Five9, Inc.
Form 10-Q
May 01, 2019
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-36383

Five9, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	94- 3394123
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Bishop Ranch 8
4000 Executive Parkway, Suite 400
San Ramon, CA 94583
(Address of Principal Executive Offices) (Zip Code)
(925) 201-2000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes: x No: o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	x	Accelerated Filer	o
Non-accelerated filer	o (Do not check if a smaller reporting Company)	Smaller Reporting Company	o
		Emerging Growth Company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes: o No: o

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

As of April 26, 2019, there were 59,676,850 shares of the Registrant's common stock, par value $0.001 per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which involve substantial risks and uncertainties. These statements reflect the current views of our senior management with respect to future events and our financial performance. These forward-looking statements include statements with respect to our business, expenses, strategies, losses, growth plans, product and client initiatives, market growth projections, and our industry. Statements that include the words "expect," "intend," "plan," "believe," "project," "forecast," "estimate," "may," "should," "ar similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

Forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. These factors include the information set forth in Part 1, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, which we encourage you to carefully read, and include the following:

- our quarterly and annual results may fluctuate significantly, including as a result of the timing and success of new product and feature introductions by us, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock;
- if we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed;
- our recent rapid growth may not be indicative of our future growth, and even if we continue to grow rapidly, we may fail to manage our growth effectively;
- failure to adequately expand our sales force could impede our growth;
- if we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages;
- security breaches and improper access to or disclosure of our data or our clients' data, or other cyber attacks on our systems, could result in litigation and regulatory risk, harm our reputation and adversely affect our business;
- the markets in which we participate involve numerous competitors and are highly competitive, and if we do not compete effectively, our operating results could be harmed;
- if our existing clients terminate their subscriptions or reduce their subscriptions and related usage, our revenues and gross margins will be harmed and we will be required to spend more money to grow our client base;
- our growth depends in part on the success of our strategic relationships with third parties and our failure to successfully grow and manage these relationships could harm our business;
- we have established, and are continuing to increase, our network of master agents and resellers to sell our solution; our failure to effectively develop, manage, and maintain this network could materially harm our revenues;
- we sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results;
- because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern;
- we rely on third-party telecommunications and internet service providers to provide our clients and their customers with telecommunication services and connectivity to our cloud contact center software and any failure by these service providers to provide reliable services could cause us to lose clients and subject us to claims for credits or damages, among other things;
- we have a history of losses and we may be unable to achieve or sustain profitability;
- the contact center software solutions market is subject to rapid technological change, and we must develop and sell incremental and new products in order to maintain and grow our business;

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- we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs;
- failure to comply with laws and regulations could harm our business and our reputation; and
- we may not have sufficient cash to service our convertible senior notes and repay such notes, if required.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may differ materially from what we anticipate. You should not place undue reliance on our forward-looking statements. Any forward-looking statements you read in this report reflect our views only as of the date of this report with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We undertake no obligation to update any forward-looking statements made in this report to reflect events or circumstances after the date of this report or to reflect new information or the occurrence of unanticipated events, except as required by law.

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PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
FIVE9, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	March 31, 2019 (Unaudited)	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 93,492	$ 81,912
Marketable investments	205,450	209,907
Accounts receivable, net	25,840	24,797
Prepaid expenses and other current assets	9,719	8,014
Deferred contract acquisition costs	10,095	9,372
Total current assets	344,596	334,002
Property and equipment, net	27,496	25,885
Operating lease right-of-use assets	6,735	—
Intangible assets, net	543	631
Goodwill	11,798	11,798
Other assets	936	836
Deferred contract acquisition costs — less current portion	23,262	21,514
Total assets	$ 415,366	$ 394,666
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,233	$ 7,010
Accrued and other current liabilities	17,965	13,771
Operating lease liabilities	4,322	—
Accrued federal fees	1,348	1,434
Sales tax liabilities	1,404	1,741
Finance lease liabilities	6,208	6,647
Deferred revenue	17,853	17,391
Total current liabilities	56,333	47,994
Convertible senior notes	199,842	196,763
Sales tax liabilities — less current portion	839	841
Operating lease liabilities — less current portion	3,012	—
Finance lease liabilities — less current portion	3,316	4,509
Other long-term liabilities	1,358	1,811
Total liabilities	264,700	251,918
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock	60	59
Additional paid-in capital	303,946	294,279
Accumulated other comprehensive income (loss)	81	(93)
Accumulated deficit	(153,421)	(151,497)
Total stockholders' equity	150,666	142,748
Total liabilities and stockholders' equity	$ 415,366	$ 394,666

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE LOSS
(Unaudited, in thousands, except per share data)

	Three Months Ended March 31, 2019	March 31, 2018
Revenue	$74,538	$58,905
Cost of revenue	30,851	24,702
Gross profit	43,687	34,203
Operating expenses:		
Research and development	10,546	7,772
Sales and marketing	21,701	17,478
General and administrative	11,762	9,103
Total operating expenses	44,009	34,353
Loss from operations	(322)	(150)
Other income (expense), net:		
Interest expense	(3,396)	(810)
Interest income and other	1,745	398
Total other income (expense), net	(1,651)	(412)
Loss before income taxes	(1,973)	(562)
Provision for (benefit from) income taxes	(49)	45
Net loss	$(1,924)	$(607)
Net loss per share:		
Basic and diluted	$(0.03)	$(0.01)
Shares used in computing net loss per share:		
Basic and diluted	59,367	56,399
Comprehensive Loss:		
Net loss	$(1,924)	$(607)
Other comprehensive income	$174	$5
Comprehensive loss	$(1,750)	$(602)

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIVE9, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance as of December 31, 2017	56,632	$ 57	$ 222,202	$ —	$ (175,421)	$ 46,838
Net reduction to opening accumulated deficit due to adoption of ASC 606	—	—	—	—	24,145	24,145
Issuance of common stock upon exercise of stock options	786	1	4,745	—	—	4,746
Issuance of common stock upon vesting of restricted stock units	236	—	—	—	—	—
Stock-based compensation	—	—	5,325	—	—	5,325
Other comprehensive income	—	—	—	5	—	5
Net loss		—	—	—	(607)	$ (607)
Balance as of March 31, 2018	57,654	$ 58	$ 232,272	$ 5	$ (151,883)	$ 80,452
Balance as of December 31, 2018	59,210	$ 59	$ 294,279	$ (93)	$ (151,497)	$ 142,748
Issuance of common stock upon exercise of stock options	216	1	981	—	—	982
Issuance of common stock upon vesting of restricted stock units	211	—	—	—	—	—
Stock-based compensation	—	—	8,686	—	—	8,686
Other comprehensive income	—	—	—	174	—	174
Net loss	—	—	—	—	(1,924)	(1,924)
Balance as of March 31, 2019	59,637	$ 60	$ 303,946	$ 81	$ (153,421)	$ 150,666

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three Months Ended	
	March 31, 2019	March 31, 2018
Cash flows from operating activities:		
Net loss	$(1,924)	$(607)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,192	2,320
Amortization of operating lease right-of-use asset	1,010	—
Amortization of premium on marketable investments	(421)	—
Provision for doubtful accounts	14	48
Stock-based compensation	8,686	5,325
Gain on sale of convertible note held for investment	(217)	(312)
Amortization of discount and issuance costs on convertible senior notes	3,079	—
Others	(17)	(14)
Changes in operating assets and liabilities:		
Accounts receivable	(1,046)	519
Prepaid expenses and other current assets	(1,721)	(1,833)
Deferred contract acquisition costs	(2,471)	(1,662)
Other assets	(7,845)	(90)
Accounts payable	552	1,181
Accrued and other current liabilities	7,724	2,791
Accrued federal fees and sales tax liability	(425)	(115)
Deferred revenue	416	121
Other liabilities	2,604	325
Net cash provided by operating activities	11,190	7,997
Cash flows from investing activities:		
Purchases of marketable investments	(34,427)	—
Proceeds from maturities of marketable investments	39,497	—
Purchases of property and equipment	(3,985)	(433)
Proceeds from sale of convertible note held for investment	217	1,923
Net cash provided by investing activities	1,302	1,490
Cash flows from financing activities:		
Proceeds from exercise of common stock options	982	4,751
Payments of notes payable	—	(157)
Payments of finance leases	(1,894)	(2,352)
Net cash (used in) provided by financing activities	(912)	2,242
Net increase in cash and cash equivalents	11,580	11,729
Cash and cash equivalents:		
Beginning of period	81,912	68,947
End of period	$93,492	$80,676
Supplemental disclosures of cash flow data:		
Cash paid for interest	$235	$765
Cash paid for income taxes	$42	$33
Non-cash investing and financing activities:		
Equipment obtained under capital lease	$—	$2,635

Equipment purchased and unpaid at period-end	$1,875	$281

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIVE9, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Five9, Inc. and its wholly-owned subsidiaries (the “Company”) is a provider of cloud software for contact centers. The Company was incorporated in Delaware in 2001 and is headquartered in San Ramon, California. The Company has offices in Europe and Asia, which primarily provide research, development, sales, marketing, and client support services.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. All intercompany transactions and balances have been eliminated in consolidation.

Certain prior period amounts included in the condensed consolidated financial statements have been reclassified to conform to the current period presentation.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The significant estimates made by management affect revenue and related reserves. Management periodically evaluates such estimates and they are adjusted prospectively based upon such periodic evaluation. Actual results could differ from those estimates.

Significant Accounting Policies

The Company’s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended December 31, 2018. Other than the accounting policies discussed in Note 12 related to the adoption of Accounting Standards Codification (“ASC”) 842, Leases, there has been no material change to the Company’s significant accounting policies during the three months ended March 31, 2019. See Note 12 for the updated accounting policies.

Recently Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2016-02, Leases (Topic 842) and issued subsequent amendments to the initial guidance in 2017, 2018 and 2019 (collectively “ASC 842”). Under the new guidance, a lessee is required to recognize assets and liabilities for both finance, previously known as capital, and operating leases with lease terms of more than 12 months. The ASU also requires disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. Lessor accounting remained largely unchanged from current GAAP. In transition, the Company was required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach that included a number of optional practical expedients that the Company elected to apply. The Company adopted ASC 842 using the modified retrospective method on January 1, 2019. See Note 12 for disclosure on the impact of adopting this standard.

In August 2018, the FASB issued ASU 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (ASU 2018-15), which clarifies the accounting for implementation costs in cloud computing arrangements. The Company early adopted ASU 2018-15 prospectively effective January 1, 2019, to align the requirements for capitalizing implementation costs in a hosting arrangement that is a service contract with

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the requirements for capitalization costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. The adoption of ASU 2018-15 did not have a material impact on the Company's consolidated financial position, operating results or cash flows.

Recent Accounting Pronouncements Not Yet Effective

The Company has reviewed or is in the process of evaluating all other issued, but not yet effective, accounting pronouncements and does not believe the future adoption of any such accounting pronouncements will cause a material impact on its consolidated financial position, operating results or cash flows.

2. Revenue

Contract Balances

The following table provides information about accounts receivable, net, deferred contract acquisition costs, contract assets and contract liabilities from contracts with customers (in thousands):

	March 31, 2019	December 31, 2018
Accounts receivable, net	$25,840	$ 24,797
Deferred contract acquisition costs:		
Current	$10,095	$ 9,372
Non-current	23,262	21,514
Total deferred contract acquisition costs	$33,357	$ 30,886
Contract assets and contract liabilities:		
Contract assets (included in prepaid expenses and other current assets)	$427	$ 330
Contract liabilities (deferred revenue)	17,853	17,391
Net contract assets (liabilities)	$(17,426)	$ (17,061)

The Company receives payments from customers based upon billing cycles. Invoice payment terms are usually 30 days or less. Accounts receivable are recorded when the right to consideration becomes unconditional.

Deferred contract acquisition costs are recorded when incurred and are amortized over a customer benefit period of five years.

The Company's contract assets consist of unbilled amounts typically resulting from professional services revenue recognition when it exceeds the total amounts billed to the customer. The Company's contract liabilities consist of advance payments and billings in excess of revenue recognized.

In the three months ended March 31, 2019, the Company recognized revenue of $11.3 million related to its contract liabilities at January 1, 2019.

Remaining Performance Obligations

As of March 31, 2019, the aggregate amount of the total transaction price allocated in contracts with original duration of greater than one year to the remaining performance obligations was $105.6 million. The Company expects to recognize revenue on approximately three-fourths of the remaining performance obligation over the next 24 months, with the balance recognized thereafter. The Company has elected the optional exemption, which allows for the exclusion of the amounts for remaining performance obligations that are part of contracts with an original expected duration of one year or less. Such remaining performance obligations represent unsatisfied or partially unsatisfied performance obligations pursuant to ASC 606.

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3. Investments and Fair Value Measurements

Marketable Investments

The Company's marketable investments have been classified and accounted for as available-for-sale. The Company's marketable investments as of March 31, 2019 and December 31, 2018 were as follows (in thousands):

	March 31, 2019			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposit	$3,083	$ —	$ —	$3,083
U.S. treasury	7,290	3	—	7,293
U.S. agency securities and government sponsored securities	129,630	12	(7)	129,635
Commercial paper	11,296	—	—	11,296
Municipal bonds	5,989	—	—	5,989
Corporate bonds	48,144	11	(1)	48,154
Total	$205,432	$ 26	$ (8)	$205,450

	December 31, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposit	$4,259	$ —	$ —	$4,259
U.S. treasury	637	—	—	637
U.S. agency securities and government sponsored securities	154,314	1	(111)	154,204
Commercial paper	3,475	—	—	3,475
Municipal bonds	6,090	—	(4)	6,086
Corporate bonds	41,307	—	(61)	41,246
Total	$210,082	$ 1	$ (176)	$209,907

The following table presents the gross unrealized losses and the fair value for those marketable investments that were in an unrealized loss position for less than 12 months as of March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019		December 31, 2018	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. treasury	$—	$140	$—	$637
U.S. agency securities and government sponsored securities	(7)	83,007	(111)	153,212
Municipal bonds	—	5,989	(4)	6,086
Corporate bonds	(1)	12,307	(61)	41,246
Total	$(8)	$101,443	$(176)	$201,181

The contractual maturities of the Company's marketable investments as of March 31, 2019 and December 31, 2018 were less than one year.

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Fair Value Measurements

The Company carries cash equivalents and marketable investments at fair value. Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 — Observable inputs, which include unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are based on management's assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.

The Company determined the fair value of its Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.

Marketable investments classified within Level 2 of the fair value hierarchy are valued based on other observable inputs, including broker or dealer quotations or alternative pricing sources. When quoted prices in active markets for identical assets or liabilities are not available, the Company relies on non-binding quotes from its investment managers, which are based on proprietary valuation models of independent pricing services. These models generally use inputs such as observable market data, quoted market prices for similar instruments, historical pricing trends of a security as relative to its peers. To validate the fair value determination provided by its investment managers, the Company reviews the pricing movement in the context of overall market trends and trading information from its investment managers. The Company performs routine procedures such as comparing prices obtained from independent source to ensure that appropriate fair values are recorded.

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The following table sets forth the Company's assets measured at fair value by level within the fair value hierarchy (in thousands):

	March 31, 2019			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents				
Money market funds	$26,140	$—	$ —	$26,140
U.S. treasury	8,979	—	—	8,979
Commercial paper	—	2,793	—	2,793
Total cash equivalents	$35,119	$2,793	$ —	$37,912
Marketable investments				
Certificates of deposit	$—	$3,083	$ —	$3,083
U.S. treasury	7,293	—	—	7,293
U.S. agency securities and government sponsored securities	—	129,635	—	129,635
Commercial paper	—	11,296	—	11,296
Municipal bonds	—	5,989	—	5,989
Corporate bonds	—	48,154	—	48,154
Total marketable investments	$7,293	$198,157	$ —	$205,450

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents				
Money market funds	$10,833	$—	$ —	$10,833
U.S. treasury	638	—	—	638
U.S. agency securities	—	50	—	50
Commercial paper	—	498	—	498
Total cash equivalents	$11,471	$548	$ —	$12,019
Marketable investments				
Certificates of deposit	$—	$4,259	$ —	$4,259
U.S. treasury	637	—	—	637
U.S. agency securities and government sponsored securities	—	154,204	—	154,204
Commercial paper	—	3,475	—	3,475
Municipal bonds	—	6,086	—	6,086
Corporate bonds	—	41,246	—	41,246
Total marketable investments	$637	$209,270	$ —	$209,907

As of March 31, 2019 and December 31, 2018, the estimated fair value of the Company's outstanding 0.125% convertible senior notes due 2023 was $363.7 million and $316.1 million, respectively. The fair value was determined based on the quoted price of the convertible senior notes in an inactive market on the last trading day of the reporting period and has been classified as Level 2 in the fair value hierarchy. See Note 6 for further information on the Company's 0.125% convertible senior notes due 2023.

There were no assets or liabilities measured at fair value on a non-recurring basis as of March 31, 2019 and December 31, 2018.

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4. Financial Statement Components

Cash and cash equivalents consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Cash	$ 55,580	$ 69,893
Money market funds	26,140	10,833
U.S. treasury	8,979	638
U.S. agency securities	—	50
Commercial paper	2,793	498
Total cash and cash equivalents	$ 93,492	$ 81,912

Accounts receivable, net consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Trade accounts receivable	$ 23,729	$ 23,068
Unbilled trade accounts receivable, net of advance client deposits	2,122	1,741
Allowance for doubtful accounts	(11)	(12)
Accounts receivable, net	$ 25,840	$ 24,797

Prepaid expenses and other current assets consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Prepaid expenses	$ 5,741	$ 5,005
Other current assets	3,551	2,679
Contract assets	427	330
Prepaid expenses and other current assets	$ 9,719	$ 8,014

Property and equipment, net consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Computer and network equipment	$ 57,302	$ 54,452
Computer software	11,241	10,064
Internal-use software development costs	500	500
Furniture and fixtures	1,889	1,491
Leasehold improvements	894	855
Property and equipment	71,826	67,362
Accumulated depreciation and amortization	(44,330)	(41,477)
Property and equipment, net	$ 27,496	$ 25,885

Depreciation and amortization expense associated with property and equipment was $3.1 million and $2.2 million for the three months ended March 31, 2019 and 2018, respectively.

Property and equipment capitalized under finance lease obligations consists primarily of computer and network equipment and was as follows (in thousands):

	March 31, 2019	December 31, 2018
Gross	$ 47,114	$ 47,383
Less: accumulated depreciation and amortization	(35,002)	(33,547)
Total	$ 12,112	$ 13,836

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Accrued and other current liabilities consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Accrued compensation and benefits	$ 13,901	$ 10,277
Accrued expenses	4,064	3,494
Accrued and other current liabilities	$ 17,965	$ 13,771

5. Intangible Assets

The component of intangible assets was as follows (in thousands):

	March 31, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$2,460	$ (1,917)	$ 543	$2,460	$ (1,829)	$ 631

Amortization expense for intangible assets was $88 thousand and $116 thousand for the three months ended March 31, 2019 and 2018, respectively.

As of March 31, 2019, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
2019	263
2020	280
Total	$ 543

6. Debt

0.125% Convertible Senior Notes and Capped Call

In May 2018, the Company issued $258.8 million aggregate principal amount of 0.125% convertible senior notes (“Notes”) due May 1, 2023 in a private offering. The Notes are the Company’s senior unsecured obligations and bear interest at a fixed rate of 0.125% per annum, payable semiannually in arrears on May 1 and November 1 of each year, beginning on November 1, 2018. The total net proceeds from the offering, after deducting initial purchase discounts and estimated debt issuance costs, were approximately $250.7 million.

Each $1,000 principal amount of the Notes is initially convertible into 24.4978 shares of the Company’s common stock (the “Conversion Option”), which is equivalent to an initial conversion price of approximately $40.82 per share of common stock, subject to adjustment upon the occurrence of specified events. The Notes are initially convertible, in multiples of $1,000 principal amount, at the option of the holders at any time prior to the close of business on the business day immediately preceding November 1, 2022, only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ended on September 30, 2018 (and only during such calendar quarter), if the last reported sale price of the Company’s common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the initial conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the “Measurement Period”) in which the trading price (as defined in the indenture governing the Notes) per $1,000 principal amount of Notes for each trading day of the Measurement Period was less than 98% of the product of the last reported sale price of the Company’s common stock and the conversion rate in effect on each such trading day; (3) if the Company calls any or all of the Notes for redemption, at any time prior to the close of business on the second scheduled trading day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate events. On or after November 1, 2022 until the close of business on the second scheduled trading day immediately

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preceding the maturity date, holders may convert all or any portion of their Notes, in multiples of $1,000 principal amount, at the option of the holder regardless of the foregoing circumstances.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. If the Company undergoes a fundamental change (as defined in the indenture governing the Notes), subject to certain conditions, holders may require the Company to repurchase for cash all or any portion of their Notes, in principal amounts of $1,000 or a multiple thereof, at a fundamental change repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date. In addition, following certain corporate events that occur prior to the maturity date or if the Company issues a notice of redemption, it will, under certain circumstances, increase the conversion rate for holders who elect to convert their Notes in connection with such corporate event or during the relevant redemption period.

The closing market price of the Company's common stock of $52.83 per share as of March 29, 2019, the last trading day, during the three months ended March 31, 2019, was below $53.07 per share, which represents 130% of the initial conversion price of $40.82 per share. Additionally, the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day, March 29, 2019, was not greater than or equal to 130% of the initial conversion price on each applicable trading day. As such, during the three months ended March 31, 2019, the conditions allowing holders of the Notes to convert were not met. The Notes were therefore not convertible during the three months ended March 31, 2019 and were classified as long-term debt.

The Company may not redeem the Notes prior to May 5, 2021. The Company may redeem for cash all or any portion of the Notes, at its option, on or after May 5, 2021 if the last reported sale price of its common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period (including the last trading day of such period) ending not more than two trading days immediately preceding the date on which the Company provides notice of redemption at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest, if any, to, but excluding, the redemption date. No sinking fund is provided for the Notes.

The Notes are the Company's senior unsecured obligations and will rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of the Company's unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of the Company's subsidiaries.

In accounting for the transaction, the Notes were separated into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated conversion feature. The carrying amount of the equity component representing the conversion option was $63.8 million and was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component was recorded in additional paid-in-capital and is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount (the "Debt Discount") is being amortized to interest expense over the contractual term of the Notes at an effective interest rate of 6.39%.

In accounting for the debt issuance cost of $8.1 million related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were $6.1 million and are being amortized to interest expense using the effective interest method over the contractual term of the Notes. Issuance costs attributable to the equity component were netted with the equity component in additional paid-in-capital.

The net carrying amount of the liability component of the Notes was as follows (in thousands):

	March 31, 2019	December 31, 2018
Principal	$258,750	$ 258,750
Unamortized debt discount	(53,755)	(56,564)

Unamortized issuance costs	(5,153)	(5,423)
Net carrying amount	$ 199,842	$ 196,763

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There was no change to net carrying amount of the equity component of the Notes since it continued to meet the conditions for equity classification as presented below (in thousands):

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The Company s continuation as a going concern is dependent upon its ability to generate sufficient operating cash flow or to obtain additional financing or refinancing to meet its obligations. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and liabilities should the Company be unable to continue as a going concern.

3. Inventories

Inventories consisted of the following:

	December 31, 2007	2006
Finished goods	$69,027	$65,887
Subassemblies	131,195	316,401
Raw-materials	263,617	908,433
Allowance for excess inventories	(246,000)	(495,000)
	$217,839	$795,721

The total allowance for excess inventories charged to cost of goods sold was approximately $527,000 and $449,000 in 2007 and 2006, respectively. The increase in the allowance in both years related primarily to the VisionFlex robotic inspection system inventories. The Company has not sold any robotic inspection systems since July 2006. At December 31, 2007, all of the inventories related to the VisionFlex robotic inspection systems have been written off against the allowance. Obsolete inventories written off against the allowance were approximately $776,000 and $106,000 in 2007 and 2006, respectively.

4. Property and Equipment

Property and equipment consisted of the following:

	December 31, 2007	2006	Estimated Useful Lives Years
Furniture and fixtures	$148,894	$ 145,042	3 to 7
Machinery and equipment	70,325	70,325	5 to 7
Leasehold improvements	20,866	20,866	1 to 3
	240,085	236,233	
Less accumulated depreciation	231,589	221,739	
	$8,496	$ 14,494	

5. Bank Line of Credit

Effective May 21, 2007, the Company entered into a bank line of credit through May 1, 2009 in the amount of $1,170,000. The interest rate is the bank s reference rate, 7.25% at December 31, 2007. The line is collateralized by a security interest in the assets of the Company and guaranteed by eleven individuals, one of whom is a director of the Company. The Company granted the guarantors five-year warrants to purchase 585,000 shares of common stock at $1.00 per share and, for certain guarantors, a two-year extension to exercise their existing warrants. Warrants to purchase shares of common stock were extended as follows: 250,000 shares at $.70 per share extended to August 1, 2010; 79,197 shares at $1.00 per share extended to July 31, 2009; 20,000 shares at $1.35 per share extended to December 5, 2010; 275,000 shares at $2.75 per share extended to April 14, 2010; and 257,250 shares at $3.50 per share extended to August 24, 2009. Warrants to purchase an aggregate of 46,235 units at $10.80 per unit were extended to March 31, 2009; a unit consists of four (4) shares of common stock and a warrant to purchase one share of common stock at $1.00 per share extended to July 31, 2009. The valuation of the newly issued and incremental cost of the extended warrants was $662,313 as determined by the Black-Scholes-Merton option pricing model. The $662,313 was recorded as deferred financing costs. These costs are amortized to interest expense over the term of the line of credit and the net unamortized balance is offset against stockholders equity. The Company had outstanding indebtedness of $300,000 under the line at December 31, 2007.

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6. Stockholders Equity

Stock Options

Previously, the Company s Board of Directors adopted and the shareholders approved the 2004 Equity Incentive Plan. The Plan, as amended in 2007 and 2005, authorizes the granting of nonqualified or incentive stock options and restricted stock to officers, directors, consultants, advisors and employees for up to 3,800,000 shares of common stock. Vesting and award terms are at the discretion of the Board of Directors or a committee appointed by the Board, but incentive stock options cannot exceed ten years. The Company is incorporated under the laws of New Mexico which do not provide for treasury stock. As a result, the Company issues new shares upon the exercise of stock options and warrants.

In January 2007, the Company granted seven-year stock options to purchase an aggregate of 275,000 shares of common stock at $.70 per share and five-year options to purchase an aggregate of 275,000 shares of common stock at $.77 per share to eight employees and a consultant of the Company. All of the options vested immediately. No options were granted or exercised in 2006.

Stock option activity in 2007 was as follows:

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, beginning of year	1,679,000	$ .72		
Granted	550,000	.74		
Exercised	(19,500)	.50		
Forfeited	(104,000)	.77		

Outstanding, end of year	2,105,500	.72	3.8	$
Exercisable, end of year	2,105,500	.72	3.8	

The weighted-average grant-date fair value of options granted in 2007 was $.55 per share. The aggregate intrinsic value (the amount by which the market price of the stock on the date of exercise exceeded the exercise price) of options exercised in 2007 was $10,797. Net cash proceeds from the exercise of options, in 2007, was $9,653. At December 31, 2007, there was no unrecognized compensation cost related to options.

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Stock Warrants

In December 2007, the Company issued five-year warrants to purchase an aggregate of 120,000 shares of common stock at $.11 per share in satisfaction of accounts payable in the amount of $105,789.

In May 2007, the Company issued warrants to purchase 585,000 shares of common stock to guarantors of the line of credit (Note 5).

In February 2007, the Company extended the exercise date on certain warrants previously granted to a consultant. The fair value of the warrant extensions was $12,304 as determined by the Black-Scholes-Merton option pricing model.

In January 2007, the Company granted five-year warrants to purchase an aggregate of 150,000 shares of common stock at $.70 per share to two directors and a consultant. The warrants were exercisable immediately. The warrants had a market value of $74,531 as determined by the Black-Scholes-Merton option pricing model.

In June 2006, the Company issued five-year warrants to purchase an aggregate of 10,000 shares of common stock at $.56 per share to two directors. The warrants were exercisable immediately. The warrants had a market value of $4,169 as determined by the Black-Scholes-Merton option pricing model.

No stock warrants were exercised in 2007 or 2006.

Warrant activity in 2007 was as follows:

	Warrants	Weighted-Average	Weighted-Average	Aggregate Intrinsic

		Exercise Price	Remaining Contractual Term (in years)	Value
Outstanding, beginning of year	4,599,432	$ 1.92		
Issued	855,000	.82		
Expired	(1,988,810)	1.12		
Outstanding, end of year	3,465,622	2.11	2.5	$
Exercisable, end of year	3,465,622	2.11	2.5	

The weighted-average grant-date fair value for warrants issued during 2007 and 2006 was $.73 and $.42, respectively, per share.

Assumptions

The fair value of options and warrants is estimated at grant date using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions:

	Year Ended December 31,	
	2007	2006
Risk-free interest rates	4.65%	4.93%
Dividend yields	0%	0%
Volatility factors of expected market price of common stock	93%	139%
Weighted average expected life	1.9 years	2.5 years

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Note Receivable for Common Stock

In August 2004, warrants to purchase 114,000 shares of common stock at $1.35 per share were exercised in exchange for a 4.25% one year note receivable for $153,900. The note was extended for one more year in August 2007, 2006 and 2005. The note is collateralized by the stock.

7. Income Taxes

The income tax provisions of $400 and $2,800 for the years ended December 31, 2007 and 2006, respectively, represent taxes currently payable for foreign and state minimum taxes.

Income tax computed at the U.S. federal statutory rate reconciled to the effective tax rate is as follows:

	Year Ended December 31,	
	2007	**2006**
Tax benefit at statutory tax rate	(34.0)%	(34.0)%
Effect of net operating loss	12.5	12.3
Judgment	19.7	
Inventory reserve	(1.5)	15.5
Stock-based compensation	2.5	2.3
Nondeductible interest expense	1.2	1.6
Other	(0.4)	2.4
	0.0%	0.1%

Significant components of net deferred tax assets are as follows:

	December 31,	
	2007	**2006**
Deferred tax assets:		
Operating loss carryovers	$1,482,400	$758,800
Judgment	1,140,700	
Tax credit carryovers	70,500	70,500
Inventory reserve	83,600	168,100
Patent rights	45,500	55,600
Other temporary differences	34,500	46,200
Valuation allowance	(2,857,200)	(1,099,200)
Net deferred tax	$	$

The valuation allowance was provided as it is more likely than not the deferred tax assets will not be realized. The valuation allowance increased $1,758,000 and $323,400 in 2007 and 2006, respectively, primarily because of the Company s inability to utilize net operating losses and the judgment against the Company.

At December 31, 2007, the Company had approximately $4,360,000 in federal net operating loss and $71,000 in federal general business credit carryovers, which expire on various dates through 2027 and 2024, respectively.

Certain foreign and state tax effects are immaterial and not separately disclosed.

8. Employee Benefit Plan

The Company maintains a 401(k) plan for its employees. The employees are allowed to contribute to the Plan as provided under the law. Any matching contributions by the Company are at the discretion of the Board of Directors. The Company contributed $10,641 to the plan during 2007. There were no matching contributions for the year ended December 31, 2006.

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9. Commitments

Operating Leases

Facilities are leased under operating leases, one of which was amended in March 2008, and expire on various dates through 2010. The leases require monthly base rents plus increases for operating expenses and/or property taxes as defined in the leases. Rent expense for all leases was approximately $122,400 and $125,100 for 2007 and 2006, respectively.

Approximate future minimum lease payments are as follows:

2008	$90,500
2009	49,500
2010	12,400
	$152,400

Employment Agreements

The Company has an employment agreement with its Chief Executive Officer at an annual salary of $280,000. The agreement also contains a provision that requires the Company to pay an amount equal to the annual salary if he is terminated without cause. The agreement can be terminated by either party with a 30-day written notice to the other.

The Company has an employment agreement with its President at an annual salary of $180,000. The agreement also contains a provision that requires the Company to pay an amount equal to one half the annual salary if he is terminated without cause. The agreement can be terminated by either party with a 30-day written notice to the other.

On July 13, 2007, as an incentive for their continued employment with the Company, the Compensation Committee authorized the grant of a security interest in all of the assets of the Company to its Chief Executive Officer and President securing payment of the salary and severance payments due to them under the terms of their employment agreements. The respective employment agreements were amended on July 13, 2007 to reflect this security interest. On October 29, 2007, the Company entered into a Security Agreement and a Patent Security and License Agreement with its Chief Executive Officer and President. Together, these agreements grant a security interest, subordinated to the bank line of credit, in all of the assets of the Company to them.

10. Major Customers and Geographic Information

The following table shows by major customer and by country the percentage of revenues for the respective years and the percentage of receivables at December 31 of the respective years:

Customer (Location)		2007 Revenues		Receivables		2006 Revenues		Receivables	
A	(Singapore)	57	%	70	%	32	%	72	%
B	(Japan)					14			
C	(United States)					13			
D	(Japan)	10				13		2	
E	(United States)	1				12		1	

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Geographic Information

Revenues	Year Ended December 31, 2007	2006
Singapore	$861,500	$868,400
United States	190,600	741,400
Japan	130,000	673,300
Canada	99,500	2,800
Malaysia	40,200	29,400
Taiwan	25,800	161,800
Others outside the United States	19,429	20,050
	$1,367,029	$2,497,150

11. Contingencies and Uncertainty

In an agreement dated April 19, 2002, the Company s Chief Executive Officer (CEO) forgave the payment of his accrued salary of $1,254,575 and released the Company, its successors, its officers and directors from any liability in connection with the accrued salary. In exchange, the Company agreed that its CEO will receive certain proceeds, if any, that Scanner may receive out of litigation involving patents that Scanner had licensed. Under the agreement, the Company keeps 60% of any proceeds of the currently ongoing litigation and pays its CEO 40% of such proceeds until the Company has been reimbursed for all attorney fees and other expenses incurred in connection with the current litigation, and its CEO has received the total of $1,254,575. If one party receives all the amounts owing to such party before the other party s claim under this provision is satisfied, the other party receives 100% of the proceeds until its claim is satisfied. If any proceeds remain after such payment, the Company s CEO receives 50% of such remainder. He also has a right to receive part of the proceeds, if any, the Company may receive out of any subsequent litigation involving the licensed patents. The Company keeps 60% of any such proceeds until its attorney fees and other expenses incurred in connection with the current and any subsequent litigation have been reimbursed, and its CEO receives 40% of any such proceeds until he has received a total of $1,254,575 of the proceeds of the currently ongoing and any subsequent litigation. If any proceeds of the subsequent litigation remain after such distribution, the Company will pay 25% of such remaining proceeds to its CEO. To date, aggregate proceeds of $160,000, related to this agreement, were paid to the CEO, which occurred in 2003.

To provide the Company s President with an incentive to continue his employment with the Company, and to compensate him for compensation which the Company believes was less than he might have received in a comparable position elsewhere, the President was also a party to the agreement regarding the distribution of litigation proceeds. The Company agreed to pay him 20% of the remaining proceeds, if any, Scanner receives out of the current ongoing litigation, and 25% of the remaining proceeds, if any, that Scanner may receive out of any future litigation involving the licensed patents, and that remain after the aforesaid payments to the Company and its CEO have been made out of such proceeds.

In July 2000, the Company instituted a lawsuit against ICOS Vision Systems Corp. N.V. (ICOS) for infringement of two of its patents (U.S. Patent Nos. 6,064,756 and 6,064,757). The patents disclose systems and methods of inspecting ball grid array devices in three dimensions. The United States District Court for the Southern District of New York found no infringement with regard to two-illumination source devices that ICOS sold. In June 2003, the Company reached a settlement with ICOS concerning one-illumination source inspection systems. Pursuant to the settlement agreement, ICOS made a one-time payment of $400,000 to the Company, in 2003 to settle all issues with regard to these one-light source inspection systems. The Company agreed to the settlement agreement with respect to one-light source devices in order to allow it to immediately appeal the court s ruling concerning inspection systems involving two-light sources, eliminating the need, delay and expense of a trial with regard to these systems at that stage. On April 23, 2004, the United

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States Court of Appeals ruled in the Company s favor with regard to the two-illumination source devices, finding that the claim terms an illumination apparatus and illuminating in the Company s patents encompass one or more illumination sources and overturned the District Court s entry of summary judgment of no infringement. A trial was held in March 2005 in the District Court regarding the Company s ongoing litigation with ICOS. ICOS later instituted actions against the Company in 2005 and 2007 asking the court to declare patents 6,064,756 and 6,064,757, and other related patents invalid and not infringed. On June 1, 2007, the New York court entered an order finding the Company s 6,064,756 and 6,064,757 patents not infringed by ICOS and its customers, and barring the Company from enforcing all of its patents related to inspecting ball grid array devices in three dimensions. The Company wrote off the net unamortized balance of the invalid patents in the second quarter of 2007. As a result of the ruling, the court dismissed the 2005 and 2007 ICOS actions and permitted ICOS to move for attorney s fees and costs. On September 12, 2007, the Company filed an appeal with the United States Court of Appeals for the District Court regarding this case. On November 2, 2007, the New York District court issued a supplemental judgment that ordered Scanner to pay ICOS $2,717,934 in attorney s fees, $245,229 in costs, and $391,870 in expert fees, for a total award of fees and costs of $3,355,033. On November 7, 2007, the Company filed an emergency motion with the United States Court of Appeals for the District Court regarding the judgment and on November 8, 2007, the Court of Appeals ordered a temporary stay of the supplemental judgment. On January 3, 2008, the Court of Appeals ordered a stay of the supplemental judgment. The Court of Appeals order stated: To obtain a stay, pending appeal, a movant must establish a strong likelihood of success on the merits or, failing that, nonetheless demonstrate a substantial case on the merits provided that the harm factors militate in its favor and Based upon our review of the parties submissions, and without prejudicing the ultimate determination of this case by a merits panel, we determine that Scanner Tech has shown that a stay, pending appeal, is warranted. As of March 13, 2008, the Company completed briefing on the appeal of the original and supplemental judgments, and the matter is expected to be heard by the Court of Appeals by the summer of 2008. The Company intends to vigorously defend itself and its intellectual property rights and expects to incur significant additional expenses to pursue its claims. If the Company is successful on its appeal, some of the proceeds received or to be received, if any, by Scanner in connection with the foregoing lawsuit or subsequent litigation with respect to patent litigation have been or will be distributed to its CEO and President in accordance with employment agreements. No assessment of the likely outcome of the appeal can be made at this time.

12. Subsequent Event

On January 11, 2008, the Company granted ten-year stock options to purchase an aggregate of 700,000 shares of common stock at $.07 per share and five-year stock options to purchase an aggregate of 1,050,000 shares of common stock at $.077 per share to seven employees and a consultant to the Company. All of the options vest immediately. In addition, the Company granted ten-year warrants to purchase an aggregate of 350,000 shares of common stock at $.07 per share to two directors and a consultant. The warrants are immediately exercisable. The fair value of the stock options and warrants issued was approximately $133,300 as determined by the Black-Scholes-Merton option pricing model. This stock-based compensation will be expensed in the quarter ending March 31, 2008.

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EXHIBIT INDEX

SCANNER TECHNOLOGIES CORPORATION

FORM 10-KSB FOR THE YEAR ENDED DECEMBER 31, 2007

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of the Registrant--incorporated by reference to Exhibit 2.3 to the Registrant s Current Report on Form 8-K filed on August 15, 2002
3.2	Amended and Restated Bylaws of the Registrant--incorporated by reference to Exhibit 2.4 to the Registrant s Current Report on Form 8-K filed on August 15, 2002
10.1	License Agreement dated November 16, 1990 between the Registrant, Elwin M. Beaty and Elaine E. Beaty--incorporated by reference to Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2002
10.2	Agreement dated April 19, 2002 among the Registrant, Elwin M. Beaty and David P. Mork relating to forgiveness of salary--incorporated by reference to Exhibit 10.3 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2002
10.3	Lease Agreement dated December 7, 2000 between Registrant and Carleton Investors, L.L.C. relating to Registrant s Arizona premises--incorporated by reference to Exhibit 10.4 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2002
10.4	Amendment to Lease dated December 15, 2003 and Second Amendment to Lease dated January 21, 2004 between Registrant and Carleton Investors, L.L.C. relating to Registrant s Arizona premises--incorporated by reference to Exhibit 10.5 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2003
10.5	Amendment to Lease Agreement dated November 21, 2003 between Registrant and Parkers Lake II Realty Corp. relating to Registrant s Minnesota premises--incorporated by reference to Exhibit 10.6 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2003
10.6	Employment Agreement by and between the Registrant and Elwin M. Beaty, as amended July 13, 2007--incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2007**
10.7	Employment Agreement by and between the Registrant and David P. Mork, as amended July 13, 2007--incorporated by reference to Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2007**
10.8	2004 Equity Incentive Plan, as amended--incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on June 11, 2007**
10.9	Form of incentive stock option agreement and nonqualified stock option agreement currently used under the 2004 Equity Incentive Plan--incorporated by reference to Exhibit 10.12 to Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2004**

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Exhibit Number	Description
10.10	Form of restricted stock agreement currently used under the 2004 Equity Incentive Plan--incorporated by reference to Exhibit 10.13 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2004**
10.11	Common Stock Purchase Warrant (20,000 shares) dated December 27, 2004 issued to Betsy Brenden Radtke--incorporated by reference to Exhibit 10.14 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2004**
10.12	Common Stock Purchase Warrant (20,000 shares) dated December 27, 2004 issued to Michael A. Thorsland--incorporated by reference to Exhibit 10.15 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2004**
10.13	Common Stock Purchase Warrant (5,000) shares dated June 8, 2006 issued to Betsy Brenden Radtke--incorporated by reference to Exhibit 10.18 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2006**
10.14	Common Stock Purchase Warrant (5,000) shares dated June 8, 2006 issued to Michael A. Thorsland--incorporated by reference to Exhibit 10.19 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2006**
10.15	Third Amendment to Lease dated February 19, 2004 and Lease Renewal Addendum dated January 29, 2007 to Lease Agreement between the Registrant and Carleton Park Associates, L.L.C. as successor to Carleton Investors, L.L.C. relating to Registrant s Arizona premises--incorporated by reference to Exhibit 10.20 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2006
10.16	Amendment to Lease Agreement dated March 9, 2007 between the Registrant and Parkers Lake II Realty Corp. relating to Registrant s Minnesota premises--incorporated by reference to Exhibit 10.21 to the Registrant s Annual Report on Form 10-KSB for the year ended December 31, 2006
10.17	Business Loan Agreement dated April 12, 2007 between the Company and Bremer Bank, N.A.--incorporated by reference to Exhibit 10.1 of the Registrant s Quarterly Report on Form 10-QSB for the quarter ended June 30, 2007
10.18	Promissory Note dated April 12, 2007 in favor of Bremer Bank, N.A., Commercial Security Agreement dated April 12, 2007 between the Company and Bremer Bank, N.A. and Change in Terms Agreement dated May 21, 2007 between the Company and Bremer Bank, N.A.--incorporated by reference to Exhibit 10.2 of the Registrant s Quarterly Report on Form 10-QSB for the quarter ended June 30, 2007
10.19	Security Agreement by and between the Registrant, David P. Mork and Elwin M. Beaty, dated October 29, 2007--incorporated by reference to Exhibit 10.3 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2007**
10.20	Patent Security and License Agreement by and between the Registrant, David P. Mork and Elwin M. Beaty, dated October 29, 2007--incorporated by reference to Exhibit 10.4 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended September 30, 2007**

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Exhibit Number	**Description**
10.21	Common Stock Purchase Warrant (50,000) shares dated January 24, 2007 issued to Betsy Brenden Radtke--incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended March 31, 2007**
10.22	Common Stock Purchase Warrant (50,000) shares dated January 24, 2007 issued to Michael A. Thorsland--incorporated by reference to Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-QSB for the quarter ended March 31, 2007**
10.23*	Common Stock Purchase Warrant (150,000) shares dated January 11, 2008 issued to Betsy Brenden Radtke**
10.24*	Common Stock Purchase Warrant (150,000) shares dated January 11, 2008 issued to Michael A. Thorsland**
10.25*	Lease Renewal Addendum dated March 2, 2008 between the Registrant and Carleton Park Associates, L.L.C. as successor in interest to Carleton Investors, L.L.C. relating to Registrant s Arizona premises
21.1	Subsidiary of the Registrant--incorporated by reference to Exhibit 21 to the Registrant s Quarterly Report Form 10-QSB filed on November 14, 2002
23.1*	Consent of Lurie Besikof Lapidus & Company, LLP
31*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32*	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

*Filed herewith.

** Management agreement or compensatory plan or arrangement.

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