Company had no unsatisfied performance obligations for contracts with an original expected duration of greater than one year. Pursuant to Topic 606, the Company has applied the practical expedient with respect to disclosure of the deferral and future expected timing of revenue recognition for transaction price allocated to remaining performance obligations. The Company elected the practical expedient allowing it to not recognize as a contract asset the commission paid to its salesforce on the sale of its products as an incremental cost of obtaining a contract with a customer but rather recognize such commission as expense when incurred as the amortization period of the asset that the Company would have otherwise recognized is one year or less.

Accounts Receivable

The Company extends credit to its customers in the normal course of business. The Company performs ongoing credit evaluations and generally does not require collateral. Payment terms are generally 30 days but up to net 60 for certain customers. The Company carries its trade accounts receivable at invoice amount less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts based upon management's estimates that include a review of the history of past write-offs and collections and an analysis of current credit conditions. At June 30, 2019, the Company established a reserve for doubtful accounts of approximately \$50,000 (\$50,000 – December 31, 2018). The Company does not accrue interest on past due accounts receivable.

Sales Commissions

Sales commissions are expensed as incurred for contracts with an expected duration of one year or less. There were no sales commissions capitalized as of June 30, 2019.

Shipping and Handling Costs

Costs incurred by the Company related to shipping and handling are included in cost of products sold. Amounts charged to customers pertaining to these costs are reflected as revenue.

See Note 13 for disaggregated revenue information.

3. Inventory

Inventory consisted of the following:

	Inventory	
	June 30, 2019	December 31, 2018
Finished Goods	\$ 879,347	\$ 1,144,695
WIP	258,279	339,091
Raw Materials	134,485	79,807
	\$ 1,272,111	\$ 1,563,593

4. Investment

The Company owns 21,196,552 ordinary shares and an existing three-year warrant to purchase up to 105,982,759 ordinary shares at an exercise price of SGD\$0.040 (US\$0.0298) per share of Singapore eDevelopment Limited ("SED"), a company incorporated in Singapore and publicly-listed on the Singapore Exchange Limited. The shares and warrants are restricted for resale until September 17, 2019. At the time of the investment, the cost of the investment was determined to be the fair value of the Company's common stock issued in the transaction, which was determined to have the most readily determinable fair value. In 2018, the Company adopted ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." and carries its investment in SED at costs. During the 4th quarter of 2018, the Company determined that its investment in Singapore eDevelopment ("SED") was impaired due to the decline in the share price of SED, especially since November of 2018, which the Company believes was influenced by a general decline in equity markets in Asia caused by the tariff dispute between the United States and China. As such, in response to the decline in the trading value of the SED shares in the fourth quarter of 2018, the Company performed an impairment test and determined an impairment of approximately \$160,000 was warranted. The carrying value of the investment as of June 30, 2019 was \$324,930.

5. Intangible Assets

Intangible assets are comprised of the following:

	Useful Life	June 30, 2019			December 31, 2018		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Acquired intangibles - customer lists, licenses and non-compete agreements	3-10 years	1,778,848	992,742	786,106	1,284,065	823,884	460,181
Acquired intangibles - patents and patent rights		500,000	500,000	-	500,000	500,000	-
Patent application costs	Varied (1)	1,168,155	787,951	380,204	1,168,155	746,925	421,230
		\$ 3,447,003	\$ 2,280,693	\$ 1,166,310	\$ 2,952,220	\$ 2,070,809	\$ 881,411

(1) Patent application costs are amortized over their expected useful life which is generally the remaining legal life of the patent. As of June 30, 2019, the weighted average remaining useful life of these assets in service was approximately 7 years.

Amortization expense for the six months ended June 30, 2019 amounted to \$209,884 (\$339,663 – June 30, 2018).

On March 5, 2019, the Company paid \$350,000 and issued 130,435 shares of the Company's common stock valued at \$144,783 in conjunction with the signing of a Master Distributor Agreement with Advanced Cyber Security Corp. ("ACS") to for the Company to distribute ACS's EndpointLockV™ cyber security software exclusively in thirteen countries in Asia and Australia, and non-exclusively, in the U.S. and Middle East. The aggregate cost of \$494,783 of the agreement was recorded as an intangible asset to be amortized over the expected useful life of 36 months.

6. Short-Term and Long-Term Debt

Revolving Credit Lines - The Company's subsidiary Premier Packaging Corporation ("Premier Packaging") has a revolving credit line with Citizens Bank ("Citizens") of up to \$800,000 that bears interest at 1 Month LIBOR plus 2.0% (4.4% as of June 30, 2019). This revolving line of credit was renewed and has a maturity date of May 31, 2020. As of June 30, 2019, and December 31, 2018, the revolving line had a balance of \$0.

On July 26, 2017, Premier Packaging entered into a Loan Agreement and accompanying Term Note Non-Revolving Line of Credit Agreement with Citizens pursuant to which Citizens agreed to lend up to \$1,200,000 to permit Premier Packaging to purchase equipment from time to time that it may need for use in its business. The aggregate principal balance outstanding under the Equipment Acquisition Line of Credit shall bear interest thereon at a per annum rate of 2% above the LIBOR Advantage Rate until the Conversion Date (as defined in the Term Note Non-Revolving Line of Credit). Effective on the Conversion Date, the interest shall be adjusted to a fixed rate equal to 2% above the bank's Cost of Funds, as determined by Citizens. Current maturities of long-term debt are based on an estimated 48-month amortization which will be adjusted upon conversion. As of June 30, 2019, the line had not yet converted and had a balance of \$339,600 (\$339,000 at December 31, 2018).

On December 1, 2017, the Company's subsidiary Plastic Printing Professionals entered into a Loan Agreement and accompanying Term Note Non-Revolving Line of Credit Agreement with Citizens pursuant to which Citizens agreed to lend up to \$800,000 to enable Plastic Printing Professionals to purchase equipment from time to time that it may need for use in its business. Advances may be made under this Equipment Acquisition Line of Credit, from time to time, from December 1, 2017 until December 1, 2018. The aggregate principal balance outstanding under the Equipment Acquisition Line of Credit bears interest at 2% above the LIBOR Advantage Rate (as defined in the agreement) (4.4% at June 30, 2019) until converted. Effective on conversion, the interest rate payable on the aggregate principal balance outstanding shall be adjusted to a fixed rate equal to 2% above Citizens' cost of funds as determined by Citizens. Prior to conversion, interest on the outstanding principal is payable in arrears monthly. After conversion, the aggregate principal balance may be repaid in (i) up to 84 installments comprised of principal and interest for new equipment or (ii) up to 60 installments comprised of principal and interest for used equipment. Commencing March 30, 2019, the line was converted into two term notes under which the Company will make monthly payments of \$13,657 until November 30, 2023. Interest under the term notes is payable monthly at 5.37%. As of June 30, 2019, the combined balance of the term notes was \$642,181 (\$684,554 at December 31, 2018).

Term Loan Debt - On April 28, 2015, Premier Packaging entered into a term note with Citizens for \$525,000, repayable over a 60-month period. The loan bears interest at 3.62% and is payable in equal monthly installments of \$9,591 until April 28, 2020. Premier Packaging used the proceeds of the term note to acquire a HP Indigo 7800 Digital press. The loan is secured by the printing press. As of June 30, 2019, the loan had a balance of \$94,310 (\$149,542 at December 31, 2018).

Promissory Notes - On August 30, 2011, Premier Packaging purchased the packaging plant it occupies in Victor, New York, for \$1,500,000, which was partially financed with a \$1,200,000 promissory note obtained from Citizens Bank ("Promissory Note"). The Promissory Note called for monthly payments of principal and interest in the amount of \$7,658, with interest calculated as 1 Month LIBOR plus 3.15%. Concurrently with the transaction, the Company entered into an interest rate swap agreement to lock into a 5.87% effective interest rate for the life of the loan (see Note 1. "Derivative Instruments"). This note, in conjunction with the Construction to Permanent Loan described below, was refinanced as of June 27, 2019.

On December 6, 2013, Premier Packaging entered into a Construction to Permanent Loan with Citizens Bank for up to \$450,000 that was converted into a promissory note upon the completion and acceptance of building improvements to the Company's packaging plant in Victor, New York. In May 2014, the Company converted the loan into a \$450,000 note payable in monthly installments over a 5-year period of \$2,500 plus interest calculated at a variable rate of 1 Month LIBOR plus 3.15%. The note was set to mature in July 2019 at which time a balloon payment of the remaining principal balance of \$300,000 was due. On June 27, 2019 the balloon payment, in conjunction with the remaining balance on promissory note identified above, was refinanced.

On June 27, 2019 Premier Packaging refinanced and consolidated the outstanding principle associated with the two promissory notes for its packaging plant located in Victor, New York, for \$1,156,742 with Citizens Bank. The new Promissory Note calls for monthly payments of \$7,181, with interest fixed at 4.22%. The new Promissory Note matures on June 27, 2029, at which time a balloon payment of \$707,689 is due. As of June 30, 2019, the new, consolidated Promissory Note had a balance of \$1,156,742.

The Citizens credit facilities to each of the Company's subsidiaries, Premier Packaging and Plastic Printing Professionals, contain various covenants including fixed charge coverage ratio, tangible net worth and current ratio covenants which are tested annually at December 31. For the year ended December 31, 2018, both Premier Packaging and Plastic Printing Professionals were in compliance with the annual covenants.

On October 24, 2018, the Company's subsidiary, DSS Asia Limited entered into a \$100,000 unsecured promissory note with HotApps International Pte Ltd in conjunction with the acquisition of Guangzhou Hotapps Technology Ltd., a Chinese subsidiary of HotApps International Pte Ltd, by DSS Asia Limited. The promissory note does not accrue interest and is payable in full on October 24, 2020.

Effective on February 18, 2019, Document Security Systems, Inc. (the "Company" or "Borrower") entered into a Convertible Promissory Note (the "Note") with LiquidValue Development Pte Ltd (the "Holder") in the principal sum of \$500,000 (the "Principal Amount"), of which up to \$500,000 of the Principal Amount can be paid by the conversion of such amount into the Company's common stock, par value \$0.02 per share, up to a maximum of 446,428 shares of common stock (the "Common Stock"), at a conversion price of \$1.12 per share. The Note carried a fixed interest rate of 8% per annum and had a term of 12-months. Accrued interest was payable in cash in arrears on the last day of each calendar quarter, with the first interest payment due on June 30, 2019, and remains payable until the Principal Amount is paid in full. The Holder is a related party, owned by one of the Company's directors. Effective on March 25, 2019, the Holder exercised its conversion option and converted the Maximum Conversion Amount under the Note. As a result of Holder's election to exercise its full conversion rights under the Note, the Note was cancelled effective on March 25, 2019.

7. Other Liabilities

On November 14, 2016, the Company entered into a Proceeds Investment Agreement (the "Agreement") with Brickell Key Investments LP ("BKI"). Pursuant to the Agreement, BKI financed an aggregate of \$13,500,000 in a patent purchase and monetization program to be implemented and managed by the Company (the "Financing"). Pursuant to the Agreement, \$3,000,000 of the Financing was used to cover the Company's purchase of a portfolio of U.S. and foreign LED patents and a license from Intellectual Discovery Co., Ltd., a Korean company (collectively, the "LED Patent Portfolio"), resulting in a basis in these assets of \$0. A total of \$6,000,000 of the Financing was directed by BKI to attorneys to cover anticipated attorneys' fees and out-of-pocket expenses for legal proceedings that may transpire relating to enforcement of the LED Patent Portfolio. This amount is not included in the Company's financial statements as the Company has no control over these funds, which are segregated and escrowed in the attorneys' trust account.

In addition, on November 14, 2016, the Company received \$4,500,000 of the Financing, which was required to be used by the Company to pay for the defense of Inter Partes Review or other similar proceedings that may be filed from time to time by defendants with the U.S. Patent & Trademark Office relating to the LED Patent Portfolio, with excess amounts available for general working capital needs. As of June 30, 2019, an aggregate of \$1,288,956 is recorded as other liabilities by the Company, of which \$1,075,280 is classified as short-term. Of this amount, the Company allocated \$2,500,000 which it subsequently adjusted to \$1,500,000 for the payment of estimated future Inter Partes Review costs. The Company will reduce this liability as it pays legal and other expenses related to the Inter Partes Review matters involving the LED Patent Portfolio as incurred. The remaining \$434,250 in other liabilities is allocated to working capital, which the Company is amortizing on a pro-rata basis over the expected remaining life of the monetization period of the LED Patent Portfolio through November 30, 2019. For this amount, the Company reduced the liability with an offset to selling, general and administrative costs by \$47,500 per month from January 2017 through July 2017, \$80,000 per month for the remainder of 2017 through March 2018, \$86,500 per month for the remainder of 2018, and \$86,850 per month through November 30, 2019. During the six months ended June 30, 2019, there was approximately \$244,331 of Inter Partes Review costs and an aggregate of \$521,100 was recorded as a reduction of the liability allocated to working capital.

On July 8, 2013, the Company's subsidiary, DSSTM, purchased two patents for \$500,000 covering certain methods and processes related to Bluetooth devices. In conjunction with the patent purchases, DSSTM entered into a Proceed Right Agreement with certain investors pursuant to which DSSTM initially received \$250,000 of a total of \$750,000 which it will ultimately receive thereunder, subject to certain payment milestones, in exchange for 40% of the proceeds which it receives, if any, from the use, sale or licensing of the two patents. As of June 30, 2019, the Company had received an aggregate of \$750,000 (\$750,000 in 2018) from the investors pursuant to the agreement of which approximately \$448,000 was in current liabilities in the consolidated balance sheets (\$476,000 as of December 31, 2018). The Company reduces the liability as it pays legal and other expenses related to its litigation involving the Bluetooth patents, for which the amount is available to be used for 50% of all such expenses.

8. Related Party Borrowing

Effective on May 31, 2019, Document Security Systems, Inc. (the "Company" or "Borrower") entered into a Promissory Note (the "Note") with LiquidValue Development Pte Ltd (the "Holder") in the principal sum of \$650,000 (the "Principal Amount"). The Note was not interest bearing with a maturity date of July 31, 2019. The Holder is a related party, owned by one of the Company's directors. This Note was paid in full on June 12, 2019.

9. Lease Liability

The Company has operating leases predominantly for operating facilities. As of June 30, 2019, the remaining lease terms on our operating leases range from less than one year to approximately five years. Renewal options to extend our leases have not been exercised due to uncertainty. Termination options are not reasonably certain of exercise by the Company. There is no transfer of title or option to purchase the leased assets upon expiration. There are no residual value guarantees or material restrictive covenants. There are no significant finance leases as of June 30, 2019.

Future minimum lease payments as of June 30, 2019 are as follows:

2019	\$	198,070
2020		393,588
2021		304,574
2022		284,766
2023		290,499
Thereafter		24,208
Total lease payments		1,495,705
Less: Imputed Interest		(157,600)
Present value of remaining lease payments	\$	1,338,105
Current	\$	332,883
Noncurrent	\$	1,005,222
Weighted-average remaining lease term (years)		4.2
Weighted-average discount rate		5.4%

The Company has an additional operating lease for equipment of \$118,219 which has not commenced as of June 30, 2019, and as such, has not been recognized on the Company's consolidated balance sheets. This operating lease is expected to commence between 2019 and 2020 with a 4-year lease term.

10. Commitments and Contingencies

On November 26, 2013, DSSTM filed suit against Apple, Inc. ("Apple") in the United States District Court for the Eastern District of Texas, for patent infringement (the "Apple Litigation"). The complaint alleges infringement by Apple of DSSTM's patents that relate to systems and methods of using low power wireless peripheral devices. DSSTM is seeking a judgment for infringement, injunctive relief, and compensatory damages from Apple. On October 28, 2014, the case was stayed by the District Court pending a determination of Apple's motion to transfer the case to the Northern District of California. On November 7, 2014, Apple's motion to transfer the case to the Northern District of California was granted. On December 30, 2014, Apple filed two Inter Partes Review ("IPR") petitions with the Patent Trial and Appeal Board ("PTAB") for review of the patents at issue in the case. The PTAB instituted the IPRs on June 25, 2015. The California District Court then stayed the case pending the outcome of those IPR proceedings. Oral arguments of the IPRs took place on March 15, 2016, and on June 17, 2016, PTAB ruled in favor of Apple on both IPR petitions. DSSTM then filed an appeal with the U.S. Court of Appeals for the Federal Circuit (the "Federal Circuit") seeking reversal of the PTAB decisions. Oral arguments for the appeal were held on August 9, 2017. On March 23, 2018, the Federal Circuit reversed the PTAB, finding that the PTAB erred when it found the claims of U.S. Patent No. 6,128,290 to be unpatentable. The Federal Circuit affirmed its decision on July 12, 2018, when it denied Apple's petition for panel rehearing of the Federal Circuit's Opinion and Judgment issued on March 23, 2018. On July 27, 2018, the District Court judge lifted the Stay resuming the litigation, which has a trial date set for February 24, 2020.

On February 16, 2015, DSSTM filed suit in the United States District Court, Eastern District of Texas, against defendants Intel Corporation, Dell, Inc., GameStop Corp., Conn's Inc., Conn Appliances, Inc., NEC Corporation of America, Wal-Mart Stores, Inc., Wal-Mart Stores Texas, LLC, and AT&T, Inc. The complaint alleges patent infringement and seeks judgment for infringement of two of DSSTM's patents, injunctive relief and money damages. On December 9, 2015, Intel filed IPR petitions with PTAB for review of the patents at issue in the case. Intel's IPRs were instituted by PTAB on June 8, 2016. On June 1, 2017, the PTAB ruled in favor of Intel for all the challenged claims. On July 28, 2017, DSSTM filed a notice of appeal of the PTAB's decision relating to U.S. Patent 6,784,552 with the Federal Circuit. On January 8, 2019, DSSTM entered into a confidential settlement agreement with Intel Corporation, Dell Inc., GameStop Corp, Conn's Inc., Conn Appliances, Inc., Wal-Mart Stores, Inc., Wal-Mart Stores Texas, LLC and AT&T Mobility LLC (collectively, the "Defendants"). The Federal Circuit Appeal involving DSSTM and Intel was dismissed on January 16, 2019, and the District Court case against the Defendants was dismissed, as to all the Defendants, on February 5, 2019.

On July 16, 2015, DSSTM filed three separate lawsuits in the United States District Court for the Eastern District of Texas alleging infringement of certain of its semiconductor patents. The defendants are SK Hynix et al., Samsung Electronics et al., and Qualcomm Incorporated. Each respective complaint alleges patent infringement and seeks judgment for infringement, injunctive relief and money damages. On November 12, 2015, SK Hynix filed an IPR petition with PTAB for review of the patent at issue in their case. SK Hynix's IPR was instituted by the PTAB on May 11, 2016. On August 16, 2016, DSSTM and SK Hynix entered into a confidential settlement agreement ending the litigation between them. The pending SK Hynix IPR was then terminated by mutual agreement of the parties on August 31, 2016. On March 18, 2016, Samsung also filed an IPR petition, which was instituted by the PTAB. On September 20, 2017, PTAB ruled in favor of Samsung for all the challenged claims relating to U.S. Patent 6,784,552. DSSTM then appealed this PTAB ruling to the Federal Circuit on November 17, 2017. The Federal Circuit joined this appeal with the Intel appeal effective on December 7, 2017. Qualcomm filed its IPR proceeding on July 1, 2016, which was then later joined with Intel's IPRs in August 2016 by PTAB. On June 1, 2017, the PTAB ruled in favor of Intel/Qualcomm for all the challenged claims. On July 28, 2017, DSSTM filed a notice of appeal of the PTAB's decision relating to U.S. Patent 6,784,552 with the Federal Circuit. A confidential patent license agreement was executed by DSSTM on November 14, 2018, covering Samsung and Qualcomm. On December 12, 2018, DSSTM and Samsung entered into a confidential release. On December 27, 2018, DSSTM and Qualcomm entered into a confidential settlement agreement. The DSSTM - Samsung District Court case was dismissed on December 17, 2018. The DSSTM - Samsung Federal Circuit Appeal was dismissed on January 2, 2019. The Federal Circuit Appeal involving DSSTM and Qualcomm was dismissed on January 16, 2019. The DSSTM - Qualcomm District Court case was dismissed on January 16, 2019. As a result, all of DSSTM's litigation matters originally filed in the District Court for the Eastern District of Texas have been resolved and are now dismissed.

On April 13, 2017, the Company filed a patent infringement lawsuit against Seoul Semiconductor Co., Ltd. and Seoul Semiconductor, Inc. (collectively, "Seoul Semiconductor") in the United States District Court for the Eastern District of Texas, alleging infringement of certain of the Company's Light-Emitting Diode ("LED") patents. The Company is seeking a judgment for infringement of the patents along with other relief including, but not limited to, money damages, costs and disbursements. On June 7, 2017, the Company refiled its patent infringement complaint against Seoul Semiconductor in the United States District Court for the Central District of California, Southern Division. On December 3, 2017, Seoul Semiconductor filed an IPR challenging the validity of certain claims of U.S. Patent No. 6,949,771. This IPR was instituted by the PTAB on June 7, 2018. On April 18, 2019, the PTAB issued a written decision determining claims 1-9 of the '771 patent unpatentable. On December 21, 2017, Seoul Semiconductor filed an IPR challenging the validity of certain claims of U.S. Patent No. 7,256,486. This IPR was instituted by the PTAB on June 21, 2018. On June 10, 2019, the PTAB issued a written decision determining claims 1-3 of the '486 patent unpatentable. On August 12, 2019, the Company filed a Notice of Appeal with the Federal Circuit Court of Appeals challenging the PTAB's decision. On January 25, 2018, Seoul Semiconductor filed an IPR challenging the validity of certain claims of U.S. Patent No. 7,524,087. This IPR was instituted by the PTAB on July 27, 2018. On July 22, 2019, the PTAB issued a written decision determining claims 1, 6-8, 15, and 17 of the '087 patent unpatentable. The Company is presently reviewing the decision to determine the next course of action with respect to this patent. These challenged patents are the patents that are the subject matter of the infringement lawsuit, which is pending but stayed pending the outcome of the IPR proceedings.

On April 13, 2017, the Company filed a patent infringement lawsuit against Everlight Electronics Co., Ltd. and Everlight Americas, Inc. (collectively, "Everlight") in the United States District Court for the Eastern District of Texas, alleging infringement of certain of the Company's LED patents. The Company is seeking a judgment for infringement of the patents along with other relief including, but not limited to, money damages, costs and disbursements. On June 8, 2017, the Company refiled its patent infringement complaint against Everlight in the United States District Court for the Central District of California. On June 8, 2018, Everlight filed IPR petitions challenging the validity of claims under U.S. Patent Nos. 7,256,486 and 7,524,087. On June 12, 2018, Everlight filed an IPR petition challenging the validity of claims under U.S. Patent No. 6,949,771, and on June 15, 2018, filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,919,787. These challenged patents are the patents that are the subject matter of the infringement lawsuit. On January 18, 2019, the Company and Everlight entered into a confidential settlement agreement resolving the litigation.

On April 13, 2017, the Company filed a patent infringement lawsuit against Cree, Inc. ("Cree") in the United States District Court for the Eastern District of Texas, alleging infringement of certain of the Company's LED patents. The Company is seeking a judgment for infringement of the patents along with other relief including, but not limited to, money damages, costs and disbursements. On June 8, 2017, the Company refiled its patent infringement complaint against Cree in the United States District Court for the Central District of California, and thereafter filed a first amended complaint for patent infringement against Cree in that same court on July 14, 2017. The case is currently pending as of the date of this Report. On June 6, 2018, Cree filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,256,486. This IPR was instituted and joined with the Seoul Semiconductor IPR. On June 7, 2018, Cree filed IPR petitions challenging the validity of certain claims U.S. Patent Nos. 7,524,087 and 6,949,771. Both IPRs were denied by the PTAB on November 14, 2018 as time-barred. The challenged patent is the patent that is the subject matter of the infringement lawsuit, which is pending but stayed pending the outcome of the IPR.

On August 15, 2017, the Company filed a patent infringement lawsuit against Lite-On, Inc., and Lite-On Technology Corporation (collectively, "Lite-On") in the United States District Court for the Central District of California, alleging infringement of certain of the Company's LED patents. The Company is seeking a judgment for infringement of the patents along with other relief including, but not limited to, money damages, costs and disbursements. The case is currently pending but is stayed pending the outcome of IPR proceedings filed by other parties.

On December 7, 2017, DSS filed a patent infringement lawsuit against Nichia Corporation and Nichia America Corporation in the United States District Court for the Central District of California, alleging infringement of certain of DSS's LED patents. The Company is seeking a judgment for infringement of the patents along with other relief including, but not limited to, money damages, costs and disbursements. The case is currently pending as of the date of this Report. On May 10, 2018, Nichia filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,919,787. On May 11, 2018, Nichia filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,652,297. On May 25, 2018, Nichia filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,524,087. On May 29, 2018, Nichia filed an IPR petition challenging the validity of claims under U.S. Patent No. 6,949,771. On May 30, 2018, Nichia filed an IPR petition challenging the validity of claims under U.S. Patent No. 7,256,486. The 6,949,771 IPR was denied institution, but the remaining IPRs were instituted by the PTAB. On December 10, 2018, Nichia refiled IPRs relating to 6,949,771, which was denied by the PTAB on April 15, 2019. These challenged patents are the patents that are the subject matter of the infringement lawsuit, which is pending but stayed pending the outcome of the IPR proceedings.

In addition to the foregoing, we may become subject to other legal proceedings that arise in the ordinary course of business and have not been finally adjudicated. Adverse decisions in any of the foregoing may have a material adverse effect on our results of operations, cash flows or our financial condition. The Company accrues for potential litigation losses when a loss is probable and estimable.

Contingent Litigation Payments - The Company retains the services of professional service providers, including law firms that specialize in intellectual property licensing, enforcement and patent law. These service providers are often retained on an hourly, monthly, project, contingent or a blended fee basis. In contingency fee arrangements, a portion of the legal fee is based on predetermined milestones or the Company's actual collection of funds. The Company accrues contingent fees when it is probable that the milestones will be achieved, and the fees can be reasonably estimated. As of June 30, 2019, and December 31, 2018, the Company had not accrued any contingent legal fees pursuant to these arrangements.

Contingent Payments - The Company is party to certain agreements with funding partners who have rights to portions of intellectual property monetization proceeds that the Company receives. As of June 30, 2019, and December 31, 2018, there are no contingent payments due.

11. Stockholders' Equity

Sales of Equity - On March 5, 2019, the Company issued 130,435 shares of its common stock at \$1.15 per share as partial consideration for a licensing and distribution agreement entered into with Advanced Cyber Security Corp.

On February 18, 2019, the Company had entered into a Convertible Promissory Note with LiquidValue Development Pte Ltd in the principal sum of \$500,000, of which up to \$500,000 of the Principal Amount could be paid by the conversion of such amount into the Company's common stock, par value \$0.02 per share, up to a maximum of 446,428 shares of common stock (the "Maximum Conversion Amount"), at a conversion price of \$1.12 per share. Effective on March 25, 2019, LiquidValue Development Pte Ltd exercised its conversion option and converted the Maximum Conversion Amount under the Note.

On June 5, 2019, the Company entered into an underwriting agreement (the "Underwriting Agreement") with Aegis Capital Corp., acting as representative of the several underwriters, which provided for the issuance and sale by the Company in an underwritten public offering (the "Offering") and the purchase by the Underwriters of 11,200,000 shares of the Company's common stock, \$0.02 par value per share. Subject to the terms and conditions contained in the Underwriting Agreement, the shares were sold to the Underwriters at a public offering price of \$0.50 per share, less certain underwriting discounts and commissions. The Company also granted the Underwriters a 45-day option to purchase up to 1,680,000 additional shares of the Company's common stock on the same terms and conditions for the purpose of covering any over-allotments in connection with the Offering (519,186 shares were exercised on July 18, 2019 at \$0.50 per share, less underwriting discounts and expenses). The net offering proceeds to the Company was approximately \$5.2 million, inclusive of the July 18, 2019 transaction and after deducting underwriting discounts, commissions and other offering expenses. The Company intends to use the net proceeds from the Offering for research, product and brand development, strategic initiatives and general corporate and working capital purposes.

Stock-Based Compensation - The Company records stock-based payment expense related to options and warrants based on the grant date fair value in accordance with FASB ASC 718. Stock-based compensation includes expense charges for all stock-based awards to employees, directors and consultants. Such awards include option grants, warrant grants, and restricted stock awards. During the six months ended June 30, 2019, the Company had stock compensation expense of approximately \$59,000 or less than \$0.01 basic and diluted earnings per share (\$86,000, or less than \$0.01 basic and diluted earnings per share for the corresponding six months ended June 30, 2018).

12. Supplemental Cash Flow Information

The following table summarizes supplemental cash flows for the six-month periods ended June 30, 2019 and 2018:

Supplemental Cash Information

	2019	2018
Cash paid for interest	\$ 70,000	\$ 71,000
Non-cash investing and financing activities:		
Impact of adoption of lease accounting standards	\$ 1,498,000	\$ -
(Loss) gain from change in fair value of interest rate swap derivatives	\$ (15,000)	\$ 22,000
Common stock issued upon conversion of convertible note	\$ 500,000	\$ -
Equity issued to purchase intangible assets	\$ 145,000	\$ -
Elimination of contingent liabilities through agreement	\$ -	\$ 459,000

13. Segment Information

The Company's businesses are organized, managed and internally reported as five operating segments. Two of these operating segments, Packaging and Printing, and Plastics are engaged in the printing and production of paper, cardboard and plastic documents with a wide range of features, including the Company's patented technologies and trade secrets designed for the protection of documents against unauthorized duplication and altering. The three other operating segments, DSS Digital Group, DSS Technology Management, and DSS International, which was added in 2017, are engaged in various aspects of developing, acquiring, selling and licensing technology assets and are grouped into one reportable segment called Technology.

Approximate information concerning the Company's operations by reportable segment for the three and six months ended June 30, 2019 and 2018 is as follows. The Company relies on intersegment cooperation and management does not represent that these segments, if operated independently, would report the results contained herein.

Three Months Ended June 30, 2019	Packaging and Printing	Plastics	Technology	Corporate	Total
Revenue	\$ 3,000,000	\$ 623,000	\$ 484,000	\$ -	\$ 4,107,000
Depreciation and amortization	223,000	44,000	70,000	-	337,000
Interest expense	(29,000)	(9,000)	(2,000)	-	(40,000)
Stock based compensation	4,000	-	20,000	4,000	28,000
Net loss	(21,000)	(299,000)	(594,000)	(117,000)	(1,031,000)

Three Months Ended June 30, 2018	Packaging and Printing	Plastics	Technology	Corporate	Total
Revenue	\$ 2,829,000	\$ 896,000	\$ 362,000	\$ -	\$ 4,087,000
Depreciation and amortization	168,000	29,000	150,000	-	347,000
Interest expense	(23,000)	(5,000)	-	(6,000)	(34,000)
Stock based compensation	-	-	66,000	19,000	85,000
Net Income (loss)	35,000	(87,000)	3,016,000	(287,000)	2,677,000

Six Months Ended June 30, 2019	Packaging and Printing	Plastics	Technology	Corporate	Total
Revenue	\$ 6,314,000	\$ 1,675,000	\$ 927,000	\$ -	\$ 8,916,000
Depreciation and amortization	448,000	85,000	98,000	-	631,000
Interest expense	(50,000)	(15,000)	(5,000)	-	(70,000)
Stock based compensation	9,000	-	42,000	8,000	59,000
Net Income (loss)	68,000	(316,000)	(931,000)	(302,000)	(1,481,000)
Identifiable assets	9,381,000	4,129,000	1,783,000	4,375,000	19,668,000

Six Months Ended June 30, 2018	Packaging and Printing	Plastics	Technology	Corporate	Total
Revenue	\$ 5,747,000	\$ 1,901,000	\$ 817,000	\$ -	\$ 8,465,000
Depreciation and amortization	334,000	59,000	299,000	-	692,000
Interest Expense	(46,000)	(11,000)	(12,000)	(14,000)	(83,000)
Stock based compensation	-	-	67,000	19,000	86,000
Net Income (loss)	281,000	(9,000)	2,523,000	(524,000)	2,271,000
Identifiable assets	9,048,000	2,947,000	1,113,000	2,034,000	15,142,000

The following tables disaggregate our business segment revenues by major source.

Printed Products Revenue Information:

	Total
Three months ended June 30, 2019	
Packaging Printing and Fabrication	\$ 2,775,000
Commercial and Security Printing	225,000
Technology Integrated Plastic Cards and Badges	158,000
Plastic Cards, Badges and Accessories	465,000
Total Printed Products	<u>\$ 3,623,000</u>
Three months ended June 30, 2018	
Packaging Printing and Fabrication	\$ 2,491,000
Commercial and Security Printing	338,000
Technology Integrated Plastic Cards and Badges	253,000
Plastic Cards, Badges and Accessories	643,000
Total Printed Products	<u>\$ 3,725,000</u>
Six months ended June 30, 2019	
Packaging Printing and Fabrication	\$ 5,736,000
Commercial and Security Printing	577,000
Technology Integrated Plastic Cards and Badges	661,000
Plastic Cards, Badges and Accessories	1,015,000
Total Printed Products	<u>\$ 7,989,000</u>
Six months ended June 30, 2018	
Packaging Printing and Fabrication	\$ 5,110,000
Commercial and Security Printing	638,000
Technology Integrated Plastic Cards and Badges	505,000
Plastic Cards, Badges and Accessories	1,395,000
Total Printed Products	<u>\$ 7,648,000</u>

Technology Sales, Services and Licensing Revenue Information:

	Total
Three months ended June 30, 2019	
Information Technology Sales and Services	\$ 32,000
Digital Authentication Products and Services	319,000
Royalties from Licensees	133,000
Total Technology Sales, Services and Licensing	<u>\$ 484,000</u>

Three months ended June 30, 2018	
Information Technology Sales and Services	\$ 78,000
Digital Authentication Products and Services	174,000
Royalties from Licensees	110,000
Total Technology Sales, Services and Licensing	<u>\$ 362,000</u>

Six months ended June 30, 2019	
Information Technology Sales and Services	\$ 105,000
Digital Authentication Products and Services	550,000
Royalties from Licensees	272,000
Total Technology Sales, Services and Licensing	<u>\$ 927,000</u>

Six months ended June 30, 2018	
Information Technology Sales and Services	\$ 208,000
Digital Authentication Products and Services	351,000
Royalties from Licensees	257,000
Total Technology Sales, Services and Licensing	<u>\$ 816,000</u>

FORWARD-LOOKING STATEMENTS

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Reform Act"). Document Security Systems, Inc. desires to avail itself of certain "safe harbor" provisions of the 1995 Reform Act and is therefore including this special note to enable us to do so. Except for the historical information contained herein, this report contains forward-looking statements (identified by the words "estimate", "project", "anticipate", "plan", "expect", "intend", "believe", "hope", "strategy" and similar expressions), which are based on our current expectations and speak only as of the date made. These forward-looking statements are subject to various risks, uncertainties and factors, as set forth in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2018, that could cause actual results to differ materially from the results anticipated in the forward-looking statements.

Overview

Document Security Systems, Inc. (referred to in this report as "Document Security Systems", "DSS", "we", "us", "our" or "Company") has strategically focused its core business efforts on developing and selling anti-counterfeiting technologies and solutions. We emphasize fraud and counterfeit prevention for all forms of printed documents and digital information. The Company holds numerous patents for optical deterrent technologies that provide protection of printed information from unauthorized scanning and copying. We operate two production facilities, consisting of a combined security printing and packaging facility and a plastic card facility where we produce secure and non-secure documents for our customers. We license our anti-counterfeiting technologies to printers and brand-owners. In addition, we have a digital division which provides cloud computing services for our customers, including disaster recovery, back-up and data security services. In 2013, the Company expanded its business focus by merging with DSS Technology Management, Inc., formerly known as Lexington Technology Group, Inc., which acquires intellectual property assets and interests in companies owning intellectual property assets for the purpose of monetizing these assets through a variety of value-enhancing initiatives, including, but not limited to, investments in the development and commercialization of patented technologies, licensing, strategic partnerships and commercial litigation. In January 2018, the Company commenced international operations with its wholly owned subsidiary, DSS Asia Limited, in its office in Hong Kong. In December 2018, this division acquired Guangzhou Hotapps Technology Ltd, a Chinese company that enhances the Company's ability to do business in China. Guangzhou Hotapps Technology Ltd, did not have revenue but has two employees and a license to do business in China.

We do business in five operating segments as follows:

DSS Packaging and Printing Group - Produces custom paperboard packaging serving clients in the pharmaceutical, beverage, photo packaging, toy, specialty foods and direct marketing industries, among others. The group also provides secure and commercial printing services for end-user customers along with technical support for our technology licensees. The division produces a wide array of printed materials such as security paper, vital records, prescription paper, birth certificates, receipts, manuals, identification materials, entertainment tickets, secure coupons, parts tracking forms, brochures, direct mailing pieces, catalogs, business cards, etc. The division also provides resources and production equipment resources for our ongoing research and development of security printing and related technologies.

DSS Plastics Group - Manufactures laminated and surface printed cards which can include magnetic stripes, bar codes, holograms, signature panels, invisible ink, micro fine printing, guilloche patterns, biometric, radio frequency identification (RFID) and watermarks for printed plastic documents such as ID cards, event badges, and driver's licenses.

DSS Digital Group - This division researches, develops, markets and sells the Company's digital products, including and primarily, our AuthentiGuard product, which is a brand authentication application that integrates the Company's optical deterrent technologies used in its security printing offerings with proprietary digital data security-based solutions. The AuthentiGuard product allows customers to implement a security mark utilizing conventional printing methods that is copy and counterfeit resistant that can be read and recorded utilizing smartphones and other digital image capture devices, which can be utilized by that customer's suppliers, field personnel and customers throughout its global product supply and distribution chains.

DSS Technology Management - Since its acquisition in 2013, DSS Technology Management's primary mission has been the attempted monetization of its various patent portfolios through commercial litigation. Except for investment in its social networking related patents, DSS Technology Management and the Company have historically partnered with various third-party funding groups in connection with patent monetization programs. While DSS Technology and the Company may continue to consider new patent opportunities in the future, the pursuit of such acquisitions opportunities will be very selective. As to the existing assets, management will continue to assert and defend the existing patents and pursue potential infringements as they are identified.

In connection with this patent acquisition and protection business, we have previously purchased patents in a variety of fields, including social networking, mobile communications, semi-conductors, Bluetooth and LED, and had initiated patent infringement litigation against a wide range of domestic and global companies. In our patent monetization business model, we engage with legal firms that typically work under fee caps and contingency fee arrangements. To date, we have been or are currently in litigation with, among others, Apple, Samsung, Taiwan Semiconductor Manufacturing Company, Intel, NEC, Lenovo, Seoul Semiconductor, Everlight Electronics, Cree, Nichia and Osram, GMBH. During the course of these litigation matters, we typically incur a variety of legal challenges from defendants, including defendants seeking to have the patents in question adjudicated to be invalid by the United States Patent and Trademark Office through the Inter Parts Review process. As a result of these various legal challenges issued by defendants, we have experienced varying levels of success in our efforts to monetize our patent investments. In addition, to date, most of settlements or payments received from defendants have been remitted to the Company's third-party funders in accordance with the terms of those respective funding agreements.

DSS International - Assists the DSS Digital Group in the development and marketing of the Company's digital authentication products in the Asia Pacific market.

Results of Operations for the Three and Six Months Ended June 30, 2019 as compared to the Three and Six Months Ended June 30, 2018

This discussion should be read in conjunction with the financial statements and footnotes contained in this Quarterly Report and in our Annual Report on Form 10-K for the year ended December 31, 2018.

Revenue

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	% change	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018	% change
Revenue						
Printed products	\$ 3,623,000	\$ 3,725,000	-3%	\$ 7,989,000	\$ 7,648,000	4%
Technology sales, services and licensing	484,000	362,000	34%	927,000	816,000	14%
<i>Total revenue</i>	<i>\$ 4,107,000</i>	<i>\$ 4,087,000</i>	<i>0%</i>	<i>\$ 8,916,000</i>	<i>\$ 8,464,000</i>	<i>5%</i>

For the three months ended June 30, 2019, total revenue remained relatively flat at approximately \$4.1 million as compared to the three months ended June 30, 2018. Revenues from the sale of Printed products decreased 3% during the three months ended June 30, 2019, as compared to the same period in 2018, primarily due to a significant decline in technology and vinyl card sales. Technology sales, services and licensing revenue increased 34% during the three months ended June 30, 2019 as compared to the same period in 2018, primarily due to increased AuthentiGuard sales. Revenues for the six months ended June 30, 2019 increased from \$8.5 million to \$8.9, representing an increase of 5%. Printed products revenues for the six months ended June 30, 2019 were up by 4% as compared to the same period in 2018, primarily due to increased packaging sales, while Technology sales, services and licensing revenue increased by 14%, resulting from increased AuthentiGuard sales.

Costs and expenses

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	% change	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018	% change
Costs and expenses						
Costs of goods sold, exclusive of depreciation and amortization	\$ 2,898,000	\$ 2,756,000	5%	\$ 6,057,000	\$ 5,338,000	13%
Sales, general and administrative compensation	814,000	855,000	-5%	1,734,000	1,822,000	-5%
Depreciation and amortization	337,000	347,000	-3%	631,000	692,000	-9%
Professional fees	434,000	352,000	23%	726,000	585,000	24%
Stock based compensation	28,000	85,000	-67%	59,000	86,000	-31%
Sales and marketing	164,000	121,000	36%	281,000	214,000	31%
Rent and utilities	176,000	161,000	9%	365,000	316,000	16%
Other operating expenses	230,000	222,000	4%	458,000	457,000	0%
Research and development	18,000	6,000	200%	19,000	105,000	-82%
<i>Total costs and expenses</i>	<i>\$ 5,099,000</i>	<i>\$ 4,905,000</i>	<i>4%</i>	<i>\$ 10,330,000</i>	<i>\$ 9,615,000</i>	<i>7%</i>

Costs of goods sold, exclusive of depreciation and amortization includes all direct costs of printed products revenues, including materials, direct labor, transportation and manufacturing facility costs. In addition, this category includes all direct costs associated with technology sales, services and licensing including hardware and software that are resold, and fees paid to inventors or others as a result of technology licenses or settlements, if any. Costs of goods sold increased by 5% and 13%, respectively, during the three and six months ended June 30, 2019 as compared to the same periods in 2018, representing an increase in outside services used by our technology group, and a general increase in material costs as a percentage of the printed products groups' total direct costs.

Sales, general and administrative compensation costs, excluding stock-based compensation, decreased 5% during the three and six months ended June 30, 2019, as compared to the same periods in 2018, primarily due to the reduction of overall headcount and a reduction in commissions and bonus compensation expense.

Depreciation and amortization include the depreciation of machinery and equipment used for production, depreciation of office equipment and building and leasehold improvements, amortization of software, and amortization of acquired intangible assets such as customer lists, trademarks, non-compete agreements and patents, and internally developed patent assets. For the three and six months ended June 30, 2019, depreciation and amortization expense decreased 3% and 9%, respectively, as compared to the same periods in 2018, primarily due to the write-off of the semiconductor patents during the six months ended June 30, 2018.

Professional fees increased 23% and 24%, respectively, during the three and six months ended June 30, 2019, as compared to the same periods in 2018, mostly due to increases in legal services for patent litigation, as well as the outsourcing of corporate legal services.

Stock based compensation includes expense charges for all stock-based awards to employees, directors and consultants. Such awards include option grants, warrant grants, and restricted stock awards. Stock based compensation decreased 67% and 31%, respectively, as a result of a decline in restricted stock and common stock granted to certain management members and various employees during the first and second quarters of 2019.

Sales and marketing costs, which include internet and trade publication advertising, travel and entertainment costs, sales-broker commissions, and trade show participation expenses increased 36% and 31%, respectively, during the three and six months ended June 30, 2019 as compared to the three and six months ended June 30, 2018, resulting from an increase in marketing costs for the technology group.

Rent and utilities increased by 9% and 16%, respectively, during the three and six months ended June 30, 2019, as compared to the same periods in 2018, primarily due to an increase in facilities maintenance costs and rent expense for the Company's printed products group.

Other operating expenses consist primarily of equipment maintenance and repairs, office supplies, IT support and insurance costs. Other operating expenses increased by 4% during the three months ended June 30, 2019, primarily as the result of increases in office expenses for the printed products group, as well as increases in insurance costs and state and business taxes for the corporate group. During the six months ended June 30, 2019, other operating expenses remained relatively flat.

Research and development costs consist primarily of compensation costs for research personnel, third-party research costs, and consulting costs. Research and development costs for the three months ended June 30, 2019 were \$18,000 as compared to \$6,000 for the same period in 2018, primarily due to final payments made related to the development of proprietary block chain solutions for DSS International. During the six months ended June 30, 2019, research and development costs were decreased by 82%, representing a decline in development costs related to the development of proprietary block chain solutions for DSS International.

Other Income (Expense)

	<u>Three Months Ended June 30, 2019</u>	<u>Three Months Ended June 30, 2018</u>	<u>% change</u>	<u>Six Months Ended June 30, 2019</u>	<u>Six Months Ended June 30, 2018</u>	<u>% change</u>
Other income (expense):						
Interest income	\$ 3,000	\$ 3,000	0%	\$ 4,000	\$ 6,000	-33%
Interest expense	(40,000)	(34,000)	18%	(70,000)	(83,000)	-16%
Amortization of deferred financing costs and debt discount	(1,000)	(6,000)	-83%	(1,000)	(34,000)	-97%
Gain on extinguishment of liabilities, net	-	3,533,000	-100%	-	3,533,000	-100%
<i>Total other expense</i>	<i>\$ (38,000)</i>	<i>\$ 3,496,000</i>	<i>-101%</i>	<i>\$ (67,000)</i>	<i>\$ 3,422,000</i>	<i>-102%</i>

Interest income recognized on the money market account was \$4,000 for the six months ended June 30, 2019.

Interest expense increased 18% during the three months ended June 30, 2019, as compared to the same period in 2018, due to the interest expense incurred on the consolidation of the two Promissory notes noted in Note 6. During the six months ended June 30, 2019, interest expense decreased by 16%, due to a decrease in the total debt carried by the Company.

Amortized debt discount decreased 83% and 97% during the three and six months ended June 30, 2019, as compared to the same periods in 2018, due to the impact of the write-off of the semiconductor patents during the six months ended June 30, 2018.

Net Income (loss)

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018	% change	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018	% change
Net income (loss)	\$ (1,031,000)	\$ 2,677,000	-139%	\$ (1,481,000)	\$ 2,271,000	-165%
Earnings (loss) per common share:						
Basic	\$ (0.05)	\$ 0.16	-131%	\$ (0.07)	\$ 0.14	-150%
Diluted	\$ (0.05)	\$ 0.16	-131%	\$ (0.07)	\$ 0.13	-154%

For the three and six months ended June 30, 2019, the Company recorded net loss of approximately \$1 million and \$1.5 million, respectively, as compared to net income of \$2.7 million and \$2.3 million, respectively, during the same periods in 2018. The increase in operating losses incurred during the three and six months ended June 30, 2019 as compared to the same periods in 2018 is due primarily to an approximate \$3.5 million gain on extinguishment of debt recorded in Q2 2018 as well as an increase in direct costs as a percentage of sales at the Company's printed products divisions, an increase in professional fees, and an increase in costs associated with the Company's expansion into Asia.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2019, the Company had cash and cash equivalents of \$5,321,444 and restricted cash of \$50,266.

Operating Cash Flow – During the six months ended June 30, 2019, the Company used approximately \$1,723,000 of cash for operations as compared to the \$450,000 in cash used for operations during the first six months ended June 30, 2018. The increase in the use of cash for operations primarily reflects payment of accrued liabilities during the period, and the timing of accounts receivable and accounts payable changes at the Company's packaging division.

Investing Cash Flow – During the six months ended June 30, 2019, the Company expended approximately \$261,600 on equipment for its packaging and plastic card operations, \$350,000 for ACS licensing agreement for the DSS Singapore group.

Financing Cash Flows – During the six months ended June 30, 2019, the Company made aggregate principal payments for long-term debt of approximately \$122,000. The Company also received net proceeds of approximately \$500,000 from the sale of the Company's common stock as a result of the conversion of a short-term convertible note that was entered into and converted during the six months ended June 30, 2019. In addition, the Company raised approximately \$4.9 million by the sale of common shares that occurred in June 2019.

Continuing Operations and Going Concern – The accompanying consolidated financial statements have been prepared assuming that we will continue as a going concern. This basis of accounting contemplates the recovery of our assets and the satisfaction of liabilities in the normal course of business. These consolidated financial statements do not include any adjustments to the specific amounts and classifications of assets and liabilities, which might be necessary should we be unable to continue as a going concern. While the Company has approximately \$ 5.3 million in cash, and a positive working capital position of approximately \$4.9 million as of June 30, 2019, the Company has incurred negative cash flows from operating and investing activities over the past two years and has projected that the Company will likely incur negative cash flows from operations in 2019. To continue as a going concern, on June 5, 2019, the Company entered into an underwriting agreement with Aegis Capital Corp., acting as representative of the several underwriters, which provided for the issuance and sale by the Company in an underwritten public offering (the "Offering") of 11,200,000 shares of the Company's common stock. The Company also granted the Underwriters a 45-day option to purchase up to 1,680,000 additional shares of the Company's common stock on the same terms and conditions for the purpose of covering any over-allotments in connection with the Offering (519,186 shares were exercised on July 18, 2019.) The net offering proceeds to the Company was approximately \$5.2 million, inclusive of the July 18, 2019 transaction and after deducting underwriting discounts, commissions and other offering expenses.

The expected use of cash for operations in 2019 will be primarily for funding operating losses, working capital, legal expenses associated with its intellectual property related litigation, and the costs associated with the global roll-out of the Company's AuthentiGuard product line.

The Company's management intends to take actions necessary to continue as a going concern. Management's plans concerning these matters includes, among other things, continued growth among our operating segments including international expansion of our AuthentiGuard product, and tightly controlling operating costs and reducing spending growth rates wherever possible to return to profitability.

We believe that our \$5.7 million in aggregate cash and equivalents and restricted cash as of June 30, 2019 will allow us to fund our current and planned operations through 2020. However, we may seek additional capital through the sale of debt or equity securities, if necessary, especially in conjunction with opportunistic acquisitions or licensing arrangements. Based on this, we have concluded that substantial doubt of our ability to continue as a going concern has been alleviated.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, an effect on our financial condition, financial statements, revenues or expenses.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in our financial statements and accompanying notes. The financial statements as of December 31, 2018 describe the significant accounting policies and methods used in the preparation of the financial statements. Additionally, the Company adopted ASU No. 2016-02 and its related amendments which introduced Leases (Topic 842, or "ASC 842"), as required, effective January 1, 2019 and elected the optional transition method that allows for a cumulative-effect adjustment in the period of adoption, without a restatement of prior periods. The new accounting standard requires lessees to recognize right-of-use ("ROU") assets and corresponding lease liabilities for all leases with lease terms of greater than 12 months. Further, the Company elected a short-term lease exception policy, permitting the Company to not apply the recognition requirements of this standard to short-term leases (i.e. leases with terms of 12 months or less) and an accounting policy to account for lease and non-lease components as a single component for certain classes of assets. As a result of the adoption, the Company adjusted its beginning balance for the quarter ended June 30, 2019 by recording an ROU asset and lease liability. The adoption impacted the accompanying consolidated balance sheet, but did not have an impact on the consolidated statements of operations and comprehensive loss. The Company uses a discount rate to determine the present value based on the rate implicit in the lease, if readily determinable, or its incremental borrowing rate. Critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements. A discussion of such critical accounting policies can be found in our Annual Report on Form 10-K for the year ended December 31, 2018. Other than the adoption of Topic ASC 842, there have been no material changes to such critical accounting policies as of the Quarterly Report on Form 10-Q for the quarter ended June 30, 2019.

ITEM 4 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer who is also our principal financial officer, we conducted an evaluation of our disclosure controls and procedures for the quarter ended June 30, 2019, pursuant to Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation and on the material weaknesses disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018 which remained As of June 30, 2019, our principal executive officer and principal financial officer concluded that As of June 30, 2019, our disclosure controls and procedures were not effective to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is being recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that our disclosure controls are not effectively designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is being accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Plan for Remediation of Material Weaknesses

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2018, the Company has a remediation plan and is committed to maintaining a strong internal control environment and believes that these remediation efforts will represent significant improvements in our controls. The Company has started to implement these steps, however, some of these steps will take time to be fully integrated and confirmed to be effective and sustainable. Additional controls may also be required over time. Until the remediation steps set forth above are fully implemented and tested, the material weaknesses described above will continue to exist.

Changes in Internal Control over Financial Reporting

While changes in the Company's internal control over financial reporting occurred during the quarter ended June 30, 2019 as the Company began implementation of the remediation steps described above, we believe that there were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2019, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

On January 8, 2019, DSS Technology Management, Inc. ("DSSTM"), a wholly-owned subsidiary of the Company, entered into a confidential settlement agreement with Intel Corporation, Dell Inc., GameStop Corp, Conn's Inc., Conn Appliances, Inc., Wal-Mart Stores, Inc., Wal-Mart Stores Texas, LLC and AT&T Mobility LLC (collectively, the "Defendants"), in connection with DSSTM's patent infringement suit filed against the Defendants in the United States District Court for the Eastern District of Texas (the "District Court") in February of 2015. The District Court case against the Defendants was dismissed, as to all the Defendants, on February 5, 2019.

On January 16, 2019, DSSTM's patent infringement suit originally filed against Qualcomm Incorporated in July of 2015 in the United States District Court for the Eastern District of Texas was dismissed.

In June of 2017, Document Security Systems, Inc. (the "Company") filed a patent infringement suit against Everlight Electronics Co., Ltd. and Everlight Americas, Inc. (collectively, "Everlight") in the United States District Court for the Central District of California. On January 18, 2019, the Company and Everlight entered into a confidential settlement agreement resolving the litigation.

ITEM 1A - RISK FACTORS

There have been no material changes to the discussion of risk factors previously disclosed in our most recently filed Annual Report on Form 10-K for the year ended December 31, 2018.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On February 18, 2019, the Company entered into a Convertible Promissory Note with LiquidValue Development Pte Ltd in the principal sum of \$500,000, of which up to \$500,000 of the Principal Amount could be paid by the conversion of such amount into the Company's common stock, par value \$0.02 per share, up to a maximum of 446,428 shares of common stock (the "Maximum Conversion Amount"), at a conversion price of \$1.12 per share. Effective on March 25, 2019, LiquidValue Development Pte Ltd exercised its conversion option and converted the Maximum Conversion Amount under the Note.

The Company issued 130,435 shares of the Company's common stock in conjunction with the signing of a Master Distributor Agreement with Advanced Cyber Security Corp. ("ACS") to for the Company to distribute ACS's EndpointLockV™ cyber security software exclusively in thirteen countries in Asia and Australia, and non-exclusively, in the U.S. and Middle East.

The issuance of the above securities was deemed to be exempt from the registration requirements of the Securities Act of 1933, as amended, by virtue of section 4(a)(2) thereof, as a transaction by an issuer not involving a public offering.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 - OTHER INFORMATION

None.

ITEM 6 - EXHIBITS

Exhibit Number	Exhibit Description
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer and Interim Chief Financial Officer.*
32.1	Certification of Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

*Filed herewith.

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 thereunto duly authorized.

DOCUMENT SECURITY SYSTEMS, INC.

August 13, 2019

By: /s/ Frank D. Heuszel

Frank D. Heuszel

Chief Executive Officer and Interim Chief Financial Officer

(Principal Executive Officer and Principal Financial and Accounting Officer)

RULE 13a-14(a)/15d-14(a) CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND INTERIM CHIEF FINANCIAL OFFICER

I, Frank D. Heuszel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Document Security Systems, Inc. for the quarter ended June 30, 2019;
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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)), 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (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; and
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 registrant's audit committee of the 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 13, 2019

/s/ Frank D. Heuszel

Frank D. Heuszel
Chief Executive Officer and Interim Chief Financial Officer
(Principal Executive Officer and Principal Financial and Accounting Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND INTERIM CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. 1350
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Document Security Systems, Inc. (the "*Company*") on Form 10-Q for the quarter ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, Frank D. Heuszel, Chief Executive Officer and Interim Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (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 results of operations of the Company at the dates and for the periods indicated.

Date: August 13, 2019

/s/ Frank D. Heuszel

Frank D. Heuszel

Chief Executive Officer and Interim Chief Financial Officer

(Principal Executive Officer and Principal Financial and Accounting Officer)
