SCANNER TECHNOLOGIES CORP
Form 10QSB
May 21, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2007

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 000-08149

SCANNER TECHNOLOGIES CORPORATION

(Exact name of small business issuer as specified in its charter)

New Mexico	**85-0169650**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

14505 21st Avenue North, Suite 220, Minneapolis, MN 55447
(Address of principal executive offices)

(763) 476-8271
(Issuer s telephone number)

Check whether the Issuer (1) filed all reports to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The Issuer had 12,235,568 shares of Common Stock, no par value, outstanding as of April 20, 2007.

Transitional Small Business Disclosure Format (Check one): Yes o No x

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SCANNER TECHNOLOGIES CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SCANNER TECHNOLOGIES CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended March 31, 2007	2006
REVENUES	$ 302,921	$ 865,975
COST OF GOODS SOLD	169,933	367,707
GROSS PROFIT	132,988	498,268
OPERATING EXPENSES		
Selling, general and administrative	917,281	568,760
Research and development	8,554	8,659
Legal fees	107,344	15,379
	1,033,179	592,798
LOSS FROM OPERATIONS	(900,191)	(94,530)
OTHER INCOME (EXPENSE)		
Interest expense	(83)	(20,450)
Miscellaneous	5,607	(1,570)
LOSS BEFORE INCOME TAXES	(894,667)	(116,550)
INCOME TAXES	400	2,000
NET LOSS	$ (895,067)	$ (118,550)
NET LOSS PER SHARE BASIC AND DILUTED	$ (0.07)	$ (0.01)

WEIGHTED AVERAGE SHARES OUTSTANDING BASIC AND DILUTED	12,216,925	12,216,068

See notes to condensed consolidated financial statements.

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SCANNER TECHNOLOGIES CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2007 (unaudited)	**December 31, 2006**
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 284,910	$ 688,251
Accounts receivable, less allowance of $15,000	294,436	343,926
Inventories	705,403	795,721
Prepaid expenses	27,711	36,564
TOTAL CURRENT ASSETS	1,312,460	1,864,462
PROPERTY AND EQUIPMENT, net	15,954	14,494
PATENT RIGHTS, net	82,334	97,772
OTHER	7,199	7,199
	$ 1,417,947	$ 1,983,927
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 49,346	$ 111,700
Accrued expenses	111,650	128,653
TOTAL CURRENT LIABILITIES	160,996	240,353
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock, no par value, 50,000,000 shares authorized; no shares issued and outstanding		
Common stock, no par value, 50,000,000 shares authorized; 12,235,568 and 12,216,068 shares issued and outstanding	7,670,088	7,261,644
Note receivable for common stock	(153,900)	(153,900)
Accumulated deficit	(6,259,237)	(5,364,170)
	1,256,951	1,743,574
	$ 1,417,947	$ 1,983,927

See notes to condensed consolidated financial statements.

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SCANNER TECHNOLOGIES CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three Months Ended March 31, 2007	2006
OPERATING ACTIVITIES		
Net loss	$ (895,067)	$ (118,550)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation	2,391	4,162
Amortization of patent rights	15,438	15,438
Stock option and warrant compensation expense	398,791	21,755
Amortization of deferred financing costs		17,311
Changes in operating assets and liabilities:		
Accounts receivable	49,490	(240,486)
Inventories	90,318	209,169
Prepaid expenses and other	8,853	(26,276)
Accounts payable	(62,354)	(50,656)
Accrued expenses	(17,003)	43,679
Net cash used by operating activities	(409,143)	(124,454)
INVESTING ACTIVITY		
Purchases of property and equipment	(3,851)	(952)
FINANCING ACTIVITIES		
Payments on bank line of credit		(490,000)
Proceeds from exercise of stock options	9,653	
Net cash provided (used) by financing activities	9,653	(490,000)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(403,341)	(615,406)
CASH AND CASH EQUIVALENTS		
Beginning of period	688,251	1,168,532
End of period	$ 284,910	$ 553,126
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for:		
Interest	$ 83	$ 3,139
Income taxes	400	2,000

See notes to condensed consolidated financial statements.

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SCANNER TECHNOLOGIES CORPORATION AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Basis of Presentation and Significant Accounting Policies -

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2006 included in our Annual Report on Form 10-KSB.

Nature of Business

The Company invents, develops and markets vision inspection products that are used in the semiconductor industry for the inspection of integrated circuits. The Company s customer base is small in numbers and global in location.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Scanner Technologies Corporation and its wholly owned subsidiary, Scanner Technologies Corporation International, incorporated in the United States and formerly registered in Singapore. The subsidiary ceased operations during 2006. All significant intercompany balances and transactions have been eliminated.

Revenue Recognition

Revenue is earned primarily through sales of vision inspection products to distributors and to third party customers. For sales to distributors, revenue is recognized upon shipment as the distributors have no acceptance provisions and title passes at shipment. For sales to third party customers, title passes at shipment; however, the customer has certain acceptance provisions relating to installation and training. These provisions require the Company to defer revenue recognition until the equipment is installed and the customers personnel are trained. As a result, revenue is recognized for third party customers once the product has been shipped, installed and customer personnel are trained. This process typically is completed within two weeks to a month after shipment.

Estimates

The preparation of these condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant management estimates relate to the inventory allowance for excess inventories and the valuation allowance on deferred tax assets.

Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

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Accounts Receivable

Accounts receivable arise from the normal course of selling products on credit to customers. An allowance for doubtful accounts has been provided for estimated uncollectable accounts. Accounts receivable balances, historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment terms and practices are analyzed when evaluating the adequacy of the allowance for doubtful accounts. Individual accounts are charged against the allowance when collection efforts have been exhausted.

Fair Value of Financial Instruments

The carrying amounts of financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate their fair values.

Inventories

Inventories are stated at the lower of cost or market with cost determined on the first-in, first-out method. The Company has provided an allowance for estimated excess and obsolete inventories equal to the difference between the cost of inventories and the estimated fair value based on assumptions about future demand and market conditions. Inventory quantities, historical sales, company and industry sales projections, current economic conditions and technological changes are analyzed when evaluating the adequacy of the allowance for excess inventories. Obsolete inventories are charged against the reserve.

The Company has a significant quantity of potentially excess inventories. An allowance has been provided for these excess inventories. After considering the allowance provided, the Company may have up to two years of some inventory items on hand. Depending on the occurrence of future events, the allowance may increase or decrease. Management believes that this inventory does not currently have a significant risk of technological obsolescence nor does it, based on recent selling prices and estimated carrying costs, have any significant net realization concerns.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is provided using accelerated methods. Leasehold improvements are amortized using the straight-line method over the shorter of the useful life or lease term.

Patent Rights

Patent rights are stated at cost less accumulated amortization. Amortization is provided using the straight- line method over six years, the deemed useful lives of the patents.

Long-Lived Assets

All long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. This evaluation is performed at least annually. An impairment loss is recognized when estimated undiscounted cash flows to be generated by those assets are less than the carrying value of the assets. When an impairment loss is recognized, the carrying amount is reduced to its estimated fair value, based on appraisals or other reasonable methods to estimate value.

Product Warranty

An accrual is provided for estimated incurred but unidentified product warranty issues based on historical activity. The warranty accrual and related expenses were not significant.

Accounting for Stock-Based Compensation

The Company has a stock-based employee compensation plan consisting of stock options and warrants. Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (as amended), using the modified prospective application method and the interpretations in U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 107, Share-Based Payment. Among other items, SFAS No. 123R requires companies to recognize the cost of employee/director services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements.

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Under the modified prospective application method, awards that are granted or modified after the date of adoption of SFAS No. 123R are measured and accounted for in accordance with SFAS No. 123R. Compensation cost for awards granted, prior to but not vested as of the date SFAS No. 123R was adopted, is based on the grant date attributes similar to those originally used to value those awards for the pro forma disclosure purposes under SFAS No. 123, Accounting for Stock-Based Compensation. The unaudited Condensed Consolidated Statements of Operations for the three months ended March 31, 2007 and 2006 reflect share-based compensation expense of $398,791 ($0.03 per basic and diluted share) and $21,755 ($0.00 per basic and diluted share), respectively. At March 31, 2007, there was $20,970 of total unrecognized compensation cost related to non-vested share-based compensation, which cost will be recognized in 2007.

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

	2007	**2006**
Risk-free interest rate	4.74%	4.93%
Dividend yield	0%	0%
Volatility factor of expected market price of common stock	131%	139%
Weighted average expected life	2.8 years	2.5 years

Income Taxes

The Company is taxed as a domestic U.S. corporation under the Internal Revenue Code. Deferred income tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Deferred income tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using currently enacted tax rates in effect for the years in which the differences are expected to reverse. Deferred tax assets are evaluated and a valuation allowance is established if it is more likely than not that all or a portion of the tax asset will not be utilized.

The Company s adoption, as of January 1, 2007, of Financial Accounting Standards Board Interpretation 48, Accounting for Income Tax Uncertainties, did not have a significant impact on the company s consolidated financial position, results of operations and liquidity.

Credit Risk

The Company maintains cash and cash equivalents in bank accounts which may exceed federally insured limits. The Company has not experienced any losses on such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Significant concentrations of credit risk exist in accounts receivable, which are due from customers located primarily in the Far East and the United States.

Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average common shares outstanding for the reported period. Diluted net loss per share reflects the potential dilution that could occur if holders of warrants and options that are not antidilutive converted their holdings into common stock. All warrants and options were antidulitive in the three months ended March 31, 2007 and 2006, respectively.

Options and warrants to purchase 6,443,950 and 6,499,432 shares of common stock with a weighted average exercise price of $1.58 and $1.59 were excluded from the diluted computation for the three months ended March 31, 2007 and 2006, respectively, because they were antidulitive.

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2. Inventories -

Inventories consisted of the following:

	March 31, 2007	**December 31, 2006**
Finished goods	$65,045	$65,887
Subassemblies	300,027	316,401
Raw materials	900,331	908,433
Allowance for excess inventories	(560,000)	(495,000)
	$705,403	$795,721

3. Contingencies and Uncertainty -

In an agreement dated April 19, 2002, the Company s President and Chief Executive Officer (President) 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 President 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

President 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 President 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 President 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 President 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 President. To date, aggregate proceeds of $160,000, related to this agreement, were paid to the President, which occurred in 2003.

To provide the Company s Senior Vice President with an incentive to continue his employment with the Company, and to compensate him for compensation in recent years which the Company believes was less than he might have received in a comparable position elsewhere, the Senior Vice 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 President have been made out of such proceeds.

In 2000, the Company instituted a lawsuit against ICOS Vision Systems Corp. N.V., a Belgian corporation (ICOS) for infringement of two of its patents. The patents relate to three-dimensional ball array inspection apparatus and methods. 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 U.S. District Court for the Southern District of New York found no infringement with regard to the two-illumination source devices that ICOS sold. 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 this stage. On April 23, 2004, the United 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, to be decided by the judge, was held in March 2005 in the District Court regarding the Company s ongoing litigation with ICOS. Scanner s request for relief includes requests for damages in the form of lost

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profits, a trebling of damages pursuant to 35 USC 284, and attorneys fees and costs. In its answer to the complaint, ICOS included counterclaims alleging various forms of unfair competition as well as seeking a declaration that the patents are invalid and not infringed. In addition, ICOS is requesting attorneys fees and costs. As of April 20, 2007, the judge has not issued a decision on the case. The Company intends to continue to vigorously enforce its patent rights and expects to incur significant additional expenses to pursue its claims. Some of the proceeds received or to be received by Scanner in connection with the foregoing lawsuit or subsequent litigation with respect to patent litigation have been or will be distributed to its President and Senior Vice President in accordance with employment agreements.

In July 2005 and January 2007, ICOS Vision Systems Corp. N.V. and ICOS Vision Systems, Inc. (collectively, ICOS) filed a lawsuit against the Company in the U.S. District Court for the Southern District of New York. ICOS is seeking a declaratory judgment with respect to certain patents held by Scanner finding that ICOS does not infringe such patents and that such patents are invalid. ICOS is also seeking a declaratory judgment finding that U.S. companies that purchase electronic components such as Ball Grid Array devices inspected on ICOS systems in foreign countries are not liable as infringers of such patents and injunctive relief enjoining Scanner from threatening such purchasers with claims of infringement. ICOS is seeking damages of unspecified amounts, as well as costs, expenses and attorney s fees. The Company believes that this lawsuit is without merit and intends to vigorously defend itself and the Company s intellectual property rights.

In July 2005, American Arium (Arium), a Delaware corporation with a principal office located in Tustin, California, filed a lawsuit against the Company in the U.S. District Court for the Central District of California. Arium is seeking a declaratory judgment with respect to certain patents held by Scanner finding that Arium does not infringe such patents and that such patents are invalid. Arium is also seeking injunctive relief enjoining Scanner from threatening Arium and it customers with claims of infringement. Arium is seeking its costs, expenses and attorney s fees. The Company believes that this lawsuit is without merit and intends to vigorously defend itself and the Company s intellectual property rights.

In September 2006, the Company filed a lawsuit in the United States District Court, Eastern District of Texas against nVidia Corporation claiming willful and deliberate infringement of U.S. Patents numbered 7,079,678 and 7,085,411 which disclose methods of three-dimensional inspection that allow ball grid array (BGA) devices to be manufactured more precisely and efficiently. The complaint alleges that nVidia has sold and/or is presently selling throughout the United States infringing BGA devices that are covered by one or more claims of the Company s Patents. The complaint also alleges that nVidia has induced others to infringe. These BGA devices are a component in graphics cards, motherboards, computers, video game consoles, cell phones and handheld devices that are sold in the United States. In addition to requesting preliminary and permanent injunctions, the complaint asks the court to award the Company all damages it is entitled to recover, including reasonable royalties on infringing products, treble damages and attorneys fees.

4. Stock Options and Warrants -

On January 24, 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 stock 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. In addition, 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 immediately exercisable. The fair value of the stock options and warrants was approximately $377,000 as determined by the Black-Scholes-Merton option pricing model. In addition, on February 9, 2007, the Company extended the exercise date on certain warrants previously granted to a consultant. The fair value of the warrant extensions was approximately $12,000 as determined by the Black-Scholes-Merton option pricing model.

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5. Subsequent Event -

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, currently 8.25%. The line is collateralized by a security interest in the assets of the Company and guaranteed by eleven individuals, one of whom is Michael Thorsland, 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. The valuation of the newly issued and extended warrants was approximately $496,000 as determined by the Black-Scholes-Merton option pricing model. This amount will be recorded as deferred financing costs and will be amortized over the term of the line of credit.

Item 2. Management s Discussion and Analysis Or Plan Of Operation

This Quarterly Report on Form 10-QSB includes forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended (Exchange Act). These statements are based on our beliefs and assumptions and on information currently available to us. Forward-looking statements include, among others, the information concerning possible or assumed future results of operations of Scanner Technologies Corporation and its subsidiary (Scanner) set forth under the heading Management s Discussion and Analysis or Plan of Operation. Forward-looking statements also include statements in which words such as may, will, should, could, expect, anticipate, intend, plan, estimate, predict, potential, or similar expressions are used. Forward-looking statements are not guarantees of future performance. Our future results and shareholder value may differ materially from those expressed in these forward-looking statements. We caution you not to put undue reliance on any forward-looking statements included in this document.

GENERAL

The Company generates revenues from the sale of machine-vision inspection products used in the semiconductor industry for the inspection of integrated circuits. The products include machine-vision modules sold to original equipment manufacturers that use the modules as a component of inspection systems they sell to end users, as well as complete machine-vision inspection systems that the Company sells to end users. Because the Company sells relatively few of its devices each year, the Company s business is characterized by uneven quarterly results that are dependent on the timing, nature and mix of sales.

In addition to general trends in the semiconductor marketplace, the Company must compete for sales with other providers of machine-vision inspection equipment, most of whom are larger, better financed and offer a broader selection of products. The Company must compete on the basis of price, product performance including speed and size of defects detected, ease of use and technological advancement. The Company must continue research and development to improve existing products and introduce new products in order to compete effectively with other providers of inspection equipment.

The Company is seeking to license its technologies to third parties to provide additional revenues. There is, however, no assurance that the Company will be successful in obtaining licenses on financially advantageous terms, and the Company may need to initiate lawsuits, and incur legal fees and other costs, to force potential licensees to acknowledge our proprietary rights and enter into appropriate licenses.

During the three months ended March 31, 2007, the Company s working capital position decreased primarily due to the net effect of the operating loss.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of financial condition and results of operations is based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company evaluates, on an on-going basis, its estimates and judgments, including those related to bad debts, excess inventories, warranty obligations, income taxes, contingencies and litigation. Its estimates are based on historical experience and assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its condensed consolidated financial statements.

Revenue recognition
Allowances for doubtful accounts and excess inventories
Patent rights
Deferred income taxes and valuation allowance
Valuation of options and warrants

Revenue is earned primarily through sales of vision inspection products to distributors and to third party customers. For sales to distributors, revenue is recognized upon shipment as the distributors have no acceptance provisions and title passes at shipment. For sales to third party customers, title passes at shipment; however, the customer has certain acceptance provisions relating to installation and training. These provisions require the Company to defer revenue recognition until the equipment is installed and the customers personnel are trained. As a result, revenue is recognized for third party customers once the product has been shipped, installed and customer personnel are trained. This process typically is completed within two weeks to a month after shipment.

Accounts receivable arise from the normal course of selling products on credit to customers. An allowance for doubtful accounts has been provided for estimated uncollectable accounts. Accounts receivable balances, historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment terms and practices are analyzed when evaluating the adequacy of the allowance for doubtful accounts. Individual accounts are charged against the allowance when collection efforts have been exhausted.

Inventories are stated at the lower of cost or market with cost determined on the first-in, first-out method. The Company has provided an allowance for estimated excess and obsolete inventories equal to the difference between the cost of inventories and the estimated fair value based on assumptions about future demand and market conditions. Inventory quantities, historical sales, company and industry sales projections, current economic conditions and technological changes are analyzed when evaluating the adequacy of the allowance for excess inventories. The Company has a significant quantity of potentially excess inventories. An allowance has been provided for these excess inventories. After considering the allowance provided, the Company may have up to two years of some inventory items on hand. Management believes that this inventory does not currently have a significant risk of technological obsolescence nor does it, based on recent selling prices and estimated carrying costs, have any significant net realization concerns. The preceding sentence is a forward-looking statement and subject to certain risks. There is no assurance that the Company s products or future products, if any, will not become obsolete as a result of new product introductions or other technological advancements. Obsolete inventories are charged against the allowance. Depending on the occurrence of future events, the allowance may increase or decrease.

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Patent rights are stated at cost less accumulated amortization. Amortization is provided using the straight-line method over six years. Patent rights are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. This evaluation is performed at least annually. An impairment loss is recognized when estimated cash flows to be generated by those assets are less than the carrying value of the assets. When impairment loss is recognized, the carrying amount is reduced to its estimated fair value, based on appraisals or other reasonable methods to estimate value.

The Company is taxed as a domestic U.S. corporation under the Internal Revenue Code. Deferred income tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Deferred income tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using currently enacted tax rates in effect for the years in which the differences are expected to reverse. Deferred tax assets are evaluated and a valuation allowance is established if it is more likely than not that all or a portion of the tax asset will not be utilized. The Company s adoption, as of January 1, 2007, of Financial Accounting Standards Board Interpretation 48, Accounting for Income Tax Uncertainties, did not have a significant impact on the company s consolidated financial position, results of operations and liquidity.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (as amended), using the modified prospective application method and the interpretations in U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 107, Share-Based Payment. Among other items, SFAS No. 123R requires companies to recognize the cost of employee/director services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. See Note 1 to the unaudited condensed consolidated financial statements for additional information.

The Company estimates the fair value of options and warrants at the grant date using the Black-Scholes-Merton option pricing model. The model takes into consideration weighted average assumptions related to the following: risk-free interest rate; expected life; expected volatility; and expected dividend rate.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2007 COMPARED TO THREE MONTHS ENDED MARCH 31, 2006

Sales for the three months ended March 31, 2007, were $302,921 compared to $865,975 for the three months ended March 31, 2006. Two of the Company s VisionFlex robotic inspection systems were sold in the first quarter of 2006 and none were sold in 2007. The number of modules sold in the first quarter of 2007 was also less than the number sold in the first quarter of 2006. Since the Company sells relatively few of its devices each year, its business is characterized by uneven quarterly results that are dependent on the timing, nature and mix of sales.

Cost of goods sold decreased by $197,774 to $169,933 in the three months ended March 31, 2007, from $367,707 in 2006. Cost of goods sold as a percentage of sales increased by 13.6 percentage points to 56.1% in 2007 compared to 42.5% in 2006. The increase in cost of goods sold as a percentage of sales resulted primarily from a decrease in sales of VisionFlex robotic inspection systems and an increase in the allowance for excess inventories. The total allowance for excess inventories charged to cost of goods sold was approximately $65,000 and $44,000 in the three months ended March 31, 2007 and 2006, respectively. In 2007, material cost decreased 15.1% as a percent of sales, primarily because of a change in the sales mix. This decrease was offset by an increase in manufacturing costs as a percent of sales primarily because of the large decrease in sales, which caused fixed manufacturing costs to be spread over a smaller base.

Selling, general and administrative expenses increased by $348,521 to $917,281 for the three months ended March 31, 2007, compared to $568,760 in the same quarter of 2006. The increase in expenses related primarily to an increase in stock based compensation expense of approximately $377,000 relating primarily to stock options and warrants issued in 2007, and to increases in professional fees of approximately $33,000 offset by decreases in salaries of approximately $27,000 because of fewer personnel, decreases in commissions of approximately $21,000 and decreases in other expenses of approximately $13,000.

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Research and development expenses were $8,554 in the three months ended March 31, 2007 compared to $8,659 for the three months ended March 31, 2006. The research and development activities related to the Company s development and improvement of its own line of robotic inspection systems.

Legal fees increased by $91,965 to $107,344 in the three months ended March 31, 2007, from $15,379 in the same quarter of 2006. A significant portion of the legal fees in both periods related to the patent infringement claims.

Other income (expense) was $5,524 in the three months ended March 31, 2007, compared to ($22,020) in the same quarter of 2006. Interest expense was approximately $20,000 lower in the first quarter of 2007 than it was in the first quarter of 2006.

The Company recognized no income tax benefit to offset the loss before income taxes in the three months ended March 31, 2007 and 2006, as no tax benefit could be utilized by the Company. The income taxes provided in both periods represented minimum state taxes.

The net loss for the three months ended March 31, 2007 was $895,067, or $.07 per share, compared to a net loss of $118,550, or $.01 per share in the same quarter of 2006. The change was primarily the result of a reduction in gross profit of $365,280 and increased operating expenses of $440,381 being partially offset by a decrease in nonoperating expenses of $27,544.

LIQUIDITY AND CAPITAL RESOURCES (FOR THE THREE MONTHS ENDED MARCH 31, 2007)

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, currently 8.25%. The line is collateralized by a security interest in the assets of the Company and guaranteed by eleven individuals, one of whom is Michael Thorsland, a director of the Company.

The Company believes that its working capital at March 31, 2007 along with the funds available under the bank line of credit described above will be adequate to satisfy projected operating and capital requirements for the next twelve months. The preceding sentence is a forward-looking statement and subject to several risks. Should the Company s costs and expenses prove to be greater than we currently anticipate, or should the Company change its current business plan in a manner that will increase or accelerate its anticipated costs and expenses, the depletion of the Company s working capital would be accelerated. To the extent it becomes necessary to raise additional cash in the future as the Company s current cash and working capital resources are depleted, we may seek to raise it through the public or private sale of debt or equity securities, debt financing or short-term loans, or a combination of the foregoing. There is no assurance that the Company will be able to secure the additional cash or working capital that it requires to continue operations.

Net cash used by operating activities for the three months ended March 31, 2007 totaled $409,143. Negative operating cashflows resulted from the net loss of $895,067 for the period being partially offset by non-cash adjustments of $416,620 relating to stock option and warrant compensation expense, depreciation and amortization and by net changes in operating assets and liabilities of $69,304 relating primarily to a decreases in inventories, receivables, accounts payable and accrued expenses.

Net cash used by investing activities for the three months ended March 31, 2007 totaled $3,851. The funds were used to purchase property and equipment.

Net cash provided by financing activities for the three months ended March 31, 2007 totaled $9,653. The amount relates to proceeds from the exercise of stock options.

Item 3. Controls And Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Rules 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer, concluded that, except as set forth in the final paragraph of this Item 3, (i) the Company s disclosure controls and procedures are effective to ensure that information that is required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules of the Securities Exchange Commission: and (ii) the

Company s disclosure controls and procedures are also effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. There were no changes in the Company s internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

The Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, does not expect that the disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. The design of any system of controls also is based in part upon assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Due to the lack of sufficient accounting personnel, there was an ineffective segregation of duties in the preparation of the financial statements to prevent or detect errors. This significant deficiency could result in material misstatements to annual or interim financial statements that would not be prevented or detected if left unremediated. Accordingly, management determined that this significant deficiency constitutes a material weakness. Because of this material weakness, management believes that, as of March 31, 2007, we did not maintain effective internal control over financial reporting based on the criteria proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management believes that the significant deficiency discussed above presents a risk of errors or misstatements in the financial statements and that the cost of remediating this significant deficiency exceeds the benefits that would be obtained by such remediation. Management has therefore elected not to hire the additional personnel that would be required to remediate the significant deficiency.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On January 24, 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 immediately exercisable. The Company relied upon Section 4(2) of the Securities Act for exemptions for transactions not involving a public offering.

On February 9, 2007, in consideration for consulting services, the Company extended the expiration date of warrants to purchase an aggregate of 132,000 shares originally issued to a consultant between 2002 and 2004 for an additional two years. The amended warrants are as follows: 50,000 shares @ $1.00 per share, expiring on July 31, 2009, 57,000 shares at $3.50 per share, expiring on August 24, 2009 and 25,000 shares at $1.35 per share, expiring on December 5, 2010. The Company relied upon Section 4(2) of the Securities Act for exemptions for transactions not involving a public offering.

Item 3. Defaults Upon Senior Securities

None.

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Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

See Exhibit Index on page following signature page.

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SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Scanner Technologies Corporation

Dated: May 21, 2007

By: :/s/ Elwin M. Beaty
Elwin M. Beaty
Chief Executive Officer, President and
Chief Financial Officer
(Principal executive officer and principal
financial and accounting officer)

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EXHIBIT INDEX

SCANNER TECHNOLOGIES CORPORATION

FORM 10-QSB FOR QUARTER ENDED MARCH 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*	Common Stock Purchase Warrant (50,000 shares) dated January 24, 2007 issued to Betsy Brenden Radtke
10.2*	Common Stock Purchase Warrant (50,000 shares) dated January 24, 2007 issued to Michael A. Thorsland
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.