

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

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

Date of Report (Date of earliest event reported): September 15, 2003

VASCO DATA SECURITY INTERNATIONAL, INC.

(Exact name of registrant as specified in charter)

Delaware ----- (State or other juris- diction of incorporation)	000-24389 ----- (Commission File Number)	36-4169320 ----- (IRS Employer Identification No.)
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1901 South Meyers Road, Suite 210 Oakbrook Terrace, Illinois ----- (Address of principal executive offices)	60181 ----- (Zip Code)
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Registrant's telephone number, including area code: (630) 932-8844

N/A
(Former name or former address, if changed since last report)

ITEM 5. OTHER EVENTS.

On September 11, 2003 VASCO completed the sale of \$8 million of its Series D 5% Cumulative Convertible Voting Preferred Stock and warrants to purchase common stock.

The preferred stock carries a 5% dividend, is convertible into 4 million shares of common stock and will vote with the common stock as a class on matters presented to the stockholders. In addition, investors received 600 thousand five-year warrants to purchase common stock. The preferred stock is convertible at a fixed price of \$2.00 per share and the warrants are exercisable at \$ 3.47 per share, a 20% premium to the closing price of the common stock on Wednesday, September 10, 2003.

ITEM 7. FINANCIAL STATEMENTS AND EXHIBITS.

(c) Exhibits.

See the Exhibit Index attached hereto.

ITEM 12. RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

VASCO Data Security International, Inc. issued a press release on September 12, 2003 announcing the sale of \$8 million of its Series D 5% Cumulative Convertible Voting Preferred Stock and warrants to purchase common stock. The full text of the press release is attached to this Report as Exhibit 99.1

SIGNATURE

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

Date: September 15, 2003

VASCO Data Security International, Inc.

(Registrant)

By: /s/ Clifford K. Bown

Clifford K. Bown
Chief Financial Officer

EXHIBIT INDEX

Exhibit No.
Description -

4.1 Preferred
Stock and
Warrant
Purchase
Agreement by
and among
VASCO Data
Security
International,
Inc and
various
purchasers of
the Series D
5% Cumulative
Convertible
Voting
Preferred
Stock. 4.2
Certificate
of
Designations,
Rights and
Preferences
of the Series
D 5%
Cumulative
Convertible
Voting
Preferred
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Form of
Series D
Warrant
Agreement.
99.1 Press
release,
dated
September 12,
2003,
announcing
the sale of
\$8 million of
VASCO's
Series D 5%
Cumulative
Convertible
Voting
Preferred
Stock.

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PREFERRED STOCK AND WARRANT PURCHASE AGREEMENT

DATED AS OF

September 11, 2003

BY AND AMONG

VASCO DATA SECURITY INTERNATIONAL, INC., AS ISSUER AND SELLER
AND

EACH OF THE PARTIES LISTED ON SCHEDULE 1, AS PURCHASERS
WITH RESPECT TO

SERIES D 5% CUMULATIVE CONVERTIBLE VOTING PREFERRED STOCK
AND SERIES D WARRANTS TO PURCHASE COMMON STOCK

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SCHEDULE 1

DISCLOSURE SCHEDULE

EXHIBIT A: CERTIFICATE OF DESIGNATIONS, RIGHTS AND PREFERENCES OF SERIES D 5%
CUMULATIVE CONVERTIBLE VOTING PREFERRED STOCK

EXHIBIT B: COMMON STOCK PURCHASE WARRANT

EXHIBIT C: OPINION OF SELLER'S COUNSEL

EXHIBIT D: FORM OF SELLING STOCKHOLDER QUESTIONNAIRE

PREFERRED STOCK AND WARRANT PURCHASE AGREEMENT (the "Agreement") dated as of September 11, 2003, by and among VASCO Data Security International, Inc., a Delaware corporation (the "Seller"), and each of the persons listed on Schedule 1 hereto (each, a "Purchaser" and collectively, the "Purchasers").

WITNESSETH:

WHEREAS, each of the Purchasers is willing to purchase from the Seller, and the Seller desires to sell to the Purchasers, the numbers of shares set forth opposite each Purchaser's name on Schedule 1 attached hereto, which aggregate 800 shares of Seller's Series D 5% Cumulative Convertible Voting Preferred Stock, stated value \$10,000.00 per share (the "Preferred Stock"), and Series D Common Stock Purchase Warrants (the "Warrants"), entitling the holders thereof to purchase that number of shares of the Seller's class of common stock, \$0.001 par value per share (the "Common Stock"), at an exercise price of \$3.47 per share (the "Exercise Price"), equal in number to 600,000 shares of Common Stock (subject to adjustment as more fully set forth herein and in the Warrants).

NOW, THEREFORE, in consideration of the foregoing and the mutual promises, representations, warranties, covenants and agreements set forth herein, the parties hereto, intending to be legally bound, hereby agree as follows:

ARTICLE 1
PURCHASE AND SALE

Section 1.1. PURCHASE AND SALE. On the terms and subject to the conditions set forth in this Agreement, at the Closing (as defined in Section 2.2), the Seller will sell and each of the Purchasers will purchase (i) the Preferred Stock in the amounts set forth opposite each Purchaser's name on Schedule 1 hereto, and (ii) the numbers of Warrants set forth opposite each Purchaser's name on Schedule 1 hereto. The shares of Common Stock issuable upon conversion of the Preferred Stock are referred to herein as the "Conversion Shares," and the shares of Common Stock issuable upon exercise of the Warrants are referred to herein as the "Warrant Shares." The Preferred Stock, the Warrants, the Conversion Shares, the Dividend Shares (as hereinafter defined) and the Warrant Shares are collectively referred to as the "Securities."

Section 1.2. TERMS OF THE PREFERRED STOCK AND WARRANTS. The terms and provisions of the Preferred Stock are set forth in the Form of Certificate of Designations, Rights and Preferences of Series D 5% Cumulative Convertible Voting Preferred Stock, attached hereto as Exhibit A. The terms and provisions of the Warrants are more fully set forth in the Form of Common Stock Purchase Warrant, attached hereto as Exhibit B.

Section 1.3. TRANSFERS; LEGENDS.

1.3.1. The Preferred Stock and Warrants may be transferred, in whole or in part, by any of the Purchasers at any time by delivering written transfer instructions to the Seller, and the Seller shall reflect such transfer on its books and records and reissue certificates evidencing the Preferred Stock or Warrants being transferred. The Seller hereby consents to and agrees to register on the books of the Seller and with any transfer agent for the securities of the

Seller any transfer of Preferred Stock or Warrants. Any transferee other than a purchaser of shares of Common Stock which have been registered under the Securities Act shall have the rights of a Purchaser under this Agreement. The Seller shall reissue certificates evidencing the Preferred Stock or Warrants transferred upon surrender of certificates evidencing the Preferred Stock or Warrants being transferred. Any such transfer shall be made by a Purchaser in accordance with applicable federal and state securities laws and other applicable laws. An "Affiliate" means any Person (as such term is defined below) that, directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with a Person, as such terms are used in and construed under Rule 144 under the Securities Act of 1933, as amended (the "Securities Act"). With respect to a Purchaser, any investment fund or managed account that is managed on a discretionary basis by the same investment manager as such Purchaser will be deemed to be an Affiliate of such Purchaser. A "Person" means any individual or corporation, partnership, trust, incorporated or unincorporated association, joint venture, limited liability company, joint stock company, government (or an agency or subdivision of any thereof) or other entity of any kind.

1.3.2. The certificates representing the Securities shall bear the following legend:

"THE SECURITIES REPRESENTED BY, OR ACQUIRABLE UPON CONVERSION OR EXERCISE OF SECURITIES EVIDENCED BY, THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER SAID ACT UNLESS THE ISSUER OF THIS CERTIFICATE RECEIVES AN OPINION OF LEGAL COUNSEL REASONABLY ACCEPTABLE TO THE ISSUER AND ITS LEGAL COUNSEL THAT SUCH SALE IS EXEMPT FROM REGISTRATION UNDER SUCH ACT AND IS IN COMPLIANCE WITH APPLICABLE STATE SECURITIES OR BLUE SKY LAWS UNLESS SUCH REGISTRATION IS NOT REQUIRED."

ARTICLE 2 PURCHASE PRICE AND CLOSING

Section 2.1. PURCHASE PRICE. The aggregate purchase price (the "Purchase Price") to be paid by the Purchasers to the Seller to acquire the Preferred Stock and the Warrants shall be the total amount set forth on Schedule 1 hereto. The purchase price for each share of Preferred Stock shall be \$10,000.00 and the purchase price for each Warrant shall be \$0.01.

Section 2.2. THE CLOSING. The closing of the transactions contemplated under this Agreement (the "Closing") shall take place by means of facsimile transfer on a date mutually agreed upon by the parties. The date on which the Closing occurs is herein called the "Closing Date." All proceedings to be taken and all documents to be executed at the Closing shall be

deemed to have been taken, delivered and executed simultaneously, and no proceeding shall be deemed taken nor documents deemed executed or delivered until all have been taken, delivered and executed.

Section 2.3. DELIVERIES.

2.3.1. DELIVERIES BY THE SELLER. At the Closing, the Seller shall deliver or cause to be delivered to each of the Purchasers the following:

(a) One or more certificates evidencing the aggregate number of shares of the Preferred Stock, duly authorized, fully paid and non-assessable, as is indicated on Schedule 1 for such Purchaser, registered in the name of such Purchaser, in such denominations as is indicated on Schedule 1 for such Purchaser;

(b) One or more Warrants in the form of Exhibit B hereto, registered in the name of such Purchaser, in such denominations as is indicated on Schedule 1 for such Purchaser, pursuant to which such Purchaser shall be entitled to purchase an aggregate of that number of shares of Common Stock as is indicated on Schedule 1 for such Purchaser;

(c) A certificate of the Secretary of the Seller (the "Secretary's Certificate"), in form and substance satisfactory to the Purchasers, certifying as follows:

(i) that the Certificate of Designation authorizing the Preferred Stock has been duly filed in the office of the Secretary of State of the State of Delaware, and that attached to the Secretary's Certificate is a true and complete copy of the Certificate of Incorporation of the Seller together with all amendments thereto and the Certificate of Designation;

(ii) that a true copy of the Bylaws of the Seller, as amended to the Closing Date, is attached to the Secretary's Certificate;

(iii) that attached to the Secretary's Certificate are true and complete copies of the resolutions of the Board of Directors of the Seller (the "Board of Directors") authorizing the execution, delivery and performance of this Agreement and the Related Documents (as defined below), instruments and certificates required to be executed by it in connection herewith and therewith and approving the consummation of the transactions in the manner contemplated hereby including, but not limited to, the authorization and issuance of the Preferred Stock;

(iv) the names and true signatures of the officers of the Seller signing this Agreement and all other documents to be delivered in connection with this Agreement;

(d) Proof of due filing with the Secretary of State of the State of Delaware of the Certificate of Designation authorizing the Preferred Stock;

(e) A legal opinion of the Seller's counsel, dated as of the Closing Date, in the form attached hereto as Exhibit C (the "Opinion"); and

(f) An itemized list of any and all brokerage commissions, finder's fees or similar payments owed by Purchaser relating to this Agreement or the transactions contemplated hereby (the "Broker Fee List").

2.3.2. DELIVERIES BY THE PURCHASERS. At the Closing, each of the Purchasers shall deliver or cause to be delivered to the Seller the following:

(a) Payment of the purchase price set forth opposite such Purchaser's name on Schedule 1, in cash by wire transfer of immediately available funds to an account designated in writing by Seller; and

(b) an executed copy of the Selling Stockholder Questionnaire, in the form attached hereto as Exhibit D.

Article 3
REPRESENTATIONS AND WARRANTIES OF THE SELLER

Except as set forth on a Disclosure Schedule executed and delivered by the Seller to each Purchaser (the "Disclosure Schedule"), the Seller represents and warrants to each Purchaser as follows:

Section 3.1. CORPORATE EXISTENCE AND POWER. The Seller and each of its direct and indirect subsidiaries (collectively, the "Subsidiaries") is a corporation duly incorporated, validly existing and in good standing under the laws of the jurisdiction in which it is incorporated or organized, and has all corporate powers and authority required to carry on its business as now conducted. True and complete copies of the Seller's Certificate of Incorporation, as amended, and Bylaws, as amended (collectively, the "Charter Documents") have previously or contemporaneously herewith been provided to the Purchasers. The Seller and each of its Subsidiaries is duly qualified as a foreign corporation to do business and is in good standing in every jurisdiction in which the failure so to qualify or be in good standing would have a Material Adverse Effect. For purposes of this Agreement, "Material Adverse Effect" means any effect which, individually or in the aggregate with all other effects, reasonably would be expected to be materially adverse to (i) the Securities, (ii) the ability of the Seller to perform its obligations under this Agreement or the Related Documents or (iii) the business, operations, properties, prospects, financial condition or results of operations of the Seller and its Subsidiaries, taken as a whole.

Section 3.2. CORPORATE AUTHORIZATION.

3.2.1. The execution, delivery and performance by the Seller of this Agreement, the Warrants, the Certificate of Designation and each of the other documents executed pursuant to and in connection with this Agreement (the "Related Documents"), and the consummation of the transactions contemplated hereby and thereby (including, but not limited to, the sale and delivery of the Preferred Stock and the Warrants, and the subsequent issuance of the Conversion Shares, and the subsequent issuance of the Warrant Shares upon exercise of the Warrants, and the subsequent issuance, if the Seller so elects, of shares of Common Stock in payment of the dividends on the Preferred Stock, which shares of Common Stock are herein referred to as "Dividend Shares") (the "Transactions") have been duly authorized, and no

additional corporate action is required for the approval of this Agreement or the Related Documents. The Conversion Shares, the Dividend Shares and the Warrant Shares have been duly reserved for issuance by the Seller. This Agreement and the Related Documents have been or, to the extent contemplated hereby or by the Related Documents, will be duly executed and delivered and constitute the legal, valid and binding agreement of the Seller, enforceable against the Seller in accordance with their terms, except as may be limited by bankruptcy, reorganization, insolvency, moratorium and similar laws of general application relating to or affecting the enforcement of rights of creditors, and except as enforceability of its obligations hereunder are subject to general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

3.2.2. The Preferred Stock that will be issued and delivered to the Purchasers at Closing in accordance with the terms hereof, will be duly authorized, validly issued, fully paid and non-assessable and free from all taxes, liens, claims and encumbrances and free of restrictions on transfer other than those imposed by applicable state and federal securities laws. The Common Stock issuable upon conversion of the Preferred Stock and exercise of the Warrants has been duly and validly reserved for issuance, and upon issuance in accordance with the terms of the Certificate of Designation or the Warrants, will be duly authorized, validly issued, fully paid and non-assessable and free from all taxes, liens, claims and encumbrances and free of restrictions on transfer other than those imposed by applicable federal and state securities laws and, assuming the accuracy of the representations and warranties of the Purchasers, will be issued in compliance with all applicable federal and state securities laws.

3.2.3. The issuance of the Preferred Stock, the Warrants or the Common Stock upon conversion or exercise of the Preferred Stock or Warrants, as applicable, will not result in or obligate the Seller to (i) issue or offer to issue, with or without consideration, any securities or rights to acquire any securities to any person, whether as a pre-emptive right, right of first refusal or similar rights of stockholders, or pursuant to any to rights plan, or pursuant to any agreement, undertaking or other obligation of any nature, or (ii) adjust the number or kind of securities held by or issuable (with or without the payment of any consideration) to any person.

Section 3.3. GOVERNMENTAL AUTHORIZATION; NASD AND NASDAQ.

3.3.1. Except as otherwise specifically contemplated in this Agreement and the Related Documents, and except for: (i) the filing of the Registration Statement (as defined in Article 6) with the Commission; (ii) any filings required under Regulation D or any state securities laws that are permitted to be made after the date hereof, and (iii) the filing of the Certificate of Designation in the office of the Secretary of State of the State of Delaware; the execution, delivery and performance by the Seller of this Agreement and the Related Documents, and the consummation of the Transactions require no action by or in respect of, or filing with, any governmental body, agency, official or authority.

3.3.2. The Seller will provide an Additional Listing Notice, which shall include, if required, true copies of this Agreement, the form of Certificate of Designation and the form of Warrant to the Nasdaq Stock Market, Inc. with respect to the Conversion Shares, Warrant Shares and Dividend Shares (collectively, the "Shares").

Section 3.4. NON-CONTRAVENTION. The execution, delivery and performance by the Seller of this Agreement and the Related Documents, and the consummation by the Seller of the Transactions do not and will not (a) violate or conflict with the Charter Documents or any Material Agreement (which, for purposes of this Agreement, means any material undischarged written or oral contracts, agreements, leases or other instruments to which the Seller or any Subsidiary is a party or by which the Seller or any Subsidiary is bound or to which any of the properties or assets of the Seller or any Subsidiary is subject) to which the Seller is a party or bound; (b) violate or conflict with or constitute a material violation of any provision of any law, regulation, judgment, injunction, order or rule or regulation of any self-regulatory organizations or decree binding upon or applicable to the Seller; (c) constitute a default under or give rise to a right of termination, amendment (including, without limitation, the triggering of any anti-dilution provisions) cancellation or acceleration or loss of any benefit under any Material Agreement, contract or other instrument binding upon the Seller or under any material license, franchise, permit or other similar authorization held by the Seller; or (d) result in the creation or imposition of any Lien (as defined below) on any material asset of the Seller. For purposes of this Agreement, the term "Lien" means, with respect to any asset, any mortgage, lien, pledge, charge, security interest, claim or encumbrance of any kind in respect of such asset.

Section 3.5. COMPLIANCE. The Seller is not in violation of its Charter Documents or other organizational documents and no Subsidiary is in violation of any of its organizational documents. Neither the Seller nor any of its Subsidiaries is in default (and no event has occurred that with notice or lapse of time or both would put the Seller or any of its Subsidiaries in default) under, nor has there occurred any event giving others (with notice or lapse of time or both) any rights of termination, amendment, acceleration or cancellation of, any agreement, indenture or instrument to which the Seller or any of its Subsidiaries is a party (including, without limitation, any Material Agreement), except for actual or possible violations, defaults or rights that would not, individually or in the aggregate, have a Material Adverse Effect. The businesses of the Seller and its Subsidiaries are not being conducted, and shall not be conducted so long as any Purchaser owns any of the Preferred Stock or Warrants, in violation of any law, ordinance or regulation of any governmental entity, except for possible violations the sanctions for which either individually or in the aggregate have not had and would not have a Material Adverse Effect. To their knowledge, neither the Seller, nor any of its Subsidiaries, nor any director, officer, agent, employee or other person acting on behalf of the Seller or any Subsidiary has, in the course of his actions for, or on behalf of, the Seller or any Subsidiary, used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity, made any direct or indirect unlawful payment to any foreign or domestic government official or employee from corporate funds, violated or is in violation of any provision of the U.S. Foreign Corrupt Practices Act of 1977, or made any bribe, rebate, payoff, influence payment, kickback or other unlawful payment to any foreign or domestic government official or employee. The Seller and its Subsidiaries possess all certificates, authorizations and permits issued by the appropriate federal, state, provincial or foreign regulatory authorities that are material to the conduct of its business, and neither the Seller nor any of its Subsidiaries has received any notice of proceeding relating to the revocation or modification of any such certificate, authorization or permit.

Section 3.6. SEC DOCUMENTS. The Seller is obligated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") to file reports, Schedules, forms,

statements and other documents (all such documents filed or required to be filed by the Seller, including all exhibits thereto or incorporated therein by reference, and all documents filed by the Seller under the Securities Act are hereinafter called the "SEC Documents"). The Seller has timely filed all SEC Documents required to be filed with the SEC under the Exchange Act during the two (2) years immediately preceding the date of this Agreement. As of their respective filing dates, all such SEC Documents filed by the Seller (i) were prepared in all material respects in accordance with the requirements of the Exchange Act and the Securities Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder, and (ii) did not at the time they were filed (or, if amended or superseded by a filing prior to the date hereof, then on the date of such filing) contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. All of the information about the Seller or its Subsidiaries which has been disclosed to the Purchasers herein or in the course of discussions and negotiations with respect hereto which is material to the Seller has been disclosed in the SEC Documents.

Section 3.7. FINANCIAL STATEMENTS. Each of the Seller's consolidated balance sheets and related consolidated statements of income, cash flows and changes in stockholders' equity (including the related notes), as contained in the SEC Documents filed during the twelve (12) months immediately preceding the date of this Agreement (collectively, the "Seller's Financial Statements" or the "Financial Statements") (a) present fairly in all material respects the financial position of the Seller and its consolidated Subsidiaries as of the dates thereof and the results of operations, cash flows and stockholders' equity as of and for each of the periods then ended, except that any unaudited financial statements are subject to normal year-end adjustments, and (b) were prepared in accordance with generally accepted accounting principles ("GAAP") applied on a consistent basis throughout the periods involved, in each case, except as otherwise indicated in the notes thereto.

Section 3.8. NO MATERIAL ADVERSE CHANGE. Except as otherwise disclosed herein or on the Disclosure Schedule, since June 30, 2003, there have not been any changes in the assets, liabilities, financial condition, business prospects or operations of the Seller from that reflected in the Financial Statements except changes in the ordinary course of business which have not been, either individually or in the aggregate, materially adverse to the financial position of the Seller taken as a whole.

Section 3.9. LITIGATION. Except as disclosed on the Disclosure Schedule, there is no action, suit, proceeding, judgment, claim or investigation pending or, to the knowledge of the Seller, threatened against the Seller and any of its Subsidiaries which could reasonably be expected to have a Material Adverse Effect on the Seller or its Subsidiaries. There is no action, suit, proceeding, judgment, claim or investigation pending or, to the knowledge of the Seller, threatened, which in any manner challenges or seeks to prevent, enjoin, alter or materially delay any of the transactions contemplated hereby. There are no facts which, if known by a potential claimant or governmental authority, could give rise to a claim or proceeding which, if asserted or conducted with results unfavorable to the Seller or any of its Subsidiaries, could reasonably be expected to have a Material Adverse Effect.

Section 3.10. CAPITALIZATION. The authorized capital stock of the Seller consists of 75,000,000 shares of Common Stock, of which 30,396,984 shares are issued and outstanding as of the date hereof, and 500,000 shares of a class of preferred stock, issuable in one or more classes or series, with such relative rights and preferences as the Seller's board of directors may determine, none of which (other than the Preferred Stock) has been authorized for issuance or designated and provided with terms.

Section 3.11. FORM S-3. The Seller is eligible to use Form S-3 for the registration of its securities under the Securities Act which are offered in transactions by or for the account of selling security holders.

Section 3.12. NASDAQ COMPLIANCE. The Common Stock is registered as a class pursuant to Section 12(g) of the Exchange Act, is listed on the Nasdaq SmallCap Market of the Nasdaq Stock Market, Inc. ("Nasdaq") and the Seller has taken no action to terminate the registration of the Common Stock under the Exchange Act or delist the Common Stock from Nasdaq. The Seller is not in violation of the listing requirements of Nasdaq, does not reasonably anticipate that the Common Stock will be delisted by Nasdaq for the foreseeable future, and has not received any notice regarding the possible delisting of the Common Stock from Nasdaq. The Seller has noticed the listing of the Conversion Shares and Warrant Shares on Nasdaq (subject to official notice of issuance).

Section 3.13. TRANSACTIONS WITH AFFILIATES. Except as set forth in the SEC Documents, none of the officers, directors, or employees of the Seller or any of its Subsidiaries is presently a party to any transaction with the Seller or any of its Subsidiaries (other than for ordinary course services solely in their capacity as officers, directors or employees), including any contract, agreement or other arrangement providing for the furnishing of services to or by, providing for rental of real or personal property to or from, or otherwise requiring payments to or from any such officer, director or employee or any corporation, partnership, trust or other entity in which any such officer, director, or employee has an ownership interest of five percent or more or is an officer, director, trustee or partner.

Section 3.14. INTELLECTUAL PROPERTY. Each of the Seller and its Subsidiaries owns or is duly licensed (and, in such event, has the right to grant sublicenses) to use all patents, patent applications, trademarks, trademark applications, trade names, service marks, copyrights, copyright applications, licenses, permits, inventions, discoveries, processes, scientific, technical, engineering and marketing data, object and source codes, know-how (including trade secrets and other unpatented and/or unpatentable proprietary or confidential information, systems or procedures) and other similar rights and proprietary knowledge (collectively, "Intangibles") necessary for the conduct of its business as now being conducted and as presently contemplated to be conducted in the future. The SEC Documents accurately set forth all Intangibles owned and/or used by the Seller in its business. To the knowledge of the Seller and its Subsidiaries, neither the Seller nor any Subsidiary infringes or is in conflict with any right of any other person with respect to any third party Intangibles. Neither the Seller nor any of its Subsidiaries has received written notice of any pending conflict with or infringement upon such third party Intangibles. Neither the Seller nor any of its Subsidiaries has entered into any consent agreement, indemnification agreement, forbearance to sue or settlement agreement with respect to the validity of the Seller's or its Subsidiaries' ownership of or right to use its

Intangibles and there is no reasonable basis for any such claim to be successful. The Intangibles are valid and enforceable and no registration relating thereto has lapsed, expired or been abandoned or canceled or is the subject of cancellation or other adversarial proceedings, and all applications therefor are pending and in good standing. The Seller and its Subsidiaries have complied, in all material respects, with their respective contractual obligations relating to the protection of the Intangibles used pursuant to licenses. To the knowledge of the Seller and its Subsidiaries, no person is infringing on or violating the Intangibles owned or used by the Seller or its Subsidiaries.

Section 3.15. TITLE. The Seller and its Subsidiaries have good and marketable title in fee simple to all real property and good and merchantable title to all personal property owned by them that is material to the business of the Seller and its Subsidiaries, in each case free and clear of all liens, encumbrances and defects except such as do not materially affect the value of such property and do not materially interfere with the use made and proposed to be made of such property by the Seller and its Subsidiaries. Any real property and facilities held under lease by the Seller and its Subsidiaries are held by them under valid, subsisting and enforceable leases with such exceptions as are not material and do not materially interfere with the use made and proposed to be made of such property and buildings by the Seller and its Subsidiaries.

Section 3.16. TAX STATUS. Except as set forth in the SEC Documents, the Seller and each of its Subsidiaries has made or filed all foreign, U.S. federal, state, provincial and local income and all other tax returns, reports and declarations required by any jurisdiction to which it is subject (unless and only to the extent that the Seller and each of its Subsidiaries has set aside on its books provisions reasonably adequate for the payment of all unpaid and unreported taxes) and has paid all taxes and other governmental assessments and charges that are material in amount, shown or determined to be due on such returns, reports and declarations, except those being contested in good faith and has set aside on its books provisions reasonably adequate for the payment of all taxes for periods subsequent to the periods to which such returns, reports or declarations apply. There are no unpaid taxes in any material amount claimed to be due by the taxing authority of any jurisdiction, and the officers of the Seller know of no basis for any such claim. The Seller has not executed a waiver with respect to any statute of limitations relating to the assessment or collection of any foreign, federal, state, provincial or local tax. None of the Seller's tax returns is presently being audited by any taxing authority.

Section 3.17. INSURANCE. The Seller and each of its Subsidiaries has in force fire, casualty, product liability and other insurance policies, with extended coverage, sufficient in amount to allow it to replace any of its material properties or assets which might be damaged or destroyed or sufficient to cover liabilities to which the Seller may reasonably become subject, and such types and amounts of other insurance with respect to its business and properties, on both a per occurrence and an aggregate basis, as are customarily carried by persons engaged in the same or similar business as the Seller. No default or event has occurred that could give rise to a default under any such policy.

Section 3.18. SOLVENCY. Based on the financial condition of the Seller as of the Closing Date and taking into consideration the net proceeds from the sale of the Preferred Stock and Warrants, (i) the Seller's fair saleable value of its assets exceeds the amount that will be required to be paid on or in respect of the Seller's existing debts and other liabilities

(including known contingent liabilities) as they mature; (ii) the Seller's assets do not constitute unreasonably small capital to carry on its business for the current fiscal year as now conducted and as proposed to be conducted including its capital needs taking into account the particular capital requirements of the business conducted by the Seller, and projected capital requirements and capital availability thereof; and (iii) the current cash flow of the Seller, together with the proceeds the Seller would receive, were it to liquidate all of its assets, after taking into account all anticipated uses of the cash, would be sufficient to pay all amounts on or in respect of its debt when such amounts are required to be paid. The Seller does not intend to incur debts beyond its ability to pay such debts as they mature (taking into account the timing and amounts of cash to be payable on or in respect of its debt).

Section 3.19. ACKNOWLEDGMENT REGARDING EACH PURCHASER'S PURCHASE OF THE SECURITIES. The Seller acknowledges and agrees that each Purchaser is acting solely in the capacity of arm's length purchaser with respect to this Agreement and the Related Documents and the transactions contemplated hereby and thereby, and that no Purchaser is (i) an officer or director of the Seller, (ii) an "affiliate" of the Seller (as defined in Rule 144 under the Securities Act (including any successor rule, "Rule 144")) or (iii) to the knowledge of the Seller a "beneficial owner" of more than 5% of the Common Stock (as defined for purposes of Rule 13d-3 of the Exchange Act). The Seller further acknowledges that no Purchaser is acting as a financial advisor or fiduciary of the Seller (or in any similar capacity) with respect to this Agreement or the Related Documents and the Transactions, and any advice given by a Purchaser or any of its representatives or agents in connection with this Agreement or the Related Documents and the Transactions is merely incidental to such Purchaser's purchase of the Securities. The Seller further represents to each Purchaser that the Seller's decision to enter into this Agreement and the Related Documents has been based solely on the independent evaluation by the Seller and its representatives.

Section 3.20. NO GENERAL SOLICITATION OR INTEGRATED OFFERING. Neither the Seller nor any distributor participating on the Seller's behalf in the Transactions (if any) nor any person acting for the Seller, or any such distributor, has conducted any "general solicitation" (as described in Regulation D) with respect to any of the Securities being offered hereby. Neither the Seller nor any of its affiliates, nor any person acting on its or their behalf, has directly or indirectly made any offers or sales of any security or solicited any offers to buy any security under circumstances that would require registration of the Securities being offered hereby under the Securities Act or cause this offering of Securities to be integrated with any prior offering of securities of the Seller for purposes of the Securities Act, which result of such integration would require registration under the Securities Act, or any applicable stockholder approval provisions.

Section 3.21. NO BROKERS. Other than as set forth on the Broker Fee List, the Seller has taken no action that would give rise to any claim by any person for brokerage commissions, finder's fees or similar payments by any Purchaser relating to this Agreement or the Transactions.

Section 3.22. ACKNOWLEDGMENT REGARDING SECURITIES. The number of Conversion Shares issuable upon conversion of the Preferred Stock and the number of Warrant Shares issuable upon exercise of the Warrants may increase in certain circumstances.

The Seller's directors and executive officers have studied and fully understand the nature of the Securities being sold hereunder. The Seller acknowledges that, subject to the Beneficial Ownership Cap and Nasdaq Cap, its obligation to issue Conversion Shares upon conversion of the Preferred Stock in accordance with the terms thereof and the Warrant Shares upon the exercise of the Warrants in accordance with the terms thereof is absolute and unconditional, regardless of the dilution that such issuance may have on the ownership interests of other stockholders and the availability of remedies provided for in this Agreement or any of the Related Documents relating to a failure or refusal to issue Conversion Shares or Warrant Shares. Taking the foregoing into account, the Board of Directors has determined in its good faith business judgment that the issuance of the Securities hereunder and the consummation of the Transactions are in the best interests of the Seller and its stockholders.

3.22.1. DISCLOSURE. All information relating to or concerning the Seller and/or any of its Subsidiaries set forth in this Agreement or provided to the Purchasers pursuant to Section 4.4 hereof or otherwise in connection with the Transactions is true and correct in all material respects and the Seller has not omitted to state any material fact necessary in order to make the statements made herein or therein, in light of the circumstances under which they were made, not misleading. No event or circumstance has occurred or exists with respect to the Seller or its Subsidiaries or their respective businesses, properties, prospects, operations or financial conditions, which has not been publicly disclosed but, under applicable law, rule or regulation, would be required to be disclosed by the Seller in a registration statement filed on the date hereof by the Seller under the Securities Act with respect to a primary issuance of the Seller's securities.

ARTICLE 4 REPRESENTATIONS AND WARRANTIES OF THE PURCHASERS

Each Purchaser, for itself, hereby severally, and not jointly, represents and warrants to the Seller as follows:

Section 4.1. EXISTENCE AND POWER. If not a natural person, the Purchaser is duly organized, validly existing and in good standing under the laws of the jurisdiction of such Purchaser's organization. The Purchaser has all powers required to carry on such Purchaser's business as now conducted.

Section 4.2. AUTHORIZATION. The execution, delivery and performance by the Purchaser of this Agreement, the Related Documents to which such Purchaser is a party, and the consummation by the Purchaser of the Transactions have been duly authorized, and no additional action is required for the approval of this Agreement. This Agreement and the Related Documents to which the Purchaser is a party have been or, to the extent contemplated hereby, will be duly executed and delivered and constitute valid and binding agreements of the Purchaser, enforceable against such Purchaser in accordance with their terms, except as may be limited by bankruptcy, reorganization, insolvency, moratorium and similar laws of general application relating to or affecting the enforcement of rights of creditors and except that enforceability of their obligations thereunder are subject to general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

Section 4.3. PURCHASE FOR OWN ACCOUNT, ETC. Purchaser is purchasing the Securities for such Purchaser's own account for investment purposes only and not with a present view towards the public sale or distribution thereof, except pursuant to sales that are exempt from the registration requirements of the Securities Act and/or sales registered under the Securities Act. Such Purchaser understands that such Purchaser must bear the economic risk of this investment indefinitely, unless the Securities are registered pursuant to the Securities Act and any applicable state securities or blue sky laws or an exemption from such registration is available, and that the Seller has no present intention of registering the resale of any such Securities other than as contemplated by Article 6 hereof. Notwithstanding anything in this Section 4.3 to the contrary, by making the representations herein, such Purchaser does not agree to hold the Securities for any minimum or other specific term and reserves the right to dispose of the Securities at any time in accordance with or pursuant to a registration statement or an exemption from the registration requirements under the Securities Act.

Section 4.4. ACCREDITED INVESTOR STATUS; SELLING STOCKHOLDER QUESTIONNAIRE. Purchaser is an "Accredited Investor" as that term is defined in Rule 501(a) of Regulation D. Purchaser has completed or caused to be completed the Selling Stockholder Questionnaire attached hereto as Exhibit D for use in preparation of the Registration Statement, and the responses provided therein shall be true and correct as of the Closing Date and will be true and correct as of the effective date of the Registration Statement. Purchaser has, in connection with its decision to purchase the Securities, relied solely upon the SEC Documents and the representations and warranties of the Seller contained herein.

Section 4.5. BUSINESS OR FINANCIAL EXPERTISE; QUALIFIED INSTITUTIONAL BUYER. Purchaser has, by reason of Purchaser's business or financial expertise or the business or financial experience of its professional advisors who are unaffiliated with and who are not, to such Purchaser's knowledge, compensated by the Seller or any affiliate or selling agent of the Seller, directly or indirectly, the capacity to protect its own interests in connection with its acquisition of the Securities. If the Purchaser is identified on Schedule 1 as being a "qualified institutional buyer," such Purchaser is a "qualified institutional buyer" as defined in Rule 144A promulgated under the Securities Act. The Purchaser acknowledges that it has been afforded: (a) the opportunity to ask such questions as it has deemed necessary of, and to receive answers from, representatives of the Seller concerning the terms and conditions of the offering of the Securities and the merits and risks of investing in the Securities; (b) access to information about the Seller and its Subsidiaries and their respective financial condition sufficient to enable it to evaluate its investment; and (c) the opportunity to obtain such additional information that the Seller possesses or can acquire without unreasonable effort or expense that is necessary to make an informed investment decision with respect to the Securities.

Section 4.6. NONCONTRAVENTION. Neither the execution and the delivery of this Agreement, nor the consummation of the transactions contemplated hereby, will violate any constitution, statute, regulation, rule, injunction, judgment, order, decree, ruling, charge, or other restriction of any government, governmental agency, or court to which Purchaser is subject or any provision of its organizational documents or other similar governing instruments.

Section 4.7. NO LEGAL, TAX OR INVESTMENT ADVICE. Purchaser understands that nothing in this Agreement or any other materials presented to Purchaser in

connection with the purchase and sale of the Securities constitutes legal, tax or investment advice. Purchaser has consulted such legal, tax and investment advisors as it, in its sole discretion, has deemed necessary or appropriate in connection with its purchase of the Securities.

Section 4.8. GOVERNMENTAL REVIEW. Purchaser understands that no United States federal or state agency or any other government or governmental agency has passed upon or made any recommendation or endorsement of the Securities.

Section 4.9. FOREIGN INVESTORS. If Purchaser is not a United States person (as defined by Section 7701(a)(30) of the Internal Revenue Code of 1986, as amended), Purchaser hereby represents that it has satisfied itself as to the full observance of the laws of its jurisdiction in connection with any invitation to subscribe for the Preferred Stock and the Warrants or any use of this Agreement, including (a) the legal requirements within its jurisdiction for the purchase of the Preferred Stock and the Warrants, (b) any foreign exchange restrictions applicable to such purchase, (c) any government or other consents that may need to be obtained, and (d) the income tax and other tax consequences, if any, that may be relevant to the purchase, holding, redemption, sale or transfer of the Securities. Purchaser's subscription and payment for and continued beneficial ownership of the Securities will not violate any applicable securities or other laws of Purchaser's jurisdiction.

Section 4.10. NO BROKERS. The Purchaser has taken no action that would give rise to any claim by any person for brokerage commissions, finder's fees or similar payments by the Seller relating to this Agreement or the transactions contemplated hereby.

Section 4.11. LITIGATION. There is no action, suit, proceeding, judgment, claim or investigation pending or, to the knowledge of the Purchaser, threatened against the Purchaser which could reasonably be expected in any manner to challenge or seek to prevent, enjoin, alter or materially delay any of the Transactions.

Section 4.12. GOVERNMENTAL AUTHORIZATION. The execution, delivery and performance by the Purchaser of this Agreement and the Related Documents to which it is a party, and the consummation of the Transactions, require no material action by or in respect of, or material filing with, any governmental body, agency, official or authority, by the Purchaser other than (a) any filings, authorizations, consents and approvals as may be required under the Hart-Scott-Rodino Improvements Act of 1976, as amended; (b) the filing by the Purchaser with the SEC of such reports under the Exchange Act as may be required in connection with this Agreement and Related Documents and the Transactions to be effected at or prior to the Closing, and filings required to be made pursuant to Nasdaq rules; and (c) any filings required by the securities or blue sky laws of the various states and filings under the Securities Act and/or the Exchange Act.

ARTICLE 5 COVENANTS OF THE SELLER AND PURCHASERS

Section 5.1. INSURANCE. The Seller shall maintain insurance coverage which is adequate and customary coverage for the business in which the Seller shall then be engaged in.

Section 5.2. REPORTING OBLIGATIONS. So long as any Purchaser (or any of its respective Affiliates) beneficially owns any Preferred Stock, the Seller shall continue to timely file and furnish to the SEC all reports and other filings that Seller does or is required to so file or furnish pursuant to the Exchange Act or the Securities Act, and the Seller shall use its best efforts to maintain its status as an issuer required to file such reports under the Exchange Act. . In addition, the Seller shall take all actions necessary to meet the "registrant eligibility" requirements set forth in the general instructions to Form S-3 or any successor form thereto, to continue to be eligible to register the resale of the Shares under the Securities Act on such Form. Notwithstanding the foregoing, the Seller shall be allowed to pursue other forms of organization it deems appropriate and if such new form of organization is implemented, such action shall be deemed a Merger, Consolidation or Disposition of Assets as set forth in the Certificate of Designation of the Preferred Stock attached hereto as Exhibit A and the Purchasers shall be allowed to exercise their rights as therein defined.

Section 5.3. DISPOSITIONS. Purchaser will not, prior to the effectiveness of the Registration Statement, if then prohibited by law or regulation, sell, offer to sell, solicit offers to buy, dispose of, loan, pledge or grant any right with respect to the Shares. In addition, the Purchaser agrees that for so long as it owns any Securities, it will not enter into any Short Sales. For such purposes, a "Short Sale" by the Purchaser means a short sale of Shares executed at a time when the Purchaser has no equivalent offsetting long position in the Common Stock. For purposes of determining whether the Purchaser has an equivalent offsetting long position in the Common Stock, except as set forth in Section 5.17, shares that the Purchaser is entitled to receive within sixty (60) days (whether pursuant to contract or upon conversion or exercise of convertible securities) will be included as if held long by the Purchaser.

Section 5.4. INVESTIGATION. The representations, warranties, covenants and agreements set forth in this Agreement shall not be affected or diminished in any way by any investigation (or failure to investigate) at any time by or on behalf of the party for whose benefit such representations, warranties, covenants and agreements were made. Without limiting the generality of the foregoing, the inability or failure of the Purchasers to discover any breach, default or misrepresentation by the Seller under this Agreement or the Related Documents (including under any certificate furnished pursuant to this Agreement) shall not in any way diminish any liability hereunder.

Section 5.5. PUBLIC ANNOUNCEMENTS. Neither the Purchasers nor the Seller shall (and each such party shall use its reasonable efforts to cause its Subsidiaries, Affiliates, directors, officers, employees and authorized representatives not to), issue any press release, make any public announcement or furnish any written statement to its employees or stockholders generally concerning the Transactions without the consent of the other party (which consent shall not be unreasonably withheld), except to the extent required by applicable law or the applicable requirements of applicable stock exchange rules (including Nasdaq) or as otherwise contemplated herein (and in either such case such party shall, to the extent consistent with timely compliance with such requirement, consult with the other party prior to making the required release, announcement or statement). Notwithstanding the foregoing, the Seller shall, promptly after the Closing, and, if not simultaneous with the Closing, promptly after the execution of this Agreement, issue a press release disclosing the Transactions, provided,

however, the Seller shall provide each of the Purchasers with the text of such press release prior to such issuance.

Section 5.6. USE OF PROCEEDS. The Seller covenants and agrees that the proceeds of the Purchase Price shall be used by the Seller for working capital and general corporate purposes. Furthermore, The Seller agrees that a portion of the net proceeds shall be used to repay in full all of its existing indebtedness to Dexia Bank, including, but not limited to, its term loan in the principal amount of \$3,400,000.

Section 5.7. CORPORATE EXISTENCE. So long as a Purchaser owns Preferred Stock, the Seller shall preserve and maintain and cause its Subsidiaries to preserve and maintain their corporate existence and good standing in the jurisdiction of their incorporation and the rights, privileges and franchises of the Seller and its Subsidiary in each case where failure to so preserve or maintain could have a Material Adverse Effect.

Section 5.8. PERFORM COVENANTS. The Seller shall (a) make full and timely payment of any and all payments on the Preferred Stock, and all other indebtedness of the Seller to the Purchasers in connection therewith, whether now existing or hereafter arising, and (b) duly comply with all the terms and covenants contained herein and in each of the instruments and documents given to the Purchasers in connection with or pursuant to this Agreement, all at the times and places and in the manner set forth herein or therein.

Section 5.9. LISTING OF SHARES. The Seller shall use its commercially reasonable best efforts to list the Shares on Nasdaq. The Seller shall use its best efforts to continue the listing and trading of its Common Stock on Nasdaq and shall comply in all respects with the reporting, filing and other obligations under the bylaws or rules of the Nasdaq Stock Market, Inc. Subject to Section 5.11, the Seller shall promptly provide to each Purchaser copies of any notices it receives regarding the continued eligibility of the Common Stock for trading on Nasdaq.

Section 5.10. RESERVATION OF SHARES. The Seller shall hereafter take all action necessary to at all times have authorized, and reserved for the purpose of issuance, no less than 110% of the number of shares of Common Stock needed to provide for the issuance of the shares of Common Stock upon conversion of all outstanding Preferred Stock and exercise of all outstanding Warrants (without regard to any limitations on conversions or exercise).

Section 5.11. FILING OF FORM D. The Seller will timely file a Form D in accordance with the provisions of Regulation D promulgated by the SEC under the Securities Act. The Seller shall, on or before the Closing Date, take such action as the Seller shall reasonably determine is necessary to qualify the Securities for sale to each Purchaser pursuant to this Agreement under applicable securities or "blue sky" laws of the states of the United States or obtain exemption therefrom, and shall provide evidence of any such action so taken to each Purchaser on or prior to the Closing Date. Within two days after the Closing Date, the Seller shall file a Form 8-K with the SEC concerning this Agreement and the Transactions, which Form 8-K shall attach this Agreement and its Exhibits as exhibits to such Form 8-K (the "8-K Filing"). Upon the submission of the 8-K Filing, the Seller hereby acknowledges that no Purchaser shall be in possession of any material nonpublic information received from the Seller, any of its

Subsidiaries or any of its respective officers, directors, employees or agents, that is not disclosed in the 8-K Filing. The Seller shall not, and shall cause each of its Subsidiaries and its and each of their respective officers, directors, employees and agents not to, provide any Purchaser with any material nonpublic information regarding the Seller or any of its Subsidiaries from and after the 8-K Filing without the express written consent of such Purchaser. Subject to the foregoing, neither the Seller nor any Purchaser shall issue any press releases or any other public statements with respect to the Transactions, provided, however, that the Seller shall be entitled, without the prior approval of any Purchaser, to make any press release or other public disclosure with respect to the Transactions (i) in substantial conformity with the 8-K Filing and contemporaneously therewith and (ii) as is required by applicable law and regulations (provided that in the case of clause (i) each Purchaser shall be consulted by the Seller in connection with any such press release or other public disclosure prior to its release).

Section 5.12. NO SOLICITATION OF TRANSACTION. Prior to the earlier of (i) the Closing, or (ii) the termination of this Agreement pursuant to Section 10, the Seller shall not, and shall use its commercially reasonable best efforts to cause its representatives not to, directly or indirectly, take any of the following actions with any person other than the Purchasers without the prior written consent of all the Purchasers: (A) solicit, initiate, facilitate or encourage, or furnish information with respect to the Seller, in connection with, any inquiry, proposal or offer with respect to any equity transaction involving the Seller (an "Alternative Transaction") (other than the information which the Seller provides to other persons in the ordinary course of its business consistent with past custom and practice, so long as the Seller and its stockholders have no reason to believe that the information may be utilized to evaluate an Alternative Transaction); (B) negotiate, discuss explore or otherwise communicate or cooperate in any way with any third party with respect to any Alternative Transaction; or (C) enter into any agreement, arrangement or understanding with respect to an Alternative Transaction or requiring the Seller to abandon, terminate or refrain from consummating a transaction with the Purchasers. The Seller shall, and shall use its commercially reasonable best efforts to cause its representatives to, notify the Purchasers orally and in writing promptly upon receipt of any inquiry, offer or proposal with respect to an Alternative Transaction, including the identity of the party making such inquiry, offer or proposal and stating the terms thereof. The Seller shall immediately cease any existing discussions or negotiations with any third party relating to any proposed Alternative Transaction; provided, however, that the foregoing restrictions with respect to Alternative Transactions shall have no effect if the Board of Directors reasonably concludes in good faith, after consultation with its outside legal counsel, that, in light of such Alternative Transaction, the failure to take any such action would reasonably be expected to be a violation of the fiduciary obligations of the Board of Directors to the Seller's stockholders.

Section 5.13. CONDUCT OF THE SELLER. The Seller covenants and agrees that until the earlier of the time of Closing or the termination of the Agreement pursuant to Section 10, the Seller shall conduct its business only in the ordinary course consistent with past practice and shall use its commercially reasonable best efforts to preserve intact its business organizations and relationships with third parties. The Seller shall conduct its business and the business of its Subsidiaries in compliance with all laws, ordinances or regulations of governmental entities applicable to such business, except where the failure to do so would not have a Material Adverse Effect.

Section 5.14. BENEFICIAL OWNERSHIP CAP. In no event shall the Seller issue Common Stock to any holder of Preferred Stock as payment of any Dividend, and in no event shall a holder of shares of Preferred Stock have the right to convert shares of Preferred Stock into shares of Common Stock or to dispose of any shares of Preferred Stock to the extent that such payment of Dividends or right to effect such conversion or disposition would result in the holder and its Affiliates together beneficially owning more than 4.95% of the outstanding shares of Common Stock. For purposes of this Section 5.14, beneficial ownership shall be determined in accordance with Section 13(d) of the Securities Exchange Act of 1934, as amended, and Regulation 13D-G thereunder. The restriction contained in this Section 5.14 may not be altered, amended, deleted or changed in any manner whatsoever unless the holders of a majority of the outstanding shares of Common Stock and the holders of a majority of the Preferred Stock shall approve, in writing, such alteration, amendment, deletion or change. In the event the Seller is prohibited from issuing Common Stock to any holder of Preferred Stock as payment of any Dividend, it shall pay such Dividend to such holder in cash.

Section 5.15. REDEMPTIONS AND DIVIDENDS. So long as any Purchasers (or any of their respective Affiliates) beneficially own any of the Preferred Stock, the Seller shall not, without first obtaining the written approval of the holders of a majority of the shares of Preferred Stock then outstanding (which approval may be given or withheld by such holders in their sole and absolute discretion), repurchase, redeem or declare or pay any cash dividend or distribution on any shares of capital stock of the Seller.

Section 5.16. SHAREHOLDERS RIGHTS PLAN. No claim shall be made or enforced by the Seller or any other person that any Purchaser is an "Acquiring Person" under any shareholders rights plan or similar plan or arrangement in effect or hereafter adopted by the Seller, or that any Purchaser could be deemed to trigger the provisions of any such plan or arrangement, by virtue of receiving Securities under this Agreement or any Related Documents or under any other agreement between the Seller and the Purchasers.

Section 5.17. PLEDGE OF SECURITIES. The Seller acknowledges and agrees that the Securities may be pledged by any Purchaser in connection with a bona fide margin agreement or other loan or financing arrangement that is secured by the Securities. The pledge of Securities shall not be deemed to be a transfer, sale or assignment of the Securities hereunder, and no Purchaser effecting a pledge of Securities shall be required to provide the Seller with any notice thereof or otherwise make any delivery to the Seller pursuant to this Agreement or any Related Document. The Seller shall execute and deliver such documentation as a pledgee of the Securities may reasonably request in connection with a pledge of the Securities to such pledgee by a Purchaser. The foregoing notwithstanding, for purposes of Section 5.3 above, any Securities so pledged shall not be considered part of any Purchaser's equivalent long position in the Common Stock.

Section 5.18. EXPENSES. At the Closing, the Seller shall pay to each Purchaser reimbursement for the out-of-pocket expenses reasonably incurred by such Purchaser, its Affiliates and its or their advisors in connection with the negotiation, preparation, execution and delivery of this Agreement and the Related Documents and the consummation of the Transactions, including, without limitation, each Purchaser's and their respective Affiliates' and advisors' reasonable due diligence and attorneys' fees and expenses (the "Expenses"); provided,

however, that each Purchaser shall provide a detailed list of its Expenses prior to Closing to be reviewed and approved by Seller and may, in such Purchasers' discretion with advance notice to Seller, deduct such Expenses from the Purchase Price payable by such Purchaser hereunder.

Section 5.19. PROHIBITED TRANSFERS. Notwithstanding anything to the contrary herein, the Holder shall at all times be prohibited from transferring any Convertible Preferred Stock, Warrants, Conversion Shares, Warrant Shares or Dividend Shares to any Person who, at the time of such determination, is currently engaging, or is reasonably likely to engage, in the same or a substantially similar business as that of the Company.

Section 5.20. REGISTRATION DAMAGES. If the Registration Statement (as hereinafter defined) has not been declared effective by the SEC on or before the 120th day from the Closing Date, the Seller shall pay to the Purchasers, as liquidated damages, on the 121st day an amount, in cash, equal to one percent (1%) of the Purchase Price paid by each Purchaser, and shall pay each Purchaser an additional amount, in cash, equal to one-half of one percent (0.5%) in arrears of such Purchase Price for each month that the Registration Statement has not been so declared effective.

ARTICLE 6 REGISTRATION OF SHARES

Section 6.1. CERTAIN DEFINITIONS. For the purposes of this Article 6, the term "Registrable Securities" means (a) the Conversion Shares, (b) the Warrant Shares, and (c) any shares of capital stock issued or issuable, from time to time, as a distribution on or in exchange for or otherwise with respect to any of the foregoing or the Preferred Stock and Warrants, whether as dividends, default payments, on account of anti-dilution or other adjustments or otherwise.

Section 6.2. REGISTRATION OF SHARES. The Seller shall prepare promptly and file with the SEC as soon as practicable, but in no event later than sixty (60) days after the Closing Date, a Registration Statement on Form S-3 (or, if Form S-3 is not then available, on such form of Registration Statement as is then available to effect a registration of all of the Registrable Securities, subject to the consent of the Purchasers, the "Registration Statement") with the SEC for the resale of the Registrable Securities. The Registration Statement filed hereunder, to the extent allowable under the Securities Act and the rules and regulations promulgated thereunder (including Rule 416), shall state that the Registration Statement also covers such indeterminate number of additional shares of Common Stock as may become issuable upon conversion of the Preferred Stock and exercise of the Warrants to prevent dilution resulting from stock splits, stock dividends or similar transactions. The Registration Statement (and each amendment or supplement thereto, and each request for acceleration of effectiveness thereof) shall be provided to (and subject to the approval of) SDS Merchant Fund, LP ("SDS") and its counsel prior to its filing or other submission. If the Registration Statement has not been filed with the SEC within ninety (90) days after the Closing Date the Seller shall be liable to the Purchasers for liquidated damages in an amount equal to two percent (2%) per month (prorated on a daily basis) of the Purchase Price from the 90th day after the Closing Date until the earlier to

occur of the filing of the Registration Statement or the redemption of 100% of the Preferred Stock. Such liquidated damages shall be paid in cash upon demand pro rata according to each Purchaser's respective interests.

Section 6.3. The Seller shall use its best efforts to cause the Registration Statement to become effective as soon as practicable. At the time of effectiveness, the Seller shall ensure that such Registration Statement covers at least 110% of the Registrable Securities issuable upon full conversion of the Preferred Stock (without giving effect to any limitations on conversion contained in the Certificate of Designation) and exercise of the Warrants (without giving effect to any limitations on exercise contained in the Warrants), including, if necessary, by filing an amendment prior to the effective date of the Registration Statement to increase the number of Registrable Securities covered thereby.

Section 6.4. In connection with the registration of the Registrable Securities, the Seller shall have the following obligations:

6.4.1. The Seller shall respond promptly to any and all comments made by the staff of the SEC to the Registration Statement, and shall submit to the SEC, before the close of business on the third business day immediately following the business day on which the Seller learns (either by telephone or in writing) that no review of such Registration Statement will be made by the SEC staff or that the staff of the SEC has no further comments on such Registration Statement, as the case may be, a request for acceleration of the effective time of such Registration Statement to a time and date as soon as practicable. The Seller shall keep such Registration Statement effective pursuant to Rule 415 at all times until such date as is the earlier of (i) the date on which all of the Registrable Securities have been sold and (ii) the date on which all of the Registrable Securities may be immediately sold to the public without registration or restriction pursuant to Rule 144(k) under the Securities Act or any successor provision (the "Registration Period"), which Registration Statement (including any amendments or supplements thereto and prospectuses contained therein and all documents incorporated by reference therein) (A) shall comply in all material respects with the requirements of the Securities Act and the rules and regulations of the SEC promulgated thereunder and (B) shall not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein, or necessary to make the statements therein not misleading. The financial statements of the Seller included in any such Registration Statement or incorporated by reference therein (x) shall comply as to form in all material respects with the applicable accounting requirements and the published rules and regulations of the SEC applicable with respect thereto, (y) shall be prepared in accordance with U.S. generally accepted accounting principles, consistently applied during the periods involved (except as may be otherwise indicated in such financial statements or the notes thereto or, in the case of unaudited interim statements, to the extent they may not include footnotes or may be condensed on summary statements) and (z) fairly present in all material respects the consolidated financial position of the Seller and its consolidated subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to immaterial year-end adjustments).

6.4.2. The Seller shall (i) prepare and file with the SEC such amendments (including post-effective amendments) and supplements to the Registration Statement and the prospectus which forms a part thereof as may be necessary to keep such Registration Statement

effective at all times during the Registration Period, and (ii) during the Registration Period, comply with the provisions of the Securities Act with respect to the disposition of all Registrable Securities covered by the Registration Statement during the Registration Period. In the event the number of shares available under the Registration Statement is, for any three (3) consecutive trading days (the last of such three (3) trading days being the "Registration Trigger Date"), insufficient to cover 110% of the Registrable Securities then issued or issuable upon conversion of the Preferred Stock (without giving effect to any limitations on conversion contained in the Certificate of Designation) and exercise of the Warrants (without giving effect to any limitations on exercise contained in the Warrants), the Seller shall provide each Purchaser written notice of such Registration Trigger Date within three business days thereafter and shall file a new Registration Statement (on the short form available therefor, if applicable), so as to cover 110% of the Registrable Securities issued or issuable upon conversion of the Preferred Stock (without giving effect to any limitations on conversion contained in the Certificate of Designation) or exercise of the Warrants (without giving effect to any limitations on exercise contained in the Warrants) as of the Registration Trigger Date, in each case, as soon as practicable, but in any event within 15 days after the Registration Trigger Date. The Seller shall cause such new Registration Statement(s) to become effective as soon as practicable following the filing thereof.

6.4.3. The Seller shall furnish to each Purchaser whose Registrable Securities are included in a Registration Statement and to counsel for SDS as the lead Purchaser (i) promptly after the same is prepared and publicly distributed, filed with the SEC or received by the Seller, as applicable, one copy of the Registration Statement and any amendment thereto, each preliminary prospectus and prospectus and each amendment or supplement thereto, and, in the case of the Registration Statement required to be filed pursuant to Section 6.2, each letter written by or on behalf of the Seller to the SEC or the staff of the SEC (including, without limitation, any request to accelerate the effective time of the Registration Statement or amendment thereto), and each item of correspondence from the SEC or the staff of the SEC, in each case relating to the Registration Statement (other than any portion thereof that contains information for which the Seller has sought confidential treatment), (ii) on the date of effectiveness of the Registration Statement or any amendment thereto, a notice stating that the Registration Statement or amendment has been declared effective, and (iii) such number of copies of a prospectus, including a preliminary prospectus, all amendments and supplements thereto and all such other documents as such Purchaser may reasonably request in order to facilitate the disposition of the Registrable Securities owned by such Purchaser.

6.4.4. As promptly as practicable after becoming aware of such event, the Seller shall (i) notify each Purchaser by telephone or facsimile of the happening of any event, as a result of which the prospectus included in any Registration Statement that includes Registrable Securities, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and (ii) promptly prepare a supplement or amendment to such Registration Statement to correct such untrue statement or omission, and deliver such number of copies of such supplement or amendment to each Purchaser as such Purchaser may reasonably request.

6.4.5. The Seller shall use its best efforts (i) to prevent the issuance of any stop order or other suspension of effectiveness of any Registration Statement that includes Registrable Securities, and, if such an order is issued, to obtain the withdrawal of such order at

the earliest practicable moment (including in each case by amending or supplementing such Registration Statement), and (ii) to notify each Purchaser who holds Registrable Securities being sold (or, in the event of an underwritten offering, the managing underwriters) of the issuance of such order and the resolution thereof (and if such Registration Statement is supplemented or amended, deliver such number of copies of such supplement or amendment to each Purchaser as such Purchaser may reasonably request).

6.4.6. The Seller shall provide a transfer agent and registrar, which may be a single entity, for the Registrable Securities not later than the effective date of the Registration Statement required to be filed pursuant to Section 6.2 hereof.

6.4.7. At the request of any Purchaser, the Seller shall prepare and file with the SEC such post-effective amendments to any Registration Statement required to be filed hereunder and the prospectus used in connection with such Registration Statement as may be necessary in order to change the plan of distribution set forth in such Registration Statement.

6.4.8. The Seller shall comply with all applicable laws related to a Registration Statement and offering and sale of securities and all applicable rules and regulations of governmental authorities in connection therewith (including, without limitation, the Securities Act and the Exchange Act and the rules and regulations thereunder promulgated by the SEC.)

ARTICLE 7 SECURITIES TRANSFER MATTERS

Section 7.1. CONVERSION AND EXERCISE. Upon conversion of the Preferred Stock or exercise of the Warrants by any person, (i) if the DTC Transfer Conditions (as defined below) are satisfied, the Seller shall cause its transfer agent to electronically transmit all Conversion Shares and Warrant Shares by crediting the account of such person or its nominee with the Depository Trust Company ("DTC") through its Deposit Withdrawal Agent Commission system; or (ii) if the DTC Transfer Conditions are not satisfied, the Seller shall issue and deliver, or instruct its transfer agent to issue and deliver, certificates (subject to the legend and other applicable provisions hereof and the Certificate of Designation and Warrants), registered in the name of such person or its nominee, physical certificates representing the Conversion Shares and Warrant Shares, as applicable. Even if the DTC Transfer Conditions are satisfied, any person effecting a conversion of Preferred Stock or exercising Warrants may instruct the Seller to deliver to such person or its nominee physical certificates representing the Conversion Shares and Warrant Shares, as applicable, in lieu of delivering such shares by way of DTC Transfer. For purposes of this Agreement, "DTC Transfer Conditions" means that the Seller's transfer agent is participating in the DTC Fast Automated Securities Transfer program.

Section 7.2. TRANSFER OR RESALE. Each Purchaser understands that (i) except as provided in Article 6 hereof, the sale or resale of the Securities have not been and are not being registered under the Securities Act or any state securities laws, and the Securities may not be transferred unless (A) the transfer is made pursuant to and as set forth in an effective registration statement under the Securities Act covering the Securities; or (B) such Purchaser shall have delivered to the Seller an opinion of counsel (which opinion shall be in form, substance and scope customary for opinions of counsel in comparable transactions) to the effect

that the Securities to be sold or transferred may be sold or transferred pursuant to an exemption from such registration; or (C) sold under and in compliance with Rule 144; or (D) sold or transferred to an Affiliate of such Purchaser that agrees to sell or otherwise transfer the Securities only in accordance with the provisions of this Section 7.2; and (ii) neither the Seller nor any other person is under any obligation to register such Securities under the Securities Act or any state securities laws (other than pursuant to the terms of Article 6 hereof).

Section 7.3. LEGENDS.

7.3.1. Each Purchaser understands that, until such time as the Registration Statement is declared effective by the SEC and the Shares are subsequently sold and transferred pursuant to the Registration Statement or the Securities may be sold pursuant to Rule 144(k) under the Securities Act, the Securities will bear a restrictive legend in substantially the following form set forth in Section 1.3.3.

7.3.2. The Seller shall, immediately prior to a registration statement covering the Shares (including, without limitation, the Registration Statement contemplated by Article 6 hereof) being declared effective, deliver to its transfer agent an opinion letter of counsel, opining that at any time such registration statement is effective, the certificates representing any Conversion Shares and Warrant Shares sold and transferred pursuant to such effective registration statement shall be issued without the restrictive legend above.

7.3.3. The legend set forth above shall be removed and the Seller shall issue a replacement certificate without such legend (i) upon the sale and transfer of the Shares pursuant to the Registration Statement, or (ii) to any Holder who so requests in writing and provides the Seller with an opinion of counsel, in customary form, substance and scope, to the effect that such legend may be removed in accordance with Rule 144(k) promulgated under the Securities Act.

Section 7.4. TRANSFER AGENT INSTRUCTION. Upon compliance by any Purchaser with the provisions of this Section 7 with respect to the transfer of any Securities, the Seller shall permit the transfer of such Securities and, in the case of the transfer of Conversion Shares or Warrant Shares, promptly instruct its transfer agent to issue one or more certificates (or effect a DTC Transfer) in such name and in such denominations as specified by such Purchaser. The Seller shall not give any instructions to its transfer agent with respect to the Securities, other than any permissible or required instructions provided in this Section 7, and the Securities shall otherwise be freely transferable on the books and records of the Seller as and to the extent provided in this Agreement.

ARTICLE 8 CONDITIONS TO THE CLOSING

Section 8.1. CONDITIONS TO OBLIGATIONS OF THE PURCHASERS. The obligations of the Purchasers are subject to the fulfillment or satisfaction, on and as of the Closing Date, except as otherwise expressly indicated below or in Section 2.3 hereof, of each of the following conditions (any one or more of which may be waived by any Purchaser, in its sole

discretion, but only with respect to its investments and only in a writing signed by such Purchaser):

8.1.1. PROOF OF FILING. At the Closing, the Seller shall deliver or cause to be delivered to each of the Purchasers proof of due filing with the Secretary of State of the State of Delaware of the Certificate of Designation authorizing the Preferred Stock.

8.1.2. SUPPORTING DOCUMENTS. The Purchasers shall have received the following:

(a) A certificate evidencing compliance with the conditions set forth in this Article 8, to the extent such conditions must be satisfied on or before the Closing Date, as may be reasonably requested by the Purchasers, executed by the chief executive officer and chief financial officer of the Seller.

(b) A certificate of good standing with respect to the Seller issued by the Secretary of State of Delaware; and copies of the resolutions of the Board of Directors approving this Agreement, the creation and issuance of the Preferred Stock, the filing of the Certificate of Designation and the transactions, contemplated herein and therein, certified by an appropriate officer.

(c) The Opinion.

(d) The Broker Fee List.

8.1.3. PREFERRED STOCK, WARRANTS. The Seller shall have executed and delivered certificates evidencing the Preferred Stock and the Warrants purchased hereby.

8.1.4. PERFORMANCE; REPRESENTATION AND WARRANTIES. COVENANTS; REPRESENTATIONS AND WARRANTIES. (i) The Seller shall have performed and observed in all material respects all of its obligations hereunder required to be performed by it at or prior to the Closing Date; (ii) the representations and warranties of the Seller contained in this Agreement and in any certificate delivered by the Seller pursuant hereto shall be true and correct in all material respects (except to the extent such representations and warranties contain a materiality qualification, in which case they shall be true and correct in all respects) at and as of the Closing Date as if made at and as of such time (except to the extent expressly made as of an earlier date, in which case as of such earlier date); and (iii) the Purchasers shall have received a certificate signed by the Seller's chief executive officer and the chief financial officer to the foregoing effect.

8.1.5. NO MATERIAL ADVERSE EFFECT. There shall not have been, nor shall there have occurred any event which could result in, a Material Adverse Effect of the Seller taken as a whole from and after the date of this Agreement and until the Closing Date.

8.1.6. NO LITIGATION. No litigation, arbitration or other legal or administrative proceeding against the Seller or its Subsidiaries shall have been commenced or be pending by or before any court, arbitration panel or governmental authority or official, and no

statute, rule or regulation of any foreign or domestic, national or local government or agency thereof shall have been enacted, and no judicial or administrative decision shall have been rendered which, in the case of any of the foregoing, enjoins or prohibits, or seeks to enjoin or prohibit, the consummation of all or any of the transactions contemplated by this Agreement.

Section 8.2. CONDITIONS TO OBLIGATIONS OF THE SELLER. The obligations of the Seller hereunder with respect to each Purchaser are subject to the fulfillment or satisfaction, on and as of the Closing Date, of the following condition (which may be waived by the Seller, in its sole discretion):

8.2.1. PERFORMANCE; REPRESENTATION AND WARRANTIES. Such Purchaser shall have performed and complied in all respects with all agreements and conditions contained in this Agreement which are required to be performed or complied with by such Purchaser prior to or at the Closing, the representation and warranties of such Purchaser contained herein shall be true and correct on and as of the Closing Date as though made on such date.

8.2.2. NO LITIGATION. No litigation, arbitration or other legal or administrative proceeding against the Purchasers shall have been commenced or be pending by or before any court, arbitration panel or governmental authority or official, and no statute, rule or regulation of any foreign or domestic, national or local government or agency thereof shall have been enacted after the date of this Agreement, and no judicial or administrative decision shall have been rendered which, in the case of any of the foregoing, enjoins or prohibits, or seeks to enjoin or prohibit, the consummation of all or any of the transactions contemplated by this Agreement.

8.2.3. ADDITIONAL DOCUMENT. Such other documents as the Purchasers may reasonably request in connection with the Closing.

ARTICLE 9 INDEMNIFICATION

Section 9.1. SURVIVAL OF REPRESENTATIONS. Except as otherwise provided herein, and for so long as the Preferred Stock is outstanding, the representations and warranties of the Seller and the Purchasers contained in or made pursuant to this Agreement shall survive the execution and delivery of this Agreement and the Closing Date and shall in no way be affected by any investigation of the subject matter thereof made by or on behalf of the Seller or the Purchasers.

Section 9.2. INDEMNIFICATION.

9.2.1. INDEMNIFICATION BY THE SELLER. In consideration of each Purchaser's execution and delivery of this Agreement and the Related Documents and the purchase of the Securities hereunder, and in addition to all of the Seller's other obligations under this Agreement and the Related Documents, from and after the Closing, the Seller shall defend, protect, indemnify and hold harmless each Purchaser and each other holder of the Securities and all of their stockholders, partners, members, officers, directors, employees and direct or indirect investors and any of the foregoing persons' agents or other representatives (including, without

limitation, those retained in connection with the Transactions, collectively, the "Indemnitees") from and against any and all actions, causes of action, suits, claims, losses, costs, penalties, fees, liabilities and damages, and expenses in connection therewith (irrespective of whether any such Indemnitee is a party to the action for which indemnification hereunder is sought), and including reasonable attorneys' fees and disbursements (the "Indemnified Liabilities"), incurred by any Indemnitee as a result of, or arising out of, or relating to

(a) any misrepresentation or breach of any representation or warranty made by the Seller in this Agreement, any Related Document or any other certificate, instrument or document contemplated hereby or thereby,

(b) any breach of any covenant, agreement or obligation of the Seller contained in this Agreement, any Related Document or any other certificate, instrument or document contemplated hereby or thereby,

(c) any cause of action, suit or claim brought or made against such Indemnitee by a third party (including for these purposes a derivative action brought on behalf of the Seller) and arising out of or resulting from (i) the execution, delivery, performance or enforcement of this Agreement, any Related Document or any other certificate, instrument or document contemplated hereby or thereby, (ii) any transaction financed or to be financed in whole or in part, directly or indirectly, with the proceeds of the issuance and sale of the Securities, or (iii) the status of such Purchaser or holder of the Securities as an investor in the Seller, or

(d) (i) except with respect to the Purchaser Information (as hereinafter defined), any untrue statement or alleged untrue statement of a material fact in the Registration Statement or the omission or alleged omission to state therein a material fact required to be stated or necessary to make the statements therein not misleading, (ii) except with respect to the Purchaser Information, any untrue statement or alleged untrue statement of a material fact contained in any preliminary prospectus if used prior to the effective date of such Registration Statement, or contained in the final prospectus (as amended or supplemented, if the Seller files any amendment thereof or supplement thereto with the SEC) or the omission or alleged omission to state therein any material fact necessary to make the statements made therein, in light of the circumstances under which the statements therein were made, not misleading, or (iii) any violation or alleged violation by the Seller of the Securities Act, the Exchange Act or any other law (including, without limitation, any state securities law), rule or regulation relating to the offer or sale of the Registrable Securities.

To the extent that the foregoing undertaking by the Seller may be unenforceable for any reason, the Seller shall make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities which is permissible under applicable law.

9.2.2. INDEMNIFICATION BY THE PURCHASERS. Each of the Purchasers (severally, but not jointly) agrees to indemnify and hold harmless the Seller, its Affiliates, and each of their Indemnitees, from and against any Indemnified Liabilities (net of any related insurance proceeds) which are caused by or arise out of (i) any breach or default in the performance by it of any covenant or agreement made by it in this Agreement or in any of the

Related Documents; (ii) any breach of warranty or representation made by it in this Agreement or in any of the Related Documents; provided, however, that a Purchaser's liability under this Section 9.2.2 shall not exceed the Purchase Price paid by such Purchaser hereunder.

9.2.3. INDEMNIFICATION REGARDING REGISTRATION STATEMENTS. In connection with any Registration Statement in which a Purchaser is participating, (i) each such Purchaser shall, severally and not jointly, indemnify, hold harmless and defend, to the same extent and in the same manner set forth in Section 9.2.1, the Seller, each of its directors, each of its officers who signs the Registration Statement, its employees and each person, if any, who controls the Seller within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, and any other stockholder selling securities pursuant to the Registration Statement or any of its directors or officers or any person who controls such stockholder within the meaning of the Securities Act or the Exchange Act (each, a "Seller Indemnified Person"), against any Indemnified Liabilities to which any of them may become subject insofar as such Indemnified Liabilities arise out of or are based upon any written information furnished to the Seller by any such Purchaser expressly for use in connection with such Registration Statement (the "Purchaser Information"); and (ii) subject to the restrictions set forth in Section 9.3, such Purchaser shall reimburse the Seller Indemnified Persons, promptly as such expenses are incurred and are due and payable, for any legal fees or other reasonable expenses incurred by them in connection with investigating or defending any such Claim; provided, however, that the indemnification obligations contained in this Section 9.2.3 shall not apply to amounts paid in settlement of any Indemnified Liabilities if such settlement is effected without the prior written consent of such Purchaser, which consent shall not be unreasonably withheld; and provided, further, that the Purchaser shall be liable under this Agreement (including this Section 9) for only that amount as does not exceed the net proceeds actually received by such Purchaser as a result of the sale of Registrable Securities pursuant to such Registration Statement. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of such Seller Indemnified Person. Notwithstanding anything to the contrary contained herein, the indemnification obligations contained in this Section 9.2.3 with respect to any preliminary prospectus shall not inure to the benefit of any Seller Indemnified Person if the untrue statement or omission of material fact contained in the preliminary prospectus was corrected on a timely basis in the prospectus, as then amended or supplemented.

Section 9.3. INDEMNITY PROCEDURE. A party or parties hereto agreeing to be responsible for or to indemnify against any matter pursuant to this Agreement is referred to herein as the "Indemnifying Party" and the other party or parties claiming indemnity is referred to as the "Indemnified Party".

9.3.1. An Indemnified Party under this Agreement shall, with respect to claims asserted against such party by any third party, give written notice to the Indemnifying Party of any liability which might give rise to a claim for indemnity under this Agreement within sixty (60) business days of the receipt of any written claim from any such third party, but not later than twenty (20) days prior to the date any answer or responsive pleading is due, and with respect to other matters for which the Indemnified Party may seek indemnification, give prompt written notice to the Indemnifying Party of any liability which might give rise to a claim for indemnity; provided, however, that any failure to give such notice will not waive any rights of

the Indemnified Party except to the extent the rights of the Indemnifying Party are materially prejudiced.

9.3.2. The Indemnifying Party shall have the right to conduct and control, through counsel of its choosing, the defense, compromise or settlement of any third person claim, action or suit against an Indemnified Party as to which indemnification will be sought by any Indemnified Party from any Indemnifying Party hereunder, and in any such case the Indemnified Party shall cooperate in connection therewith and shall furnish such records, information and testimony and attend such conferences, discovery proceedings, hearings, trials and appeals as may be reasonably requested by the Indemnifying Party in connection therewith; provided, that the Indemnified Party may participate, through counsel chosen by it and at its own expense, in the defense of any such claim, action or suit as to which the Indemnifying Party has so elected to conduct and control the defense thereof; and provided, further, that the Indemnified Party shall not, without the written consent of the Indemnifying Party (which written consent shall not be unreasonably withheld), pay, compromise or settle any such claim, action or suit, except that no such consent shall be required if, following a written request from the Indemnified Party, the Indemnifying Party shall fail, within 14 days after the making of such request, to acknowledge and agree in writing that, if such claim, action or suit shall be adversely determined, such Indemnifying Party has an obligation to provide indemnification hereunder to such Indemnified Party. Notwithstanding the foregoing, the Indemnified Party shall have the right to pay, settle or compromise any such claim, action or suit without such consent, provided, that in such event the Indemnified Party shall waive any right to indemnity therefore hereunder unless such consent is unreasonably withheld.

9.3.3. The parties agree to cooperate in defending such third party claims and the Indemnified Party shall provide such cooperation and such access to its books, records and properties as the Indemnifying Party shall reasonably request with respect to any matter for which indemnification is sought hereunder; and the parties hereto agree to cooperate with each other in order to ensure the proper and adequate defense thereof.

9.3.4. With regard to claims of third parties for which indemnification is payable hereunder, such indemnification shall be paid by the Indemnifying Party upon the earlier to occur of: (i) the entry of a judgment against the Indemnified Party and the expiration of any applicable appeal period, or if earlier, five (5) days prior to the date that the judgment creditor has the right to execute the judgment; (ii) the entry of an unappealable judgment or final appellate decision against the Indemnified Party; or (iii) a settlement of the claim. Notwithstanding the foregoing, the reasonable expenses of counsel to the Indemnified Party shall be reimbursed on a current basis by the Indemnifying Party if such expenses are required to be paid pursuant to this Agreement. With regard to other claims for which indemnification is payable hereunder, such indemnification shall be paid promptly by the Indemnifying Party upon demand by the Indemnified Party.

ARTICLE 10 TERMINATION

Section 10.1. BEST EFFORTS. Subject to the terms and conditions provided in this Agreement, each of the parties shall use their respective best efforts in good faith to take or

cause to be taken as promptly as practicable all reasonable actions that are within its power to cause to be fulfilled those of the conditions precedent to its obligations or the obligations of the other parties to consummate the transactions contemplated by this Agreement that are dependent upon its actions, including obtaining all necessary consents, authorizations, orders, approvals and waivers.

Section 10.2. TERMINATION. This Agreement and the transactions contemplated hereby may be terminated:

10.2.1. at any time by the mutual consent of the Seller and the Purchasers;

10.2.2. by the Purchasers at any time at or prior to Closing in their sole discretion if:

(a) any of the representations or warranties of the Seller in this Agreement are not true, accurate and complete in all material respects and such breach, if curable, is not cured by the Closing Date;

(b) the Seller materially breaches any covenant contained in this Agreement and such breach, if curable, is not cured by the Closing Date;

(c) any of the conditions precedent to the Purchasers' obligations to conduct the Closing have not been satisfied by the date required thereof; or

(d) any legal proceeding is commenced or threatened by any governmental agency or other person directed against the consummation of the Closing or any other transaction contemplated hereby, and the Purchasers reasonably and in good faith deem it impractical or inadvisable to proceed in view of such legal proceeding or threat thereof.

10.2.3. by the Seller at any time at or prior to Closing in its sole discretion if:

(a) any of the representations or warranties of the Purchaser in this Agreement are not true, accurate and complete in all material respects (except to the extent such representations and warranties contain a materiality qualification, in which case they shall be true and correct in all respects) and such breach, if curable, is not cured by the Closing Date;

(b) Purchasers materially breach any covenant contained in this Agreement and such breach, if curable, is not cured by the Closing Date; or

(c) any of the conditions precedent to Seller's obligations to conduct the Closing have not been satisfied by the date required thereof.

Section 10.3. EFFECT OF TERMINATION. In the event of termination of this Agreement as expressly permitted under 10.2 hereof, this Agreement shall forthwith become void and no party hereto shall be liable to any other party hereto or their respective officers, directors or Affiliates, provided, that, if such termination shall result from the willful breach by a party of the covenants of such party contained in this Agreement, such party shall be fully liable

for any and all damages sustained or incurred as a result of such breach, including without limitation all expenses incurred in connection with this Agreement.

ARTICLE 11
MISCELLANEOUS

Section 11.1. FURTHER ASSURANCES. Each party agrees to cooperate fully with the other parties and to execute such further instruments, documents and agreements and to give such further written assurances as may be reasonably requested by any other party to better evidence and reflect the transactions described herein and contemplated hereby and to carry into effect the intents and purposes of this Agreement, and further agrees to take promptly, or cause to be taken, all actions, and to do promptly, or cause to be done, all things necessary, proper or advisable under applicable law to consummate and make effective the transactions contemplated hereby, to obtain all necessary waivers, consents and approvals, to effect all necessary registrations and filings, and to remove any injunctions or other impediments or delays, legal or otherwise, in order to consummate and make effective the transactions contemplated by this Agreement for the purpose of securing to the parties hereto the benefits contemplated by this Agreement.

Section 11.2. NOTICES. Any and all notices or other communications or deliveries required or permitted to be provided hereunder shall be in writing and shall be deemed given and effective on the earliest of (a) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section prior to 5:00 p.m. (New York City time) on a business day, (b) the next business day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a business day or later than 5:00 p.m. (New York City time) on any business day, or (c) the business day following the date of mailing, if sent by U.S. nationally recognized overnight courier service such as Federal Express. The address for such notices and communications shall be as follows:

If to the Seller:

VASCO Data Security International, Inc.
1901 South Meyers Road, Suite 210
Oakbrook Terrace, Illinois 60181
Attention: Mr. Cliff Bown
Telephone: 630-932-8844
Facsimile: 630-932-8852

with a copy to:

Pepper Hamilton LLP
Hamilton Square
600 Fourteenth Street, N.W.
Washington, DC 20005
Attention: Robert B. Murphy, Esq.

Telephone: 202-220-1454
Facsimile: 202-220 1665

If to the Purchasers:

SDS Capital Partners, LLC
One Sound Shore Drive
Second Floor
Greenwich, Connecticut 06830
Attention: Mr. Brinton Cox
Telephone: 203.967.5883
Facsimile: 203.967.5851

with a copy to:

Drinker Biddle & Reath LLP
One Logan Square
18th and Cherry Streets
Philadelphia, Pennsylvania 19103
Attention: Marc Marshall, Esq.
Telephone: 215-988-2966
Facsimile: 215-988-2757

Unless otherwise stated above, such communications shall be effective when they are received by the addressee thereof in conformity with this Section. Any party may change its address for such communications by giving notice thereof to the other parties in conformity with this Section.

Section 11.3. GOVERNING LAW. All questions concerning the construction, validity, enforcement and interpretation of this Agreement shall be governed by and enforced in accordance with the laws of the State of Delaware without reference to the choice of law principles thereof.

Section 11.4. JURISDICTION AND VENUE. The Seller and each Purchaser irrevocably consent to the jurisdiction of the United States federal courts and the state courts located in the County of New Castle, State of Delaware, in any suit or proceeding based on or arising under this Agreement and irrevocably agree that all claims in respect of such suit or proceeding may be determined in such courts. The Seller irrevocably waives the defense of an inconvenient forum to the maintenance of such suit or proceeding in such forum. The Seller further agrees that service of process upon the Seller mailed by first class mail shall be deemed in every respect effective service of process upon the Seller in any such suit or proceeding. Nothing herein shall affect the right of any Purchaser to serve process in any other manner permitted by law. The Seller agrees that a final non-appealable judgment in any such suit or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on such judgment or in any other lawful manner.

Section 11.5. SUCCESSORS AND ASSIGNS. This Agreement is personal to each of the parties and may not be assigned without the written consent of the other parties;

provided, however, that any of the Purchasers shall be permitted to assign their rights under this Agreement to any transferee of such Purchaser to whom it assigns or transfers the Securities, as provided in Section 1.3 hereof.

Section 11.6. SEVERABILITY. If any provision of this Agreement, or the application thereof, shall for any reason or to any extent be invalid or unenforceable, the remainder of this Agreement and application of such provision to other persons or circumstances shall continue in full force and effect and in no way be affected, impaired or invalidated.

Section 11.7. ENTIRE AGREEMENT. This Agreement and the other agreements and instruments referenced herein constitute the entire understanding and agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements and understandings.

Section 11.8. OTHER REMEDIES. Except as otherwise provided herein, any and all remedies herein expressly conferred upon a party shall be deemed cumulative with and not exclusive of any other remedy conferred hereby or by law, or in equity on such party, and the exercise of any one remedy shall not preclude the exercise of any other.

Section 11.9. AMENDMENT AND WAIVERS. Any term or provision of this Agreement may be amended, and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively) only by a writing signed by the Seller and the holders of at least a majority of the outstanding Preferred Stock. The waiver by a party of any breach hereof or default in the performance hereof shall not be deemed to constitute a waiver of any other default or any succeeding breach or default.

Section 11.10. NO WAIVER. The failure of any party to enforce any of the provisions hereof shall not be construed to be a waiver of the right of such party thereafter to enforce such provisions.

Section 11.11. CONSTRUCTION OF AGREEMENT; KNOWLEDGE. For purposes of this Agreement, the term "knowledge" of any person or entity shall mean and include (i) actual knowledge and (ii) that knowledge which a reasonably prudent business person could have obtained in the management of his or her business affairs after making due inquiry and exercising due diligence which a prudent business person should have made or exercised, as applicable, with respect thereto.

Section 11.12. COUNTERPARTS; FACSIMILE. This Agreement may be executed in any number of counterparts, each of which shall be an original as against any party whose signature appears thereon and all of which together shall constitute one and the same instrument. This Agreement shall become binding when one or more counterparts hereof, individually or taken together, shall bear the signatures of all of the parties reflected hereon as signatories. In the event that any signature is delivered by facsimile transmission, such signature shall create a valid and binding obligation of the party executing (or on whose behalf such signature is executed) with the same force and effect as if such facsimile signature page were an original thereof.

Section 11.13. NO THIRD PARTY BENEFICIARY. Nothing expressed or implied in this Agreement is intended, or shall be construed, to confer upon or give any person other than the parties hereto and their respective heirs, personal representatives, legal representatives, successors and permitted assigns, any rights or remedies under or by reason of this Agreement.

IN WITNESS WHEREOF, the undersigned Purchasers and the Seller have caused this Preferred Stock and Warrant Purchase Agreement to be duly executed as of the date first above written.

VASCO DATA SECURITY INTERNATIONAL, INC.

By:

T. Kendall Hunt, Chairman and
Chief Executive Officer

Merchant
Fund, LP
120 90,000
BayStar
Capital
II, L.P.
120 90,000
Crest View
Capital
Fund 2, LP
80 60,000
J R
Squared,
LLC 80
60,000
TOTAL: 800
600,000

DISCLOSURE SCHEDULE
TO
VASCO DATA SECURITY INTERNATIONAL, INC.
PREFERRED STOCK AND WARRANT PURCHASE AGREEMENT

Litigation and Intellectual Property

On March 13, 2002, a suit was filed against the Seller claiming patent infringement, false designation of origin and trade dress infringement. The case is currently being evaluated by the Seller and its legal counsel. The Seller believes the suit is without merit. As the suit is in its early stages, management is unable to estimate the effect of this suit at this time.

Broker Fee List

Wedbush Morgan Securities: 1000 Wilshire Blvd. Los Angeles, CA 90017	\$280,000.00
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Gilford Securities Incorporated 850 Third Avenue New York, New York 10022	\$280,000.00
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EXHIBIT A

CERTIFICATE OF DESIGNATIONS, RIGHTS AND PREFERENCES
OF
SERIES D 5% CUMULATIVE CONVERTIBLE VOTING PREFERRED STOCK

A-1

COMMON STOCK PURCHASE WARRANT

B-1

OPINION OF SELLER'S COUNSEL

FORM OF SELLING STOCKHOLDER QUESTIONNAIRE

CERTIFICATE OF DESIGNATIONS, RIGHTS AND PREFERENCES
OF THE
SERIES D 5% CUMULATIVE CONVERTIBLE VOTING PREFERRED STOCK
OF
VASCO DATA SECURITY INTERNATIONAL, INC.

(Pursuant to Section 151 of the General Corporation Law of
the State of Delaware)

The undersigned, being the Chief Executive Officer of VASCO Data Security International, Inc., a Delaware corporation (the "CORPORATION"), does hereby certify, that the following resolution has been duly adopted by the board of directors of the Corporation:

RESOLVED, that pursuant to the authority expressly granted to and vested in the board of directors of the Corporation (the "BOARD") pursuant to the General Corporation Law of the State of Delaware, as amended, and by the provisions of the Corporation's Certificate of Incorporation, as amended to date (the "CERTIFICATE OF INCORPORATION"), the Board hereby creates a series of preferred stock of the Corporation, par value \$0.01 per share, each share having a stated value (the "STATED VALUE") of \$10,000.00, such series consisting of 800 shares (which shall not be subject to increase without the consent of the Holders (as defined below) of a majority of the outstanding Preferred Stock, which shall be designated as the "Series D 5% Cumulative Convertible Voting Preferred Stock" (the "CONVERTIBLE PREFERRED STOCK"), which series shall have the following powers, designations, preferences and relative participating, optional, voting or other rights, and the following qualifications, limitations or restrictions:

I. DIVIDENDS. The holders of the Convertible Preferred Stock (each, a "HOLDER" and collectively, the "HOLDERS") shall be entitled to receive, when, if and as declared by the Board, out of funds legally available therefor, cumulative dividends payable as set forth in this Section I.

A. Accrual and Payment. Dividends on the Convertible Preferred Stock shall accrue and shall be cumulative from the date of issuance of the shares of Convertible Preferred Stock (the "DATE OF ORIGINAL ISSUE"), whether or not earned or declared by the Board. Until paid, the right to receive dividends on the Convertible Preferred Stock shall accumulate, and shall be payable in arrears in cash or shares of the Corporation's class of common stock, par value \$0.001 per share (the "COMMON STOCK"), or stock of any other class into which such shares may hereafter have been reclassified or changed, on March 31, June 30, September 30 and December 31 of each year (a "DIVIDEND PAYMENT DATE"), commencing on December 31, 2003 (the "INITIAL DIVIDEND PAYMENT DATE") except that if such Dividend Payment Date is not a Business Day, then the Dividend Payment Date will be the immediately preceding Business Day. The dividend payment to be made on the Initial Dividend Payment Date shall include a prorated accrued dividend for the period between the Date of Original Issue and September 30, 2003. The decision whether to pay dividends hereunder in Common Stock or cash shall be at the sole discretion of the Corporation; provided, however, that if the Corporation elects to pay a dividend in Common Stock and the receipt thereof by a Holder would be in excess of the Beneficial Ownership Cap (as hereinafter defined), then such dividend shall cumulate for up to 10 years after the Date of Original Issue (the "FINAL DISTRIBUTION DATE") and shall be paid, in whole or in part, on the first date when such payment would not be in excess of the Beneficial Ownership

Cap, and the unpaid portion of any such dividend shall continue to cumulate and be paid thereafter on the next date when such payment would not be in excess of the Beneficial Ownership Cap. Any dividends not paid pursuant to the preceding sentence shall be paid on the Final Distribution Date. Without limiting the foregoing, it shall be the responsibility of the Corporation to determine compliance with the Nasdaq Cap (as hereinafter defined). If at any time the Corporation determines that the Nasdaq Cap is likely to be exceeded, whether as a result of a dividend paid in Common Stock or otherwise, the Corporation shall pay all subsequent dividends in cash, until such time as the Corporation determines that the Nasdaq Cap is no longer likely to be exceeded. Subject to the foregoing, each such dividend declared by the Board shall be paid to the Holders of record as they appear on the stock register of the Corporation on the Record Date (defined below). Dividends in arrears for any past dividend period may be declared by the Board and, subject to the provisions with respect to the Beneficial Ownership Cap and the Nasdaq Cap, paid on shares of the Convertible Preferred Stock on any date fixed by the Board, whether or not a regular Dividend Payment Date, to Holders of record as they appear on the Corporation's stock register on the record date. The record date (the "RECORD DATE"), shall be fixed in advance by the Board, or, to the extent not fixed, shall be the Business Day immediately preceding the date such dividend is paid. Any dividend payment made on shares of the Convertible Preferred Stock shall first be credited against the dividends accumulated with respect to the earliest dividend period for which dividends have not been paid. Dividends not paid on a Dividend Payment Date shall bear interest, whether or not such dividend has been declared, at the Dividend Rate (or such lesser rate equal to the highest rate permitted by applicable law) until paid. For purposes hereof, a "BUSINESS DAY" is any day that is not a Saturday or Sunday or a day on which banks are required or permitted to be closed in the State of Delaware.

B. Dividend Rate. The dividend rate (the "DIVIDEND RATE") on each share of Convertible Preferred Stock shall be five percent (5%) per share per annum compounded quarterly on the Stated Value of each such share for the period from the Date of Original Issue until the Initial Dividend Payment Date and, for each dividend period thereafter, which shall commence on the last day of the preceding dividend period and shall end on the next Dividend Payment Date, shall be at the Dividend Rate on such Stated Value. The amount of dividends per share of the Convertible Preferred Stock payable for each dividend period or part thereof (the "DIVIDEND VALUE") shall be computed by multiplying the Dividend Rate for such dividend period by a fraction the numerator of which shall be the number of days in the dividend period or part thereof (calculated by counting the first day thereof but excluding the last day thereof) on which such share was outstanding and the denominator of which shall be 360 and multiplying the result by the Stated Value. If a dividend is to be paid in Common Stock, the Common Stock shall be valued at the Current Market Price as of the Business Day immediately preceding the date on which the dividend is paid. In furtherance thereof, the Corporation shall reserve out of the authorized but unissued shares of Common Stock, solely for issuance in respect of the payment of dividends as herein described, a sufficient number of shares of Common Stock to pay such dividends, when, if and as declared by the Board of Directors.

For purposes hereof, "CURRENT MARKET PRICE" means, in respect of any share of Common Stock on any date herein specified:

1. if there shall not then be a public market for the Common Stock, ninety percent (90%) multiplied by the Appraised Value (as hereinafter defined) per share of Common Stock at such date, or

2. if there shall then be a public market for the Common Stock, ninety percent (90%) multiplied by the average of the daily market prices for the 20 consecutive trading days immediately before such date. The daily market price for each such trading day shall be (a) the last sale price on such day on the principal stock exchange (including the Nasdaq Stock Market, Inc. ("NASDAQ")) on which such Common Stock is then listed or admitted to trading, or quoted, as applicable, (b) if no sale takes place on such day on any such exchange, the average of the last reported closing bid and asked prices on such day as officially quoted on any such exchange (including Nasdaq), (c) if the Common Stock is not then listed or admitted to trading on any stock exchange, the average of the last reported closing bid and asked prices on such day in the over-the-counter market, as furnished by Nasdaq or the National Quotation Bureau, Inc., (d) if neither such corporation at the time is engaged in the business of reporting such prices, as furnished by any similar firm then engaged in such business, or (e) if there is no such firm, as furnished by any member of the National Association of Securities Dealers, Inc. ("NASD") selected mutually by the Holders of a majority of the Preferred Stock and the Corporation or, if they cannot agree upon such selection, as selected by two such members of the NASD, one of which shall be selected by a majority of the Holders and one of which shall be selected by the Corporation.

For purposes hereof, "APPRAISED VALUE" means, in respect of any share of Common Stock on any date herein specified, the fair saleable value of such share of Common Stock (determined without giving effect to the discount for (i) a minority interest or (ii) any lack of liquidity of the Common Stock or to the fact that the Corporation may have no class of equity registered under the Securities Exchange Act of 1934, as amended (the "EXCHANGE ACT")) as of the last day of the most recent fiscal month end prior to such date specified, based on the value of the Corporation, as determined by a nationally recognized investment banking firm selected by the Board and having no prior relationship with the Corporation, and reasonably acceptable to the holders of at least a majority of the then outstanding shares of Convertible Preferred Stock (the "MAJORITY HOLDERS").

C. Except as hereinafter provided, no dividends shall be declared or paid or set apart for payment on the shares of Common Stock or any other class or series of capital stock of the Corporation for any dividend period unless full cumulative dividends have been or contemporaneously are declared and paid on the Convertible Preferred Stock through the most recent Dividend Payment Date. If full cumulative dividends have not been paid on shares of the Convertible Preferred Stock, all dividends declared on shares of the Convertible Preferred Stock shall be paid pro rata to the Holders in proportion to the full accrued but unpaid dividends attributable to each such Holder's Convertible Preferred Stock. No dividend on any other class or series of capital stock of the Corporation shall be paid unless, at the time of such payment, all accrued dividends on the Convertible Preferred Stock have been paid.

II. VOTING RIGHTS.

A. General. Except as otherwise provided herein or by law, the Holders shall have full voting rights and powers, subject to the Beneficial Ownership Cap and the Nasdaq Cap (as defined in Section V.F), equal to the voting rights and powers of holders of Common Stock and shall be entitled to notice of any stockholders meeting in accordance with the Bylaws of the Corporation, and shall be entitled to vote, with respect to any question upon which holders of Common Stock have the right to vote, including, without limitation, the right to vote for the election of directors, voting together with the holders of Common Stock as one class. Each Holder shall be entitled to a number of votes equal to the number of shares of Common Stock into which such shares of Convertible Preferred Stock could be converted on the record date for the taking of a vote at the then current Conversion Value (as hereinafter defined), subject to the Beneficial Ownership Cap and the Nasdaq Cap, or, if no record date is established, at the day prior to the date such vote is taken or any written consent of shareholders is first executed. Fractional votes shall not be permitted, and any fractional voting rights resulting from the above formula (after aggregating all shares into which shares of Convertible Preferred Stock held by each Holder could be converted) shall be rounded to the nearest whole number (with one-half being rounded upward), subject to the Beneficial Ownership Cap and the Nasdaq Cap.

B. Special. The Corporation shall not, without the affirmative vote of the Majority Holders:

1. authorize, create (by way of reclassification or otherwise) or issue any additional shares of Convertible Preferred Stock, or any Senior Securities (as hereinafter defined) or Pari Passu Securities (as hereinafter defined) or any obligation or security convertible into, exchangeable for or evidencing the right to purchase any Senior Securities or Pari Passu Securities;

2. alter or change the rights, preferences or privileges of the Convertible Preferred Stock, or increase the authorized number of shares of Convertible Preferred Stock;

3. alter or change the rights, preferences or privileges of any capital stock of the Corporation so as to affect adversely the Convertible Preferred Stock;

4. redeem, repurchase or otherwise acquire, or declare or pay any cash dividend or distribution on, any Junior Securities;

5. increase the par value of the Common Stock;

6. other than (A) a credit facility with an Eligible Lender (as that term is defined below); or (B) any financing with any lender where (x) the interest rate, per annum, applicable to such financing is no greater than the highest rate of interest published as the "Prime Rate" in the "Money Rates" section of the Wall Street Journal from time to time (or, in the event such rate of interest is no longer reported in the Wall Street Journal, any other commercially reasonable method of determining such rate of interest as is satisfactory to the Majority Holders), plus 5%, and (y) the facility fees, up-front fees, commitment fees, set up fees or other similar fees applicable to such financing are no more than such customary and reasonable fees pursuant to such financing, issue any debt securities or incur any indebtedness that would have any

preferences over the Convertible Preferred Stock upon liquidation of the Corporation, or redeem, repurchase, prepay or otherwise acquire any outstanding debt securities or indebtedness of the Corporation, except as expressly required by the terms of such securities or indebtedness;

7. enter into any agreement, commitment, understanding or other arrangement to take any of the foregoing actions; or

8. cause or authorize any subsidiary of the Corporation to engage in any of the foregoing actions.

Notwithstanding the foregoing, no change pursuant to this Section II.B shall be effective to the extent that, by its terms, it applies to less than all of the holders of shares of Convertible Preferred Stock then outstanding. For the purposes of this Section, "ELIGIBLE LENDER" means a commercial bank, a savings and loan association, a savings bank, a finance company, insurance company or other financial institution that is engaged in making, purchasing or otherwise investing in commercial loans in the ordinary course of its business and having a combined capital and surplus or total assets of at least \$500,000,000.00.

III. RANK.

All shares of the Convertible Preferred Stock shall rank (i) prior to the Common Stock and any class or series of capital stock of the Corporation hereafter created (unless, with the consent of the Majority Holders obtained in accordance with Section II.B hereof, such class or series of capital stock specifically, by its terms, ranks senior to or pari passu with the Convertible Preferred Stock) (collectively with the Common Stock, "JUNIOR SECURITIES"); (ii) pari passu with any class or series of capital stock of the Corporation hereafter created (with the written consent of the Majority Holders obtained in accordance with Section II.B hereof) specifically ranking, by its terms, on parity with the Convertible Preferred Stock (the "PARI PASSU SECURITIES"); and (iii) junior to any class or series of capital stock of the Corporation hereafter created (with the written consent of the Majority Holders obtained in accordance with Section II.B hereof) specifically ranking, by its terms, senior to the Convertible Preferred Stock (collectively, the "SENIOR SECURITIES"), in each case as to distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary.

IV. RIGHTS ON LIQUIDATION.

A. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation (any such event being hereinafter referred to as a "LIQUIDATION"), before any distribution of assets of the Corporation shall be made to or set apart for the holders of Common Stock or of any securities of the Corporation which are junior to the Convertible Preferred Stock as to dividends, distributions or distributions upon Liquidation, the Holders shall be entitled to receive payment out of such assets of the Corporation in an amount equal to the greater of (i) the Liquidation Preference, or (ii) the cash or other property distributable upon such Liquidation with respect to the shares of Common Stock into which such shares of Convertible Preferred Stock, including any accrued dividends thereon, could have been converted immediately prior to such payment. The "LIQUIDATION PREFERENCE" for the Convertible Preferred Stock shall be an amount equal to 100% of the Stated Value plus any accumulated and unpaid dividends thereon

(whether or not earned or declared). If the assets of the Corporation available for distribution to the Holders shall not be sufficient to make in full the payment herein required, such assets shall be distributed pro-rata among the Holders based on the aggregate Liquidation Preferences of the shares of Convertible Preferred Stock held by each such Holder.

B. If the assets of the Corporation available for distribution to shareholders exceed the aggregate amount payable pursuant to Section IV.A with respect to all shares of Convertible Preferred Stock then outstanding, then, after the payment required by Section IV.A above shall have been made or irrevocably set aside, the holders of Common Stock shall be entitled to receive with respect to each share of Common Stock payment of a pro rata portion of such assets based on the aggregate number of shares of Common Stock held by each such holder.

V. CONVERSION BY THE HOLDER.

A. Right to Convert. Subject to the limitation set forth in Section V.F hereof, each Holder shall have the right at any time, at such Holder's option, to convert all or any whole number of such Holder's shares of Convertible Preferred Stock into such number of fully paid and non-assessable shares of Common Stock as is determined by dividing (i) the aggregate Stated Value of the shares of Convertible Preferred Stock to be converted plus any accrued but unpaid dividends thereon by (ii) the Conversion Value (as hereinafter defined) then in effect. No fractional shares or scrip representing fractional shares shall be issued upon the conversion of any Convertible Preferred Stock. With respect to any fraction of a share of Common Stock called for upon any conversion, the Corporation shall pay to the Holder an amount in cash equal to such fraction multiplied by the Current Market Price.

B. Mechanics of Conversion. Such right of conversion shall be exercised by any Holder by delivering to the Corporation a conversion notice in the form attached hereto as Exhibit A (the "CONVERSION NOTICE"), appropriately completed and duly signed and specifying the number of whole shares of Convertible Preferred Stock that the Holder elects to convert (the "CONVERTING SHARES") into shares of Common Stock on the date specified in the Conversion Notice (which date shall not be earlier than the date on which the Conversion Notice is delivered to the Corporation), and by surrender of the certificate or certificates representing such Converting Shares. The Conversion Notice shall also contain a statement of the name or names (with addresses and tax identification or social security numbers) in which the certificate or certificates for Common Stock shall be issued, if other than the name in which the Converting Shares are registered. Promptly, but in no event more than five (5) Business Days, after the receipt of the Conversion Notice and surrender of the Converting Shares, the Corporation shall issue and deliver, or cause to be delivered, to the holder of the Converting Shares or such holder's nominee, a certificate or certificates for the number of shares of Common Stock issuable upon the conversion of such Converting Shares together with cash in lieu of any fractional interest in a share of Common Stock together with a new certificate covering the number of shares of Convertible Preferred Stock representing the unconverted portion of the shares represented by the Convertible Preferred Stock certificate surrendered. Such conversion shall be deemed to have been effected as of the close of business on the date specified in the Conversion Notice in accordance with the terms hereof (the "CONVERSION DATE"), and the person or persons entitled to receive the shares of Common Stock issuable upon conversion shall be treated for all

purposes as the holder or holders of record of such shares of Common Stock as of the close of business on the Conversion Date.

C. Common Stock Reserved.

1. The Corporation shall at all times reserve and keep available out of its authorized but unissued Common Stock, solely for issuance upon the conversion of shares of Convertible Preferred Stock as herein provided, such number of shares of Common Stock as shall from time to time be issuable upon the conversion of all the shares of Convertible Preferred Stock at the time outstanding (the "RESERVED AMOUNT").

2. If the Reserved Amount for any three consecutive trading days (the last of such three trading days being the "AUTHORIZATION TRIGGER DATE") shall be less than one hundred percent (100%) of the number of shares of Common Stock issuable upon full conversion of the then outstanding shares of Convertible Preferred Stock (without giving effect to the limitations contained in Section V.F), the Corporation shall immediately notify the holders of Convertible Preferred Stock of such occurrence and shall take immediate action (including, if necessary, seeking stockholder approval to authorize the issuance of additional shares of Common Stock) to increase the Reserved Amount to one hundred percent (100%) of the number of shares of Common Stock then issuable upon full conversion of all of the outstanding Convertible Preferred Stock at the then current Conversion Price (without giving effect to the limitations contained in Section V.F). In the event the Corporation fails to so increase the Reserved Amount within 90 days after an Authorization Trigger Date, each Holder of Convertible Preferred Stock shall thereafter have the option, exercisable in whole or in part at any time and from time to time, by delivery of a Redemption Notice to the Corporation, to require the Corporation to redeem for cash, at an amount per share equal to the Redemption Amount (as defined in Section VII), a number of the holder's shares of Convertible Preferred Stock such that, after giving effect to such redemption, the then unissued portion of such holder's Reserved Amount is at least equal to one hundred percent (100%) of the total number of shares of Common Stock issuable upon conversion of such holder's shares of Convertible Preferred Stock. If the Corporation fails to redeem any of such shares within five business days after its receipt of such Redemption Notice, then such holder shall be entitled to the remedies provided in Section VII.

D. Conversion Value. The initial conversion value for the Convertible Preferred Stock shall be \$2.00 per share of Common Stock, such value to be subject to adjustment in accordance with the provisions of this Section V. Such conversion value in effect from time to time, as adjusted pursuant to this Section V, is referred to herein as a "CONVERSION VALUE." All of the remaining provisions of this Section V shall apply separately to each Conversion Value in effect from time to time with respect to Convertible Preferred Stock.

E. Stock Dividends, Subdivisions and Combinations. If at any time while the Convertible Preferred Stock is outstanding, the Corporation shall:

1. take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend payable in, or other distribution of, additional shares of Common Stock,

2. subdivide its outstanding shares of Common Stock into a larger number of shares of Common Stock, or

3. combine its outstanding shares of Common Stock into a smaller number of shares of Common Stock,

then in each such case the Conversion Value shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding treasury shares, if any) outstanding immediately before such event and of which the denominator shall be the number of shares of Common Stock (excluding treasury shares, if any) outstanding immediately after such event. Any adjustment made pursuant to clause (1) of this Section V.E shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution, and any adjustment pursuant to clause (2) or (3) of this Section V.E shall become effective immediately after the effective date of such subdivision or combination. If any event requiring an adjustment under this paragraph occurs during the period that a Conversion Value is calculated hereunder, then the calculation of such Conversion Value shall be adjusted appropriately to reflect such event.

F. Blocking Provisions. Notwithstanding any contrary or inconsistent provision hereof, the number of shares of Common Stock that may be acquired by any Holder upon any conversion of Convertible Preferred Stock or that shall be entitled to voting rights under Section II hereof, and for which the Corporation may issue Common Stock to any holder of Convertible Preferred Stock as payment of any dividend, shall be limited to the extent necessary to insure that, following such conversion, the number of shares of Common Stock then owned of record by such Holder and any other persons or entities whose record ownership of Common Stock would be aggregated with the Holder's for purposes of Section 13(d) of the Exchange Act (including shares held by any "group" of which the Holder is a member) does not exceed (i) 4.95% of the total number of shares of Common Stock then issued and outstanding (the "BENEFICIAL OWNERSHIP CAP"); or (ii) 19.9% of the total number of shares of Common Stock issued and outstanding as of the Date of Original Issue times a fraction the numerator of which is the maximum number of shares of Common Stock issuable upon conversion by such Holder of all of its shares of Convertible Preferred Stock and the denominator of which is the aggregate maximum amount of shares of Common Stock issuable upon conversion by all Holders of all outstanding shares of the Convertible Preferred Stock (the "NASDAQ CAP"); provided, however, that the Convertible Preferred Stock shall remain subject to the mandatory conversion provisions set forth in Section VI, notwithstanding the fact that, but for this proviso, such mandatory conversion of the Preferred Stock would exceed the Beneficial Ownership Cap. For purposes hereof, "group" has the meaning set forth in Section 13(d) of the Exchange Act and applicable regulations of the Securities and Exchange Commission, and the percentage held by the Holder shall be determined in a manner consistent with the provisions of Section 13(d) of the Exchange Act. Each delivery of a Conversion Notice by a Holder will constitute a representation by such Holder that it has evaluated the limitation set forth in this Section V.F and determined, subject to the accuracy of information filed under the Securities Act and the Exchange Act by any person or entity other than such Holder with respect to the outstanding Common Stock (including securities or property convertible into or exchangeable for Common Stock, with or without the payment of consideration), that the issuance of the full number of shares of Common Stock requested in such Conversion Notice is permitted under this Section V.F, and the Corporation

shall have no obligations to such Holder to verify compliance with the Beneficial Ownership Cap or the Nasdaq Cap. This Section V.F shall be construed and administered in such manner as shall be consistent with the intent of the first sentence of this Section V.F. Any provision hereof which would require a result that is not consistent with such intent shall be deemed severed herefrom and of no force or effect with respect to the conversion contemplated by a particular Conversion Notice. The restriction contained in this Subsection (i) of this Section V.F may not be altered, amended, deleted or changed in any manner whatsoever unless a majority of the outstanding shares of Common Stock and the Majority Holders shall approve, in writing, such alteration, amendment, deletion or change. In the event the Corporation is prohibited from issuing Common Stock to any holder of Convertible Preferred Stock as payment of any dividend, it shall pay such dividend to such holder in cash.

VI. MANDATORY CONVERSION AT THE CORPORATION'S ELECTION.

A. Subject to the Required Conditions contained in Section VI.C, the Corporation may call for conversion of all or any portion of the Convertible Preferred Stock no earlier than the later of the first anniversary of the issuance of the first share of the Convertible Preferred Stock (the "FIRST ANNIVERSARY") or the effective date of a registration statement filed with the Commission for the registration of the Common Stock into which the Preferred Stock is convertible (the "REGISTRATION DATE"), upon the occurrence of any of the following:

1. the Common Stock is traded on any national securities exchange or quoted on the Nasdaq National Market or Nasdaq SmallCap Market, and the closing price per share of the Common Stock is greater than 200% multiplied by the Conversion Value for at least twenty (20) out of thirty (30) consecutive trading days since the later of the First Anniversary and the Registration Date; or

2. the sale by the Corporation of its Common Stock in a firm commitment public underwritten offering in which (a) the per share offering price of the Common Stock is greater than 200% multiplied by the Conversion Value and (b) the aggregate gross proceeds of such offering exceeds \$15,000,000; or

3. the closing of a transaction that results in a Change of Control (as hereinafter defined), pursuant to which the Common Stock is valued at a per share price equal to or greater than 200% multiplied by the Conversion Value;

provided, however, that, if the mandatory conversion contemplated by this Section VI.A is based on the satisfaction of the conditions set forth in clause 1 of this Section VI.A, the Corporation shall be permitted to require conversion in any quarter of no more than 25% of the total number of shares of Convertible Preferred Stock issued on the Date of Original Issue.

B. If the Corporation elects to call for the mandatory conversion of the Convertible Preferred Stock in accordance with Section VI.A, the Corporation shall give written notice thereof to the Holders (the "CALL FOR CONVERSION"), signed by the Chief Executive Officer or Chief Financial Officer of the Convertible Preferred Stock. The Call for Conversion shall (A) specify on which of the three bases for mandatory conversion set forth in Section VI.A the call is based and (B) include information reasonably sufficient for the Holder to confirm compliance

with Section VI.A. No more than two (2) Business Days following receipt of a Call for Conversion, Holder shall convert the shares of Convertible Preferred Stock subject to such Call for Conversion, in the manner set forth in Section V.B.

C. The "Required Conditions" shall consist of the following:

1. Each Registration Statement required to be filed by the Corporation pursuant to the Purchase Agreement shall have been declared effective by the Securities and Exchange Commission (it being understood that the Corporation shall comply with its obligations under the Purchase Agreement relating to the effectiveness of the Registration Statements) and shall have been kept effective in accordance with the Purchase Agreement;

2. No Redemption Event (as defined in Section VII.A below) shall have occurred without having been cured;

3. All amounts, if any, then accrued and payable under this Certificate of Designation or the Purchase Agreement shall have been paid.

VII. REDEMPTION DUE TO CERTAIN EVENTS.

A. Redemption by Holder. In the event (each of the events described below after expiration of the applicable cure period (if any) being a "REDEMPTION EVENT"):

1. the Corporation fails to remove any restrictive legend on any certificate or any shares of Common Stock issued to the Holders of Convertible Preferred Stock upon conversion of the Convertible Preferred Stock upon written request of any Purchaser pursuant to Rule 144(k) promulgated under the Securities Act or the Corporation fails to cause an opinion of counsel to be delivered to the Corporation's transfer agent with respect to the subsequent transfer of Common Stock issued to the Holders of the Convertible Preferred Stock upon conversion to the effect that the certificates representing any such Common Stock sold and transferred pursuant to an effective registration statement filed with the SEC shall be issued without a restrictive legend (a "LEGEND REMOVAL Failure"), and any such failure continues uncured for five business days after the Corporation has been notified thereof in writing by the Holder;

2. the Corporation provides written notice (or otherwise indicates) to any Holder of Convertible Preferred Stock, or states by way of public announcement distributed via a press release, at any time, of its intention not to issue, or otherwise refuses to issue, shares of Common Stock to any Holder of Convertible Preferred Stock upon conversion in accordance with the terms of this Certificate of Designations, other than a refusal related to the Beneficial Ownership Cap or Nasdaq Cap;

3. the Corporation or any subsidiary of the Corporation shall make a voluntary assignment for the benefit of creditors in an amount exceeding \$1.0 million in the aggregate, or voluntarily apply for or consent to the appointment of a receiver or trustee for it or for a substantial part of its property or business;

4. Except with respect to matters covered by subparagraphs 1-3 above, as to which such applicable subparagraphs shall apply, the Corporation otherwise shall breach any

material term hereunder or under the Purchase Agreement, or the Warrants, including, without limitation, the representations and warranties contained therein relating to corporate existence, power and authorization or compliance with its charter documents or solvency (i.e., in the event of a material breach as of the date such representation and warranty was made) and if such breach is curable, shall fail to cure such breach within ten business days after the Corporation has been notified thereof in writing by the holder;

then, upon the occurrence of any such Redemption Event, each Holder of shares of Convertible Preferred Stock shall thereafter have the option, exercisable in whole or in part at any time and from time to time by delivery of a written notice to such effect (a "REDEMPTION NOTICE") to the Corporation while such Redemption Event continues, to require the Corporation to purchase for cash any or all of the then outstanding shares of Convertible Preferred Stock held by such Holder for an amount per share equal to the Redemption Amount (as defined in Section VII.B below) in effect at the time of the redemption hereunder. For the avoidance of doubt, the occurrence of any event described in clauses 2 and 3 above shall immediately constitute a Redemption Event and there shall be no cure period. Upon the Corporation's receipt of any Redemption Notice hereunder (other than during the three trading day period following the Corporation's delivery of a Redemption Announcement (as defined below) to all of the Holders in response to the Corporation's initial receipt of a Redemption Notice from a Holder of Convertible Preferred Stock), the Corporation shall immediately (and in any event within three business days following such receipt) deliver a written notice (a "REDEMPTION ANNOUNCEMENT") to all Holders of Convertible Preferred Stock stating the date upon which the Corporation received such Redemption Notice and the amount of Convertible Preferred Stock covered thereby. The Corporation shall not redeem any shares of Convertible Preferred Stock during the three trading day period following the delivery of a required Redemption Announcement hereunder. At any time and from time to time during such three trading day period, each Holder of Convertible Preferred Stock may request (either orally or in writing) information from the Corporation with respect to the instant redemption (including, but not limited to, the aggregate number of shares of Convertible Preferred Stock covered by Redemption Notices received by the Corporation) and the Corporation shall furnish (either orally or in writing) as soon as practicable such requested information to such requesting Holder.

B. Definition of Redemption Amount. The "REDEMPTION AMOUNT" with respect to a share of Preferred Stock means an amount equal to the greater of:

$$(i) \quad \frac{V \quad \times \quad M}{\text{-----}} \\ \text{CP}$$

and $(ii) \quad \frac{V \quad \times \quad R}{\text{-----}}$

where:

"V" means the Face Amount thereof plus all accrued dividends thereon through the date of payment of the Redemption Amount;

"CP" means the Conversion Price in effect on the date on which the Corporation receives the Redemption Notice;

"M" means (i) the highest Closing Sales Price of the Common Stock during the period beginning on the date on which the Corporation receives the Redemption Notice and ending on the date immediately preceding the date of payment of the Redemption Amount; and

"R" means 120%.

C. Redemption Defaults. If the Corporation fails to pay any Holder the Redemption Amount with respect to any share of Convertible Preferred Stock within five business days after its receipt of a Redemption Notice, then the Holder of the Convertible Preferred Stock entitled to redemption shall be entitled to interest on the Redemption Amount at a per annum rate equal to the lower of twenty-four percent (24%) and the highest interest rate permitted by applicable law from the date on which the Corporation receives the Redemption Notice until the date of payment of the Redemption Amount hereunder. In the event the Corporation is not able to redeem all of the shares of Convertible Preferred Stock subject to Redemption Notices delivered prior to the date upon which such redemption is to be effected, the Corporation shall redeem shares of Convertible Preferred Stock from each Holder pro rata, based on the total number of shares of Convertible Preferred Stock outstanding at the time of redemption included by such Holder in all Redemption Notices delivered prior to the date upon which such redemption is to be effected relative to the total number of shares of Convertible Preferred Stock outstanding at the time of redemption included in all of the Redemption Notices delivered prior to the date upon which such redemption is to be effected.

VIII. OTHER PROVISIONS APPLICABLE TO ADJUSTMENTS. The following provisions shall be applicable to the making of adjustments of the number of shares of Common Stock into which the Convertible Preferred Stock is convertible and the current Conversion Value provided for in Section V:

A. When Adjustments to Be Made. The adjustments required by Section V shall be made whenever and as often as any specified event requiring an adjustment shall occur, except that any adjustment to the Conversion Value that would otherwise be required may be postponed up to, but not beyond the Conversion Date if such adjustment either by itself or with other adjustments not previously made adds or subtracts less than 1% of the shares of Common Stock into which the Convertible Preferred Stock is convertible immediately prior to the making of such adjustment. Any adjustment representing a change of less than such minimum amount (except as aforesaid) which is postponed shall be carried forward and made as soon as such adjustment, together with other adjustments required by Section V and not previously made, would result in a minimum adjustment on the Conversion Date. For the purpose of any adjustment, any specified event shall be deemed to have occurred at the close of business on the date of its occurrence.

B. Fractional Adjustments. In computing adjustments under Section V, fractional adjustments to the Conversion Value shall be taken into account to the nearest 1/100th of a cent.

C. Escrow of Stock. If after any property becomes distributable pursuant to Section V by reason of the taking of any record of the holders of Common Stock, but prior to the occurrence of the event for which such record is taken, a Holder converts the Convertible Preferred Stock, such Holder shall continue to be entitled to receive any shares of Common

Stock issuable upon conversion under Section V by reason of such adjustment and such shares or other property shall be held in escrow for the Holder by the Corporation to be issued to Holder upon and to the extent that the event actually takes place. Notwithstanding any other provision to the contrary herein, if the event for which such record was taken fails to occur or is rescinded, then such escrowed shares shall be canceled by the Corporation and escrowed property returned to the Corporation.

IX. MERGER, CONSOLIDATION OR DISPOSITION OF ASSETS. If, while the Preferred Stock is outstanding, there occurs: (i) an acquisition by an individual or legal entity or group (as defined in Rule 13d-3 of the Exchange Act) of more than one-half of the voting rights or equity interests in the Corporation; or (ii) a merger or consolidation of the Corporation or a sale, transfer or other disposition of all or substantially all the Corporation's property, assets or business to another corporation where the holders of the Corporation's voting securities prior to such transaction fail to continue to hold at least a majority of the voting power of the surviving or acquiring corporation (a "CHANGE OF CONTROL"), and, pursuant to the terms of such Change of Control, shares of common stock of the surviving or acquiring corporation, or any cash, shares of stock or other securities or property of any nature whatsoever (including warrants or other subscription or purchase rights) in addition to or in lieu of common stock of the successor or acquiring corporation ("OTHER PROPERTY"), are to be received by or distributed to the holders of Common Stock, then the certificates evidencing the Convertible Preferred Stock shall, as of and after the Change of Control, evidence only the right to receive, at each Holder's election, which must be delivered by each Holder to the Corporation within 20 days after receiving notice from the Corporation of the right to make such election, either:

A. the number of shares of common stock of the successor or acquiring corporation or of the Corporation, if it is the surviving corporation, and Other Property receivable upon or as a result of such Change of Control by a Holder of the number of shares of Common Stock into which the Convertible Preferred Stock is convertible immediately prior to such event, or

B. at the effective time of such Change of Control, such Holder's Liquidation Preference multiplied by 150%.

If a timely election is not made pursuant to this Section IX, the Holder shall receive the benefit of Section IX.A and shall not be entitled to the benefit of Section IX.B. If notice of a Change of Control is given but the Change of Control transaction is not, for any reason, consummated, the elections of the Holders given in connection with such notice shall be of no force or effect, ab initio.

X. OTHER ACTION AFFECTING COMMON STOCK. In case at any time or from time to time the Corporation shall take any action in respect of its Common Stock, other than the payment of dividends permitted by Section V or any other action described in Section V, then, unless such action will not have a materially adverse effect upon the rights of the Holder of Convertible Preferred Stock, the number of shares of Common Stock or other stock into which the Convertible Preferred Stock is convertible exercisable and/or the purchase price thereof shall be adjusted in such manner as may be equitable in the circumstances.

XI. CERTAIN LIMITATIONS. Notwithstanding anything herein to the contrary, the Corporation agrees not to enter into any transaction that, by reason of any adjustment hereunder, would cause the current Conversion Value to be less than the par value per share of Common Stock.

XII. TRANSFER OF PREFERRED STOCK.

A. Transfer. Subject to compliance with all applicable federal and state securities laws by the transferor and the transferee (including the delivery of investment representation letters and legal opinions reasonably satisfactory to the Corporation, if such are requested by the Corporation; provided that such letters and legal opinions shall not be unreasonably requested with respect to a transfer to an affiliate of a Holder) and any shareholders agreement to which the transferor is a party, the Preferred Stock and all rights therein may be transferred or assigned in whole or in part.

B. Prohibited Transfers. Notwithstanding anything to the contrary herein, the Holder shall at all times be prohibited from transferring any Preferred Stock or right therein to a person or entity who, at the time of such determination, is currently engaging, or is reasonably likely to engage, in the same or a substantially similar business as that of the Corporation.

XIII. STOCK TRANSFER TAXES. The issue of stock certificates upon conversion of the Convertible Preferred Stock shall be made without charge to the converting Holder for any tax in respect of such issue; provided, however, that the Corporation shall be entitled to withhold any applicable withholding taxes with respect to such issue, if any.

XIV. CERTIFICATE AS TO ADJUSTMENTS. Upon the occurrence, if any, of each adjustment or readjustment of the Conversion Value, the Corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each Holder a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the reasonable written request at any time of any Holder, furnish or cause to be furnished to such Holder a like certificate setting forth (i) such adjustments and readjustments, (ii) the Conversion Value at the time in effect for the Convertible Preferred Stock and (iii) the number of shares of Common Stock and the amount, if any, or other property which at the time would be received upon the conversion of Convertible Preferred Stock owned by such Holder.

XV. PAYMENT OF CASH; DEFAULTS. Whenever the Corporation is required to make any cash payment to a Holder under this Certificate of Designation (as payment of any dividend, upon redemption or otherwise), such cash payment shall be made to the Holder within five business days after delivery by such Holder of a notice specifying that the Holder elects to receive such payment in cash and the method (e.g., by check, wire transfer) in which such payment should be made and any supporting documentation reasonably requested by the Corporation to substantiate the Holder's claim to such cash payment or the amount thereof. If such payment is not delivered within such five business day period, such Holder shall thereafter be entitled to interest on the unpaid amount at a per annum rate equal to the lower of eighteen

percent (18%) and the highest interest rate permitted by applicable law until such amount is paid in full to the Holder.

XVI. ALLOCATION OF NASDAQ CAP AMOUNT AND RESERVED AMOUNT. The initial Nasdaq Cap and Reserved Amount shall be allocated pro rata among the Holders of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, the holders of such other securities issued pursuant to the Purchase Agreement or other agreements entered into in connection therewith) based on the number of shares of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, such other securities) issued to each such Holder. Each increase to the Nasdaq Cap and the Reserved Amount shall be allocated pro rata among the Holders of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, the holders of such other securities issued pursuant to the Purchase Agreement or other agreements entered into in connection therewith) based on the number of shares of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, such other securities) held by each Holder at the time of the increase in the Nasdaq Cap or Reserved Amount. In the event a Holder shall sell or otherwise transfer any of such Holder's shares of Convertible Preferred Stock (or, in the case of the Nasdaq Cap, such other securities), each transferee shall be allocated a pro rata portion of such transferor's Nasdaq Cap and Reserved Amount. Any portion of the Nasdaq Cap or Reserved Amount which remains allocated to any person or entity which does not hold any Convertible Preferred Stock (or, in the case of the Nasdaq Cap, such other securities) shall be allocated to the remaining Holders of shares of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, the holders of such other securities issued pursuant to the Purchase Agreement or other agreements entered into in connection therewith), pro rata based on the number of shares of Convertible Preferred Stock (and, in the case of the Nasdaq Cap, such other securities) then held by such Holders.

XVII. NOTICES OF RECORD DATE. In the event of any fixing by the Corporation of a record date for the holders of any class of securities for the purpose of determining the holders thereof who are entitled to receive any dividend (other than a cash dividend) or other distribution, any shares of Common Stock or other securities, or any right to subscribe for, purchase or otherwise acquire, or any option for the purchase of, any shares of stock of any class or any other securities or property, or to receive any other right, the Corporation shall mail to each Holder at least twenty (20) days prior to the date specified therein, a notice specifying the date on which any such record is to be taken for the purpose of such dividend, distribution or rights, and the amount and character of such dividend, distribution or right.

XVIII. NOTICES. Any and all notices or other communications or deliveries required or permitted to be provided hereunder shall be in writing and shall be deemed given and effective on the earliest of (a) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section XVIII prior to 4:00 p.m. (Chicago time) on a Business Day, (b) the next Business Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a Business Day or later than 4:00 p.m. (Chicago time) on any Business Day, or (c) the Business Day following the date of mailing, if sent by U.S. nationally recognized overnight courier service such as Federal Express. The address for such notices and communications shall be as follows: (i) if to the Corporation, to 1901 South Meyers Road, Suite 210, Oakbrook Terrace, Illinois 60181, facsimile: 630.932.8852, Attention: Chief Executive Officer, with a copy to Pepper Hamilton LLP, 600 Fourteenth Street, N.W., Washington, D.C.

20005-2004, Fax No. 202.220.1665, Att'n Robert B. Murphy, Esquire or (ii) if to a Holder, to the address or facsimile number appearing on the Corporation's stockholder records or, in either case, to such other address or facsimile number as the Corporation or a Holder may provide to the other in accordance with this Section.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Designation on behalf of the Corporation this 9th day of September, 2003.

Name: T. Kendall Hunt
Title: Chairman of the Board and Chief
Executive Officer

FORM OF CONVERSION NOTICE

(To be executed by the registered Holder in order to convert shares
of Convertible Preferred Stock)

The undersigned hereby irrevocably elects to convert the number of shares of Series D 5% Cumulative Convertible Voting Preferred Stock (the "Convertible Preferred Stock") indicated below into shares of common stock, par value \$.001 per share (the "Common Stock"), of VASCO Data Security International, Inc., a Delaware corporation (the "Company"), according to the Certificate of Designations, Rights and Preferences of the Convertible Preferred Stock and the conditions hereof, as of the date written below. The undersigned hereby requests that certificates for the shares of Common Stock to be issued to the undersigned pursuant to this Conversion Notice be issued in the name of, and delivered to, the undersigned or its designee as indicated below. A copy of the certificate representing the Convertible Preferred Stock being converted is attached hereto.

Date to Effect Conversion

Number of shares of Convertible Preferred Stock owned prior to Conversion

Number of shares of Convertible Preferred Stock to be Converted

Stated Value of Convertible Preferred Stock to be Converted

Amount of accumulated and unpaid dividends on shares of Convertible Preferred Stock to be Converted

Number of shares of Common Stock to be Issued (including conversion of accrued but unpaid dividends on shares of Convertible Preferred Stock to be Converted)

Applicable Conversion Value

Number of shares of Convertible Preferred Stock owned subsequent to Conversion

Conversion Information: [NAME OF HOLDER]

By: -----
Name:
Title:

Address of Holder:

Issue Common Stock to (if different than above):
Name: -----
Address: -----

The undersigned represents, subject to the accuracy of information filed under the Securities Act and the Exchange Act by any person other than such holder with respect to the outstanding Common Stock of the Company (including securities or property convertible into or exchangeable for Common Stock, with or without the payment of consideration), as of the date hereof that, after giving effect to the conversion of Convertible Preferred Shares pursuant to this Conversion Notice, the undersigned will not exceed the "Beneficial Ownership Cap" contained in Section V.F of the Certificate of Designations, Rights and Preferences of the Convertible Preferred Stock.

Name of Holder

By: -----
Name:
Title:

WARRANT NO. _____

THIS WARRANT AND THE SECURITIES REPRESENTED BY, OR ACQUIRABLE UPON CONVERSION OR EXERCISE OF SECURITIES EVIDENCED BY, THIS WARRANT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER SAID ACT UNLESS THE ISSUER OF THIS WARRANT RECEIVES AN OPINION OF LEGAL COUNSEL REASONABLY ACCEPTABLE TO THE ISSUER AND ITS LEGAL COUNSEL THAT SUCH SALE IS EXEMPT FROM REGISTRATION UNDER SUCH ACT AND IS IN COMPLIANCE WITH APPLICABLE STATE SECURITIES OR BLUE SKY LAWS UNLESS SUCH REGISTRATION IS NOT REQUIRED.

SERIES D WARRANT

TO PURCHASE _____ SHARES OF COMMON STOCK OF

VASCO DATA SECURITY INTERNATIONAL, INC.

THIS IS TO CERTIFY THAT _____, or registered assigns (the "HOLDER"), is entitled, at any time prior to the Expiration Date (as hereinafter defined), to purchase from VASCO Data Security International, Inc. a Delaware corporation (the "COMPANY"), the Warrant Shares (as hereinafter defined and subject to adjustment as provided herein), in whole or in part, at a purchase price of \$_____ per share (initially and as adjusted, if at all, pursuant to the terms and conditions of this Warrant, the "EXERCISE PRICE"), all on and subject to the terms and conditions hereinafter set forth.

1. DEFINITIONS. As used in this Warrant, the following terms have the respective meanings set forth below:

"AFFILIATE" means any Person that, directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with a Person, as such terms are used in and construed under Rule 144 under the Securities Act. With respect to a Holder of Warrants, any investment fund or managed account that is managed on a discretionary basis by the same investment manager as such Holder will be deemed to be an Affiliate of such Holder.

"APPRAISED VALUE" means, in respect of any share of Common Stock on any date herein specified, the fair saleable value of such share of Common Stock (determined without giving effect to the discount for (i) a minority interest or (ii) any lack of liquidity of the Common Stock or to the fact that the Company may have no class of equity registered under the Exchange Act) as of the last day of the most recent fiscal month ending prior to such date specified, based on the value of the Company, as determined by a nationally recognized investment banking firm selected by the Company's Board of Directors and having no prior relationship with the Company.

"BUSINESS DAY" means any day that is not a Saturday or Sunday or a day on which banks are required or permitted to be closed in the State of Delaware.

"CHANGE OF CONTROL" means the (i) acquisition by an individual or legal entity or group (as defined in Rule 13d-3 of the Exchange Act) of more than one-half of the voting rights or equity interests in the Company; (ii) sale, conveyance, or other disposition of all or substantially all of the assets, property or business of the Company, (iii) reorganization of the Company's capital, or (iv) merger into or consolidation with any other corporation (other than a wholly owned subsidiary corporation) or effectuation of any transaction or series of related transactions where holders of the Company's voting securities prior to such transaction or series of transactions fail to continue to hold at least 50% of the voting power of the Company.

"CLOSING DATE" means September 10, 2003.

"COMMISSION" means the Securities and Exchange Commission or any other federal agency then administering the Securities Act and other federal securities laws.

"COMMON STOCK" means (except where the context otherwise indicates) the class of common stock, \$0.001 par value per share, of the Company as constituted on the Closing Date, and any capital stock into which such Common Stock may thereafter be changed or converted, and shall also include (i) capital stock of the Company of any other class (regardless of how denominated) issued to the holders of shares of Common Stock upon any reclassification thereof which is also not preferred as to dividends or assets on liquidation over any other class of stock of the Company and which is not subject to redemption and (ii) shares of common stock of any successor or acquiring corporation received by or distributed to the holders of Common Stock in the circumstances contemplated by Section 4.C.

"EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the Commission thereunder, all as the same shall be in effect from time to time.

"EXERCISE PERIOD" means the period during which this Warrant is exercisable pursuant to Section 2.a.

"EXPIRATION DATE" means September 10, 2008.

"MARKET PRICE" means, in respect of any share of Common Stock, if there shall not be a public market for the Common Stock on the Business Day immediately preceding the Closing Date, the higher of (a) the book value per share of Common Stock on such date and (b) the Appraised Value per share of Common Stock on such date, or if there shall then be a public market for the Common Stock on the Business Day immediately preceding the Closing Date, the higher of (a) the book value per share of Common Stock on such date, and (b) the average of the daily market prices for 20 consecutive Trading Days immediately preceding such date. The daily market price for each such Trading Day shall be (i) the last sale price on such day on the principal stock exchange on which such Common Stock is then listed or admitted to trading (including Nasdaq), (ii) if no sale takes place on such day on any such exchange, the average of the last reported closing bid and asked prices on such day as officially quoted on any such exchange (including Nasdaq), (iii) if the Common Stock is not then listed or admitted to trading

on any stock exchange, the average of the last reported closing bid and asked prices on such day in the over-the-counter market, as furnished by Nasdaq or the National Quotation Bureau, Inc., (iv) if neither such corporation at the time is engaged in the business of reporting such prices, as furnished by any similar firm then engaged in such business reasonably acceptable to holders of at least a majority of the then outstanding shares of the Company's Series D 5% Cumulative Convertible Voting Preferred Stock, or (v) if there is no such firm, as furnished by any member of the NASD selected mutually by the Holder and the Company or, if they cannot agree upon such selection, as selected by two such members of the NASD, one of which shall be selected by the Holder and one of which shall be selected by the Company.

"NASD" means the National Association of Securities Dealers, Inc., or any successor corporation thereto.

"NASDAQ" means the Nasdaq Stock Market, Inc.

"OTHER PROPERTY" has the meaning set forth in Section 4.b.i.

"PERSON" means any individual, sole proprietorship, partnership, joint venture, trust, incorporated organization, association, corporation, limited liability company, institution, public benefit corporation, entity or government (whether federal, state, county, city, municipal or otherwise, including, without limitation, any instrumentality, division, agency, body or department thereof).

"SECURITIES ACT" means the Securities Act of 1933, as amended, and the rules and regulations of the Commission thereunder, all as the same shall be in effect at the time.

"TRADING DAY" means any day on which the primary market on which shares of Common Stock are listed is open for trading.

"TRANSFER" means any disposition of any Warrant or Warrant Shares or of any interest in either thereof, which would constitute a sale thereof within the meaning of the Securities Act.

"WARRANTS" means this Warrant and all warrants issued upon transfer, division or combination of, or in substitution for, any thereof. All Warrants shall at all times be identical as to terms and conditions and date, except as to the number of shares of Common Stock for which they may be exercised.

"WARRANT PRICE" means an amount equal to (i) the number of shares of Common Stock being purchased upon exercise of this Warrant pursuant to Section 2.a, multiplied by (ii) the Exercise Price.

"WARRANT SHARES" means any one or more of the 600,000 shares of Common Stock to be purchased upon the exercise hereof, subject to adjustment as provided herein.

2. EXERCISE OF WARRANT.

a. Manner of Exercise.

i. From and after the Closing Date, and until 5:00 P.M., Delaware time, on the Expiration Date (the "EXERCISE PERIOD"), the Holder may exercise this Warrant, on any Business Day, for all or any part of the number of Warrant Shares purchasable hereunder.

ii. In order to exercise this Warrant, in whole or in part, the Holder shall deliver to the Company at its principal office or at the office or agency designated by the Company pursuant to Section I, (i) a written notice of Holder's election to exercise this Warrant, which notice shall specify the number of Warrant Shares to be purchased, (ii) payment of the Warrant Price as provided herein, and (iii) this Warrant. Such notice shall be substantially in the form of the subscription form (the "SUBSCRIPTION FORM") appearing at the end of this Warrant as Exhibit A, duly executed by the Holder or its agent or attorney. Upon receipt thereof, the Company shall, as promptly as reasonably practicable, and in any event within five (5) Business Days thereafter (the "DELIVERY PERIOD"), execute or cause to be executed and deliver or cause to be delivered to the Holder a certificate or certificates representing the aggregate number of Warrant Shares issuable upon such exercise, together with cash in lieu of any fraction of a share, as hereinafter provided. The stock certificate or certificates so delivered shall be in such denomination or denominations as the Holder may reasonably request in the notice and shall be registered in the name of the Holder or such other name as shall be designated in the notice and, following the date on which the Warrant Shares have been sold and transferred pursuant to an effective resale registration statement filed with the Commission or otherwise may be sold by the Holder pursuant to Rule 144(k) promulgated under the Securities Act (or a successor rule), shall not bear any restrictive legend. This Warrant shall be deemed to have been exercised and such certificate or certificates shall be deemed to have been issued, and the Holder or any other Person so designated to be named therein shall be deemed to have become a Holder of record of such shares for all purposes, as of the date when the notice, together with the payment of the Warrant Price and this Warrant, is received by the Company as described above. If this Warrant shall have been exercised in part, the Company shall, at the time of delivery of the certificate or certificates representing Warrant Shares, deliver to the Holder a new Warrant evidencing the rights of the Holder to purchase the unpurchased shares of Common Stock called for by this Warrant, which new Warrant shall in all other respects be identical with this Warrant, or at the request of the Holder, appropriate notation may be made on this Warrant and the same returned to the Holder.

iii. Payment of the Warrant Price may be made at the option of the Holder by: (i) certified or official bank check payable to the order of the Company, or (ii) wire transfer to the account of the Company. All shares of Common Stock issuable upon the exercise of this Warrant pursuant to the terms hereof shall be validly issued and, upon payment of the Warrant Price, shall be fully paid and nonassessable and not subject to any preemptive rights. The Company shall pay all expenses in connection with, and all transfer, stamp or similar taxes and other governmental charges that may be imposed with respect to, the issue or delivery thereof, provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance of any certificates for Warrant Shares or Warrants in a name other than the name of the Holder.

iv. Prior to the exercise of this Warrant, the Holder shall not be entitled to any rights as a stockholder of the Company with respect to the Warrant Shares,

including, without limitation, the right to vote such Warrant Shares, receive dividends or other distributions thereon or to be notified of stockholder meetings, except as set forth herein.

v. If the Company's transfer agent is participating in the Depository Trust Company ("DTC") Fast Automated Securities Transfer program, and so long as the certificates therefor do not bear a legend (pursuant to the terms of that certain Preferred Stock and Warrant Purchase Agreement, dated September 10, 2003, by and among the Company and the signatories thereto (the "PURCHASE AGREEMENT"), the Company shall cause its transfer agent to electronically transmit the Warrant Shares so purchased to the Holder or the Holder's designee by crediting the account of the Holder or the Holder's designee or its respective nominee with DTC through its Deposit Withdrawal Agent Commission system ("DTC TRANSFER"). If the aforementioned conditions to a DTC Transfer are not satisfied, the Company shall deliver to the Holder or the Holder's designee physical certificates representing the Warrant Shares so purchased. Notwithstanding the foregoing, the Holder or the Holder's designee may instruct the Company to deliver to the Holder or such designee physical certificates representing the Warrant Shares so purchased in lieu of delivering such shares by way of DTC Transfer.

vi. If, at any time, a Holder of this Warrant submits this Warrant, a Subscription Form and payment to the Company of the Exercise Price for each of the Warrant Shares specified in the Subscription Form (including pursuant to a Cashless Exercise), and the Company fails for any reason (other than the reasons contemplated by Section 2.a hereof) to deliver, on or prior to the fourth business day following the expiration of the Delivery Period for such exercise, the number of shares of Common Stock to which the Holder is entitled upon such exercise (an "EXERCISE DEFAULT"), then the Company shall pay to the Holder payments ("EXERCISE DEFAULT PAYMENTS") for an Exercise Default in the amount of (i) $(N/365)$, multiplied by (ii) the amount by which the Market Price of the Common Stock on the date the Exercise Agreement giving rise to the Exercise Default is transmitted in accordance with this Section 2 (the "EXERCISE DEFAULT DATE") exceeds the Exercise Price in respect of such Warrant Shares, multiplied by (iii) the number of shares of Common Stock the Company failed to so deliver in such Exercise Default, multiplied by (iv) $.24$, where N equals the number of days from the Exercise Default Date to the date that the Company effects the full exercise of this Warrant which gave rise to the Exercise Default. The accrued Exercise Default Payment for each calendar month shall be paid in cash and shall be made to the Holder by the fifth day of the month following the month in which it has accrued. Nothing herein shall limit the Holder's right to pursue actual damages for the Company's failure to maintain a sufficient number of authorized shares of Common Stock as required pursuant to the terms of Section 6 hereof or to otherwise issue shares of Common Stock upon exercise of this Warrant in accordance with the terms hereof, and the Holder shall have the right to pursue all remedies available at law or in equity (including a decree of specific performance and/or injunctive relief).

b. Restrictions on Exercise Amount. Notwithstanding any contrary or inconsistent provision hereof, the Holder may not acquire a number of Warrant Shares to the extent that, upon such exercise, the number of shares of Common Stock then owned of record by such Holder and its Affiliates and any other Persons or entities whose record ownership of Common Stock would be aggregated with the Holder's for purposes of Section 13(d) of the Exchange Act (including shares held by any "group" of which the Holder is a member) exceeds 4.95% of the total number of shares of Common Stock then issued and outstanding (such

limitation being herein referred to as the "BENEFICIAL OWNERSHIP CAP"). For purposes hereof, "group" has the meaning set forth in Section 13(d) of the Exchange Act and applicable regulations of the Commission, and the percentage held by the Holder shall be determined in a manner consistent with the provisions of Section 13(d) of the Exchange Act. The restriction contained in this Section 2.b may not be altered, amended, deleted or changed in any manner whatsoever unless the holders of a majority of the outstanding shares of Common Stock and the Holder hereof shall approve, in writing, such alteration, amendment, deletion or change.

3. TRANSFER, DIVISION AND COMBINATION.

a. Transfer. The Warrants and the Warrant Shares may not be transferred or assigned in whole or in part without compliance with all applicable federal and state securities laws by the transferor and the transferee (including the delivery of investment representation letters and legal opinions reasonably satisfactory to the Company, if such are requested by the Company; provided that such letters and legal opinions shall not be unreasonably requested with respect to a transfer to an Affiliate of the Holder) and any stockholders agreement to which the transferor is a party. Subject to the foregoing, Transfer of this Warrant and all rights hereunder, in whole or in part, shall be registered on the books of the Company to be maintained for such purpose, upon surrender of this Warrant at the principal office of the Company referred to in Section 10.b or the office or agency designated by the Company pursuant to Section 9, together with a written assignment of this Warrant substantially in the form of Exhibit B hereto duly executed by the Holder or its agent or attorney and funds sufficient to pay any transfer taxes payable upon the making of such Transfer. Upon such surrender and, if required, such payment, the Company shall execute and deliver a new Warrant or Warrants in the name of the assignee or assignees and in the denomination specified in such instrument of assignment, and shall issue to the assignor a new Warrant evidencing the portion of this Warrant not so assigned, and this Warrant shall promptly be cancelled. The acceptance of the new Warrant or Warrants by the transferee thereof shall be deemed the acceptance by such transferee of all of the rights and obligations of a Holder. Following a transfer that complies with the requirements of this Section 3.a, the Warrant may be exercised by a new Holder for the purchase of shares of Common Stock regardless of whether the Company issued or registered a new Warrant on the books of the Company.

b. Prohibited Transfers. Notwithstanding anything to the contrary herein, the Holder shall at all times be prohibited from transferring any Warrant and any Warrant Shares to any Person who, at the time of such determination, is currently engaging, or is reasonably likely to engage, in the same or a substantially similar business as that of the Company.

c. Restrictive Legend. Each certificate for Warrant Shares initially issued upon the exercise of this Warrant unless such Warrant Shares may otherwise be sold by the Holder pursuant to Rule 144(k) promulgated under the Securities Act (or a successor rule), each certificate for Warrant Shares issued to any subsequent transferee of any such certificate, shall be stamped or otherwise imprinted with a legend in substantially the following form:

"THE SECURITIES REPRESENTED BY, OR ACQUIRABLE UPON CONVERSION
OR EXERCISE OF SECURITIES EVIDENCED BY, THIS CERTIFICATE HAVE
NOT BEEN

REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER SAID ACT UNLESS THE ISSUER OF THIS CERTIFICATE RECEIVES AN OPINION OF LEGAL COUNSEL REASONABLY ACCEPTABLE TO THE ISSUER AND ITS LEGAL COUNSEL THAT SUCH SALE IS EXEMPT FROM REGISTRATION UNDER SUCH ACT AND IS IN COMPLIANCE WITH APPLICABLE STATE SECURITIES OR BLUE SKY LAWS UNLESS SUCH REGISTRATION IS NOT REQUIRED."

d. Division and Combination; Expenses; Books. This Warrant may be divided or combined with other Warrants upon presentation hereof at the aforesaid office or agency of the Company, together with a written notice specifying the names and denominations in which new Warrants are to be issued, signed by the Holder or its agent or attorney. Subject to compliance with Section 3.a as to any transfer which may be involved in such division or combination, the Company shall execute and deliver a new Warrant or Warrants in exchange for the Warrant or Warrants to be divided or combined in accordance with such notice. The Company shall prepare, issue and deliver at its own expense the new Warrant or Warrants under this Section 3. The Company agrees to maintain, at its aforesaid office or agency, books for the registration and the registration of transfer of the Warrants.

4. ADJUSTMENTS. The number of shares of Common Stock for which this Warrant is exercisable, and the Exercise Price, shall be subject to adjustment from time to time as set forth in this Section 4. The Company shall give the Holder notice of any event described below which requires an adjustment pursuant to this Section 4 in accordance with Sections 5.a and 5.b.

a. Stock Dividends, Subdivisions and Combinations. If at any time while this Warrant is outstanding the Company shall:

i. take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend payable in, or other distribution of, additional shares of Common Stock,

ii. subdivide its outstanding shares of Common Stock into a larger number of shares of Common Stock, or

iii. combine its outstanding shares of Common Stock into a smaller number of shares of Common Stock, then:

(1) the number of shares of Common Stock acquirable upon exercise of this Warrant immediately after the occurrence of any such event shall be adjusted to equal the number of shares of Common Stock which a record holder of the same number of shares of Common Stock that would have been acquirable under this Warrant immediately prior

to the occurrence of such event would own or be entitled to receive after the happening of such event, and

(2) the Exercise Price shall be adjusted to equal:

(A) the Exercise Price in effect immediately prior to the occurrence of such event multiplied by the number of shares of Common Stock into which this Warrant is exercisable immediately prior to the adjustment, divided by

(B) the number of shares of Common Stock into which this Warrant is exercisable immediately after such adjustment.

Any adjustment made pursuant to clause (i) of this Section 4.a shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution, and any adjustment pursuant to clauses (ii) or (iii) of this Section 4.a shall become effective immediately after the effective date of such subdivision or combination.

b. Reorganization, Reclassification, Merger, Consolidation or Disposition of Assets.

i. If, during the Exercise Period, there shall occur a Change of Control and, pursuant to the terms of such Change of Control, shares of common stock of the successor or acquiring corporation, or any cash, shares of stock or other securities or property of any nature whatsoever (including warrants or other subscription or purchase rights) in addition to or in lieu of common stock of the successor or acquiring corporation ("OTHER PROPERTY"), are to be received by or distributed to the holders of Common Stock, then the Holder shall have the right thereafter to receive, upon the exercise of the Warrant, the number of shares of common stock of the successor or acquiring corporation or of the Company, if it is the surviving corporation, and the Other Property receivable upon or as a result of such Change of Control by a holder of the number of shares of Common Stock into which this Warrant is exercisable immediately prior to such event.

ii. In case of any such Change of Control, the successor or acquiring corporation (if other than the Company) shall expressly assume the due and punctual observance and performance of each and every covenant and condition contained in this Warrant to be performed and observed by the Company and all the obligations and liabilities hereunder, subject to such modifications as may be deemed appropriate (as determined by resolution of the Board of Directors of the Company) in order to provide for adjustments of shares of the Common Stock into which this Warrant is exercisable which shall be as nearly equivalent as practicable to the adjustments provided for in this Section 4.

c. Other Action Affecting Common Stock. In case at any time or from time to time the Company shall take any action in respect of its Common Stock, then, unless such action will not have a materially adverse effect upon the rights of the Holder, the number of shares of Common Stock or other stock into which this Warrant is exercisable and/or the Exercise Price shall be adjusted in such manner as may be equitable in the circumstances.

d. Certain Limitations. Notwithstanding anything herein to the contrary, the Company agrees not to enter into any transaction which, by reason of any adjustment hereunder, would cause the Exercise Price to be less than the par value per share of Common Stock.

e. Stock Transfer Taxes. The issue of stock certificates upon exercise of this Warrant shall be made without charge to the Holder for any tax in respect of such issue.

f. Fractional Interests. The Company shall not be required to issue a fractional share of Common Stock upon exercise of any Warrant. If an adjustment made pursuant to this Section 4 entitles the Holder to any fraction of a share, such fraction shall be rounded to the nearest whole number and the Holder shall be entitled to that number of shares.

5. NOTICES TO WARRANT HOLDERS.

a. Certificate as to Adjustments. Upon the occurrence, if any, of each adjustment or readjustment of the Exercise Price, or the number of shares of Common Stock and the amount, if any of Other Property which at the time would be received upon exercise of the Warrants owned by such Holder, the Company, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to the Holder a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Company shall, upon the reasonable written request at any time of the Holder, furnish or cause to be furnished to such Holder a like certificate setting forth (i) such adjustments and readjustments, (ii) the Exercise Price at the time in effect and (iii) the number of shares of Common Stock and the amount, if any, or Other Property which at the time would be received upon the exercise of Warrants owned by such Holder.

b. Notice of Corporate Action. If at any time:

i. the Company shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or other distribution, or any right to subscribe for or purchase any evidences of its indebtedness, any shares of stock of any class or any other securities or property, or to receive any other right, or

ii. there shall be any capital reorganization of the Company, any reclassification or recapitalization of the capital stock of the Company or any consolidation or merger of the Company with, or any sale, transfer or other disposition of all or substantially all the property, assets or business of the Company to, another corporation, or

iii. there shall be a voluntary or involuntary dissolution, liquidation or winding up of the Company;

then, in any one or more of such cases, the Company shall give to the Holder (i) at least 15 days' prior written notice of the record date that shall be selected for such dividend, distribution or right or for determining rights to vote in respect of any such reorganization, reclassification, merger, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up, and (ii) in the case of any such reorganization, reclassification, merger, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up, at least 15 days' prior written notice of the

date when the same shall take place. Such notice in accordance with the foregoing clause also shall specify (1) the date on which any such record is to be taken for the purpose of such dividend, distribution or right, the date on which the holders of Common Stock shall be entitled to any such dividend, distribution or right, and the amount and character thereof, and (2) the date on which any such reorganization, reclassification, merger, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up is to take place and the time, if any such time is to be fixed, as of which the holders of Common Stock shall be entitled to exchange their shares of Common Stock for securities or Other Property deliverable upon such reorganization, reclassification, merger, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up. Each such written notice shall be sufficiently given if addressed to the Holder at the last address of the Holder appearing on the books of the Company and delivered in accordance with Section 10.b. The failure to give any notice required by this Section 5.b shall not invalidate any such corporate action.

c. Notice to Stockholders. The Holder shall be entitled to the same rights to receive notice of corporate action as any holder of Common Stock. Subject to the foregoing, the Holder, as such, shall not be entitled to vote or receive dividends or be deemed the holder of Common Stock or any other securities of the Company that may at any time be issuable on the exercise hereof for any purpose, nor shall anything contained herein be construed to confer upon the Holder, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action (whether upon any recapitalization, issuance of stock, reclassification of stock, change of par value, or change of stock to no par value, consolidation, merger, conveyance, or otherwise) or to receive dividends or subscription rights or otherwise until this Warrant shall have been exercised as provided herein.

6. RESERVATION AND AUTHORIZATION OF COMMON STOCK: REGISTRATION WITH APPROVAL OF ANY GOVERNMENTAL AUTHORITY. From and after the Closing Date until the Expiration Date, the Company shall at all times reserve and keep available for issue upon the exercise of the Warrants such number of its authorized but unissued shares of Common Stock as will be sufficient to permit the exercise in full of all outstanding Warrants. All shares of Common Stock which shall be so issuable, when issued upon exercise of any Warrant and payment therefor in accordance with the terms of such Warrant, shall be duly and validly issued and fully paid and nonassessable, and not subject to preemptive rights.

7. TAKING OF RECORD; STOCK AND WARRANT TRANSFER BOOKS. In the case of all dividends or other distributions by the Company to the holders of its Common Stock with respect to which any provision of Section 4 refers to the taking of a record of such holders, the Company will in each such case take such a record and will take such record as of the close of business on a Business Day. The Company will not at any time, except upon dissolution, liquidation or winding up of the Company, close its stock transfer books or Warrant transfer books so as to result in preventing or delaying the exercise or transfer of any Warrant.

8. LOSS OR MUTILATION. Upon receipt by the Company from the Holder of evidence reasonably satisfactory to the Company of the ownership of and the loss, theft, destruction or mutilation of this Warrant and indemnity reasonably satisfactory to the Company

(it being understood that the written agreement of the original Holder shall be sufficient indemnity) and in case of mutilation upon surrender and cancellation hereof, the Company, at its expense, will execute and deliver in lieu hereof a new Warrant of like tenor to the Holder; provided, however, that in the case of mutilation, no indemnity shall be required if this Warrant in identifiable form is surrendered to the Company for cancellation. Applicants for a replacement Warrant under such circumstances shall also comply with such other reasonable regulations and procedures and pay such other reasonable charges as the Company may prescribe.

9. OFFICE OF THE COMPANY. As long as any of the Warrants remain outstanding, the Company shall maintain an office or agency (which may be the principal executive offices of the Company) where the Warrants may be presented for exercise, registration of transfer, division or combination as provided in this Warrant.

10. MISCELLANEOUS.

a. Nonwaiver and Expenses. No course of dealing or any delay or failure to exercise any right hereunder on the part of the Holder shall operate as a waiver of such right or otherwise prejudice Holder's rights, powers or remedies. If the Company fails to make, when due, any payments provided for hereunder, or fails to comply with any other provision of this Warrant, the Company shall pay to the Holder such amounts as shall be sufficient to cover any costs and expenses including, but not limited to, reasonable attorneys' fees, including those of appellate proceedings, incurred by the Holder in collecting any amounts due pursuant hereto or in otherwise enforcing any of its rights, powers or remedies hereunder.

b. Notice Generally. All notices, requests, demands or other communications provided for herein shall be in writing and shall be deemed to have been given the next Business Day after being deposited with a nationally recognized overnight courier such as Federal Express, or, when personally delivered, or successfully sent by facsimile transmission as evidenced by a fax machine confirmation report thereof, addressed, as the case may be, to the Holder at the address on the books and records of the Company; or to the Company, VASCO Data Security International, Inc., 1901 South Meyers Road, Suite 210, Oakbrook Terrace, Illinois 60181, Att'n: Clifford K. Bown, Chief Financial Officer, Fax No. 630.932.8852; with a copy to Pepper Hamilton LLP, 600 Fourteenth Street, N.W., Washington, D.C. 20005-2004, Fax No. 202.220.1665, Att'n Robert B. Murphy, Esquire, or to such other Person or address as either party shall designate to the other from time to time in writing forwarded in like manner.

c. Successors and Assigns. Subject to compliance with the provisions of Section 3.a, this Warrant and the rights evidenced hereby shall inure to the benefit of and be binding upon the successors of the Company and the successors and assigns of the Holder. The provisions of this Warrant are intended to be for the benefit of all Holders from time to time of this Warrant, and shall be enforceable by any such Holder, but nothing in this Warrant shall be construed to give any Person, other than the Company and the Holder and their respective successors and assigns, any legal or equitable right, remedy or cause under this Warrant.

d. Amendment. This Warrant may be modified or amended or the provisions of this Warrant waived with the written consent of the Company and the Holder.

e. Severability. Wherever possible, each provision of this Warrant shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Warrant shall be prohibited by or invalid under applicable law, such provision shall be modified to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Warrant.

f. Headings. The headings used in this Warrant are for the convenience of reference only and shall not, for any purpose, be deemed a part of this Warrant

g. Governing Law. This Warrant and the transactions contemplated hereby shall be deemed to be consummated in the State of Delaware and shall be governed by and interpreted in accordance with the local laws of the State of Delaware without regard to the provisions thereof relating to conflict of laws.

[REMAINDER OF PAGE LEFT INTENTIONALLY BLANK. SIGNATURE PAGES FOLLOW].

IN WITNESS WHEREOF, the Company has caused this Series D Warrant to be executed by its duly authorized officer and attested by its Secretary.

Dated: September 10, 2003

VASCO DATA SECURITY INTERNATIONAL. INC.

By:

Name: T. Kendall Hunt
Title: Chairman of the Board and Chief
Executive Officer

Attest:

By:

Name: Clifford K. Bown
Title: Corporate Secretary

EXHIBIT A

SUBSCRIPTION FORM

[To be executed only upon exercise of Warrant]

The undersigned registered owner of this Warrant hereby exercises this Warrant for the purchase of _____ shares of Common Stock of VASCO Data Security International, Inc., a Delaware corporation (the "Company"), and herewith makes payment therefor, all at the price and on the terms and conditions specified in this Warrant and requests that certificates for the shares of Common Stock hereby purchased (and any securities or Other Property issuable upon such exercise) be issued in the name of and delivered to and whose address is _____. And, if such shares of Common Stock shall not include all of the shares of Common Stock issuable as provided in this Warrant, that a new Warrant of like tenor and date for the balance of the shares of Common Stock issuable hereunder be delivered to the undersigned.

As of the date hereof, and assuming the accuracy of all information filed by the Company with the Securities and Exchange Commission, the undersigned Holder hereby certifies that the exercise of the referenced Warrant for the number of Warrant Shares herein indicated will not put the undersigned Holder out of compliance with the Beneficial Ownership Cap (as defined in the Warrant).

By signing below, the Holder warrants and represents that the Holder is an "accredited investor" as that term is defined under Regulation D of the Securities and Exchange Commission promulgated under the Securities Act of 1933, as amended.

(Name of Registered Owner)

(Signature of Registered Owner)

(Street Address)

(City, State and Zip Code)

NOTICE: The signature on this subscription must correspond with the name as written upon the face of the Warrant.

EXHIBIT B

ASSIGNMENT FORM

FOR VALUE RECEIVED the undersigned registered owner of this Warrant for the purchase of shares of the Common Stock of VASCO Data Security International, Inc., a Delaware corporation (the "Company"), hereby sells, assigns and transfers unto the Assignee named below all of the rights of the undersigned under this Warrant, with respect to the number of shares of Common Stock set forth below:

Name and Address of Assignee:

No. of Shares of Common Stock:

and does hereby irrevocably constitute and appoint _____ attorney-in-fact to register such transfer on the books of the Company, maintained for the purpose, with full power of substitution in the premises.

Dated:

Print Name:

Signature:

Witness:

NOTICE: The signature on this assignment must correspond with the name as written upon the face of the Warrant in every particular.

VASCO ANNOUNCES \$8 MILLION CAPITAL RAISE

FINANCING STRENGTHENS BALANCE SHEET - ALLOWS VASCO TO RETIRE DEBT AND PROVIDES GROWTH CAPITAL

OAKBROOK TERRACE, Ill., and BRUSSELS, Belgium, September 12, 2003 - VASCO Data Security International, Inc. (Nasdaq: VDSI) (www.vasco.com), a global provider of security products that enable e-business and e-commerce, today announced the sale of \$8 million of its Series D Cumulative Convertible Voting Preferred Stock and warrants to purchase common stock. Wedbush Morgan Securities, Inc. acted as the Company's lead investment banker and placement agent for the transaction. Gilford Securities, Inc. acted as a co-placement agent for the transaction.

The preferred stock carries a 5% dividend, is convertible into 4 million shares of common stock and will vote with the common stock as a class on matters presented to the stockholders. In addition, investors received 600 thousand five-year warrants to purchase common stock. The preferred stock is convertible at a fixed price of \$2.00 per share and the warrants are exercisable at \$ 3.47 per share, a 20% premium to the closing price of the common stock on Wednesday, September 10, 2003.

"This financing strengthens VASCO's balance sheet substantially," noted Cliff Bown, Executive Vice President and Chief Financial Officer. "It provides the funds needed to repay our loan with Dexia Bank and provides us with additional working capital to continue to grow our business. After the repayment of the Dexia loan, VASCO's balance sheet will no longer have any significant debt outstanding and the Company will have the cash and credit facilities in place that we believe are needed to support future growth."

"This capital raise was another significant step by the Company's management and Board of Directors to prepare the Company for future growth. With a strong balance sheet, two consecutive quarters of positive cash flow and increasing profitability, and strong demand for our family of user authentication products, VASCO is well positioned for growth. We continue to work hard to earn the trust and confidence of our customers, partners and shareholders," stated T. Kendall Hunt, VASCO's Chairman and CEO.

About VASCO: VASCO designs, develops, markets and supports patented strong user authentication products for e-business and e-commerce. VASCO's strong user authentication software is delivered via its Digipass security products, small "calculator" hardware devices carried by an end user, or in a software format on mobile phones, other portable devices, and PCs. For user access control, VASCO's VACMAN products guarantee that only designated Digipass users get access to the application. VASCO's target markets are the applications and their several hundred million users that utilize fixed passwords as security. VASCO's time-based system generates a "one-time" password that changes with every use, and is virtually impossible to hack, or break. With 10 million Digipass products sold and ordered, VASCO has established itself as a world-leader for strong user authentication with over 220 international financial institutions, approximately 1200 blue-chip corporations, and governments representing more than 60 countries.

Forward Looking Statements

Statements made in this news release that relate to future plans, events or performances are forward-looking statements. Any statement containing words such as "believes," "anticipates," "plans," "expects," and similar words, is forward-looking, and these statements involve risks and uncertainties and are based on current expectations. Consequently, actual results could differ materially from the expectations expressed in these forward-looking statements.

Reference is made to the Company's public filings with the US Securities and Exchange Commission for further information regarding the Company and its operations.

More information is available at www.vasco.com.

For more information contact:

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