Cogent, Inc.
Form 10-Q
May 08, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

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

Commission file number 000-50947

COGENT, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-4305768**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
639 North Rosemead Blvd.	
Pasadena, California	**91107**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (626) 325-9600

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 ¨

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of May 1, 2009, there were 89,634,633 shares of the registrant s common stock outstanding.

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FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

COGENT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

(unaudited)

	December 31, 2008	March 31, 2009
ASSETS		
Current assets:		
Cash	$ 34,862	$ 37,882
Investments in marketable securities	277,434	236,371
Billed accounts receivable, net of allowance for doubtful accounts of $660 and $986 at December 31, 2008 and March 31, 2009, respectively	30,767	23,435
Unbilled accounts receivable	1,110	808
Inventory and contract related costs	12,715	16,317
Prepaid expenses and other current assets	3,251	3,691
Deferred income taxes	31,956	31,845
Total current assets	392,095	350,349
Investments in marketable securities	167,600	232,100
Inventory and contract related costs	5,813	6,628
Property and equipment, net	37,192	37,469
Deferred income taxes	9,112	8,899
Intangible and other assets	8,319	8,188
Total assets	$ 620,131	$ 643,633
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,629	$ 6,982
Accrued expenses	11,574	11,790
Income taxes payable		5,715
Deferred revenues	59,438	52,054
Total current liabilities	75,641	76,541
Long-term liabilities		
Deferred revenues	15,540	28,790
Other liabilities	9,478	9,434
Total liabilities	100,659	114,765
Commitments and contingencies (Note 16)		
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued or outstanding at December 31, 2008 and March 31, 2009, respectively		

Common stock, $0.001 par value; 245,000,000 shares authorized; 95,943,495 and 89,590,883 shares issued and outstanding at December 31, 2008 and March 31, 2009, respectively	120	120
Additional paid-in capital	433,843	370,707
Retained earnings	147,477	156,427
Accumulated other comprehensive income	1,278	1,614
Treasury stock, at cost; 6,379,077 and zero shares at December 31, 2008 and March 31, 2009, respectively	(63,246)	
Total stockholders equity	519,472	528,868
Total liabilities and stockholders equity	$ 620,131	$ 643,633

See accompanying notes to unaudited condensed consolidated financial statements.

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COGENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	For the three months ended March 31, 2008	2009
Revenues:		
Product revenues	$ 17,404	$ 20,666
Maintenance and services revenues	7,227	10,368
Total revenues	24,631	31,034
Cost of revenues:		
Cost of product revenues	4,981	5,553
Cost of maintenance and services revenues	2,561	4,261
Total cost of revenues	7,542	9,814
Gross profit	17,089	21,220
Operating expenses (income):		
Research and development	3,170	3,727
Selling and marketing	2,691	3,155
General and administrative	2,944	3,020
Income from settlement of lawsuit	(10,000)	
Total operating (income) expenses	(1,195)	9,902
Operating income	18,284	11,318
Other income:		
Interest income	4,970	3,256
Other, net	(37)	45
Total other income	4,933	3,301
Income before income taxes	23,217	14,619
Income tax provision	8,789	5,669
Net income	$ 14,428	$ 8,950
Basic net income per share	$ 0.16	$ 0.10
Diluted net income per share	$ 0.16	$ 0.10
Shares used in computing basic net income per share	91,508	89,579
Shares used in computing diluted net income per share	92,746	90,501

See accompanying notes to unaudited condensed consolidated financial statements.

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COGENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2009
Cash Flows from operating activities:		
Net income	$ 14,428	$ 8,950
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	378	738
Allowance for doubtful accounts	(44)	326
Share-based compensation	921	976
Excess tax benefit from share-based compensation		(103)
Amortization of bond discount on available for sale securities	(605)	1,580
Equity in earnings of investee	(25)	(114)
Deferred income taxes	2,195	(813)
Changes in assets and liabilities:		
Billed accounts receivable	7,894	6,973
Unbilled accounts receivable	(67)	302
Inventory and contract related costs	(3,958)	(4,420)
Prepaid expenses and other current assets	(692)	(443)
Other assets	(10)	49
Accounts payable	2,641	2,455
Accrued expenses	(730)	224
Other liabilities	729	(44)
Income taxes payable	5,825	5,821
Deferred revenues	10,090	5,866
Net cash provided by operating activities	38,970	28,323
Cash Flows from investing activities:		
Purchase of available-for-sale securities	(278,060)	(127,587)
Proceeds from maturities of available-for-sale securities	285,850	102,931
Purchase of equity investment	(3,000)	
Purchase of property and equipment	(485)	(825)
Net cash provided (used in) by investing activities	4,305	(25,481)
Cash Flows from financing activities:		
Payment of employment taxes related to release of nonvested share awards		(6)
Proceeds from the exercise of stock options	103	63
Excess tax benefit from share-based compensation		103
Repurchase of common stock	(36,580)	
Net cash (used in) provided by financing activities	(36,477)	160
Effect of exchange rate changes on cash	(349)	18
Net increase in cash	6,449	3,020

Cash, beginning of period		8,955		34,862
Cash, end of period	$	15,404	$	37,882
Supplemental disclosures of cash flow information				
Cash received (paid) during the period for:				
Interest income	$	4,515	$	4,718
Income taxes	$	(479)	$	(497)
Non-cash financing activities:				
Share-based compensation, capitalized and deferred as inventory and contract related costs	$	54	$	

See accompanying notes to unaudited condensed consolidated financial statements.

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COGENT, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. General

Company Background

Cogent, Inc. and subsidiaries (Cogent or the Company) was initially incorporated in the state of California on April 20, 1990 as Cogent Systems, Inc. and was reincorporated in Delaware on May 3, 2004 as Cogent, Inc. Cogent is a provider of advanced automated fingerprint identification systems (AFIS) solutions, which typically consist of Cogent s Programmable Matching Accelerator (PMA) servers and other AFIS equipment, including work stations and live-scans, bundled with Cogent s proprietary software and other fingerprint biometrics products and solutions, to governments, law enforcement agencies and other organizations worldwide. Cogent also provides professional services, technical support and maintenance services to its customers.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2009 and the condensed consolidated statements of income and cash flows for the three months ended March 31, 2008 and 2009 are unaudited. These statements should be read in conjunction with the audited consolidated financial statements and related notes, together with management s discussion and analysis of financial position and results of operations, contained in the Company s Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 3, 2009.

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or (GAAP). In the opinion of the Company s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2008 and include all adjustments necessary for the fair presentation of the Company s statement of financial position as of March 31, 2009, and its results of operations and cash flows for the three months ended March 31, 2008 and 2009. The condensed consolidated balance sheet as of December 31, 2008 has been derived from the December 31, 2008 audited financial statements. The interim financial information contained in this quarterly report is not necessarily indicative of the results to be expected for any other interim period or for the entire year.

Classification of revenues

Product Revenues

The timing of product revenues recognition is dependent on the nature of the product sold and is generally comprised of the following:

Revenues associated with AFIS solutions that do not require significant modification or customization of the Company s software, exclusive of amounts allocated to maintenance for which the Company has vendor-specific objective evidence of fair value, or VSOE, are recognized upon installation and receipt of written acceptance of the solution by the customer when required by the provisions of the contract, provided all other criteria for revenue recognition have been met. For example, the Company recognizes revenue in this manner from sales of its PMA servers to the Department of Homeland Security (DHS) under a blanket purchase agreement with the DHS. Revenue resulting from arrangements for which VSOE of the maintenance element does not exist is recognized ratably over the maintenance period.

Revenues associated with AFIS solutions that require significant modification or customization of the Company s software are recognized using the percentage-of-completion method as described by Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Production Type Contracts. The percentage-of-completion method reflects the portion of the anticipated contract revenue, excluding maintenance that has VSOE, which has been earned, equal to the ratio of labor effort expended to date to the anticipated final labor effort, based on current estimates of total labor effort necessary to complete the project. Material differences may result in the amount and timing of the Company s revenue for any period if actual results differ from the Company s judgments and estimates. The Company recognizes revenue in this manner from sales of significant initial AFIS deployments. Revenue resulting from arrangements for which VSOE of the maintenance element does not exist is recognized ratably over the contractual maintenance period or until the time when such VSOE is established. There were no revenues recognized under such arrangements for the three months ended March 31, 2008 and 2009, respectively.

Revenue associated with the sale of the Company s application specific integrated circuit, or ASIC applications, stand-alone live-scans and other biometric products, excluding maintenance when applicable, is recognized upon shipment to the customer provided (i) persuasive evidence of an arrangement exists, (ii) title and risk of ownership has passed to the buyer, (iii) the fee is fixed or determinable and (iv) collection is deemed probable.

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Revenue associated with service offerings where the Company maintains and operates a portion of the AFIS systems on an outsourced application-hosting basis is recognized on a per transaction basis provided (i) persuasive evidence of an arrangement exists, (ii) the fee is fixed or determinable and (iii) collection is deemed probable.

Revenue associated with contracts where sufficient VSOE cannot be established for the allocation of revenue to the various elements of the arrangement is deferred until the earlier of the point at which (i) such sufficient VSOE does exist or (ii) all elements of the arrangement have been delivered.

Cash received from customers in advance of recognition of the related revenue is recorded as deferred revenue.

Maintenance Revenues

Maintenance revenue consists of fees for providing technical support and software updates on a when-and-if available basis. The Company recognizes all maintenance revenue ratably over the applicable maintenance period. The Company determines the amount of maintenance revenue to be deferred through reference to substantive maintenance renewal provisions contained in a particular arrangement or, in the absence of such renewal provisions, through reference to VSOE of maintenance renewal rates. The Company considers substantive maintenance provisions to be provisions where the stated maintenance renewal as a percentage of the product fee is comparable to its normal pricing for maintenance only renewals. In the event that maintenance included in an AFIS solutions contract does not have VSOE, the entire arrangement fee, including the contractual amount of the maintenance obligation, is included in product revenues and recognized ratably over the term of the maintenance period.

Services Revenues

Professional services revenue is primarily derived from engineering services and AFIS system operation and maintenance services that are not an element of an arrangement for the sale of products. These services are generally billed on a time-and-materials basis. The majority of the Company s professional services are performed either directly or indirectly for U.S. government organizations. Revenue from such services is recognized as the services are provided.

Consistent with EITF Issue No. 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent, the amount of revenue recognized from commissions where the Company is acting as an agent is the net amount after payments are made to the primary obligor responsible for delivering the services.

Concentration

The Company derives a significant portion of its revenues and accounts receivable from a limited number of customers as described below:

	Three months ended March 31,	
Percentage of Revenues	**2008**	**2009**
Customer A	41%	50%
Customer B	11%	

Percentage of Billed Accounts Receivable	**December 31, 2008**	**March 31, 2009**
Customer A	*	*
Customer B	*	

(*) Amounts do not exceed 10% for such period

Note 2 Recent Accounting Pronouncements

The disclosure requirements of SFAS No. 157, Fair Value Measurements, which took effect on January 1, 2008, are presented in Note 7. On January 1, 2009, the Company implemented the previously deferred provisions of SFAS No. 157 for nonfinancial assets and liabilities recorded at fair value, which had no impact on the Company s financial statements.

The accounting requirements of SFAS No. 141(R), Business Combinations, which took effect on January 1, 2009, were adopted but had no impact on the Company s financial statements.

The accounting and presentation requirements of SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51, which took effect on January 1, 2009, had no impact on the Company s financial statements.

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In April 2009, the FASB issued Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume or Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have significantly decreased and requires that companies provide interim and annual disclosures of the inputs and valuation technique(s) used to measure fair value. FSP 157-4 is effective for the Company beginning April 1, 2009. The Company is still assessing the impact of FSP 157-4 on its consolidated financial position and results of operations.

In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP 115-2/124-2). FSP 115-2/124-2 provides additional guidance designed to create greater clarity and consistency in accounting and presenting impairment losses on securities. FSP 115-2/124-2 is intended to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. FSP 115-2/124-2 also requires increased and more timely disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. FSP 115-2/124-2 is effective beginning for the Company beginning April 1, 2009. The Company is still assessing the impact of FSP 115-2/124-2 on its consolidated financial statements.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP 107-1). FSP 107-1 requires disclosures about fair value of financial instruments in financial statements for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 is effective for the Company beginning April 1, 2009. The Company is still assessing the impact of FSP 107-1 on its consolidated financial position and results of operations.

Other new pronouncements issued but not effective until after March 31, 2009, are not expected to have a significant effect on the Company s consolidated financial position or results of operations.

Note 3. Settlement of Claims with Northrop

In April 2005, Cogent initiated a lawsuit against Northrop Grumman Corporation in California State Court (Cogent Systems, Inc. vs. Northrop Grumman Corporation, Northrop Grumman Technology Overseas, Inc., et al., Superior Court of the State of California, in and for the County of Los Angeles, Case No. BC 332199) based on claims of breach of contract, conversion, misappropriation of trade secrets, breach of trust, interference with prospective economic advantage, breach of the implied covenants of good faith and fair dealing, and unfair competition (the Action). On December 5, 2007, Cogent and Northrop entered into a definitive Settlement Agreement and Mutual Release of Claims (the Settlement). Pursuant to the terms of the Settlement, Cogent and Northrop formally settled and released all claims and causes of action alleged in the Action. Under the Settlement, Cogent and Northrop entered into four agreements; collectively, the Agreements :

1. The Settlement Agreement, pursuant to which Northrop agreed to pay Cogent $25 million, of which $15 million was paid in January 2008 and $10 million was paid in January 2009;

2. The Software License Agreement, pursuant to which Northrop will pay Cogent $15 million over three years for a non-exclusive license to use certain of Cogent s automated fingerprint identification software in certain existing programs, of which $5 million was paid in each of January 2008 and January 2009;

3. The Product and Services Agreement, pursuant to which Northrop will pay Cogent a minimum of $20 million for products and services over the five year term of the agreement, of which $5 million was paid in January 2009; and

4. The Strategic Alliance Agreement, pursuant to which Cogent and Northrop will meet semiannually over the three year term of the agreement to discuss business opportunities and proposal efforts for the design, development, sale and support of biometric identification solutions.

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Total proceeds to Cogent under the agreements will be $60.0 million. Cogent has accounted for the agreements as one multiple element arrangement. Contractual proceeds to Cogent under each of the agreements do not necessarily represent the fair value of each agreement. The Strategic Alliance Agreement was determined not to be an element requiring accounting recognition. The Company determined that the $20 million in proceeds scheduled under the Product and Services Agreement includes both a guaranteed payment component valued at $1.0 million and a component for the purchase of products and services valued at $19.0 million using VSOE of fair value in accordance with SOP 97-2, Software Revenue Recognition. The Company determined the fair value of the Software License Agreement and the guaranteed payment component of the Product and Services Agreement to be $30.0 million and $1.0 million, respectively, based on generally accepted valuation techniques. The residual method was used to derive the $10.0 million fair value for the Settlement Agreement.

Element	Scheduled Proceeds	Allocated Fair Value
	(in millions)	
Product and Services Agreement	$ 20.0	$ 20.0
Software License Agreement	15.0	30.0
Settlement Agreement	25.0	10.0
	$ 60.0	$ 60.0

Accounting for the Software License Agreement is subject to the guidance of SOP 97-2. However, the provision of the AFIS software under the Software License Agreement did not represent a stand-alone arm s length transaction. Rather, the revenue amount was determined based on a valuation. Thus, the Company did not believe it appropriate to apply the Company s standard maintenance VSOE rate to this amount and the Company could not determine the fair value of the associated maintenance commitment. The Company will recognize revenue under the Software License Agreement and the Products and Services Agreement, on a combined basis, based on the lowest proportion of revenue recognizable under the contracts. While the Company was not able to establish VSOE of the maintenance commitment, the Company believes its standard maintenance rate represents a reasonable basis for the allocation of revenues recognized under the Software License Agreement, between product and maintenance, as the revenues are recognized over the term of the Software License Agreement. The Company will therefore allocate a portion of the revenues representing its standard annual maintenance renewal rate (based on VSOE), to maintenance revenues. The remainder will be recorded as product revenues. The $1.0 million value of the guaranteed payment will be recognized as income on a pro-rata basis (i.e., each dollar of revenue under the Products and Services Agreement will result in ninety-five cents of revenue and five cents of Income from settlement of lawsuit). The residual value allocated to the Settlement Agreement is presented as Income from settlement of lawsuit in the accompanying condensed consolidated statement of income.

Due to the risks associated with extended payment terms, recognition of the revenues and the gain on settlement of litigation will be limited to the amounts collected from Northrop. Since the recognition of revenues from several elements is limited due to risks associated with the extended payment terms, the Company will allocate cash collections to each element on a basis consistent with their relative fair value.

In January 2008, the Company received its first scheduled payments of $15.0 million pursuant to the Settlement Agreement and $5.0 million pursuant to the Software License Agreement. During the fourth quarter of 2008, Northrop ordered $5.0 million of products and services pursuant to the Product and Services Agreement which was paid in the first quarter of 2009. Additionally, in the first quarter of 2009, the Company received its second scheduled payment of $10.0 million pursuant to the Settlement Agreement, and $5.0 million pursuant to the Software License Agreement. As of March 31, 2009, the $5.0 million order is included in deferred revenues. Of the $20.0 million in payments received under the Agreements in 2008, $10.0 million was recognized in January 2008 as income from settlement of a lawsuit in the accompanying consolidated statement of income. This $10.0 million represents the residual value allocated to the Settlement Agreement out of the total fair value of the Agreements of $60.0 million. The Company recognizes revenue under the Software License Agreement and the Products and Services Agreement, on a combined basis, based on the lowest proportion of revenue recognizable under the contracts. Of the $20.0 million received in the first quarter of 2009, no amounts were recognized as revenue under the combined Software License Agreement or the Product and Services Agreement. Additionally, the second payment of $10.0 million pursuant to the Settlement Agreement was not recognized as income for the three months ended March 31, 2009. Total deferred revenue from Northrop pursuant to the Agreements was $30.0 million as of March 31, 2009.

Note 4 Intangible Assets and Goodwill

Goodwill is tested for impairment at least annually and more frequently if an event occurs that indicate it may be impaired. Based on its annual impairment test in 2008, the Company determined that goodwill was not impaired. Furthermore, the Company determined there were no events or changes in circumstances that indicate that carrying values of goodwill or other intangible assets are not be recoverable as of December 31, 2008 and March 31, 2009.

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The following table provides information regarding the Company s intangible assets with finite lives at December 31, 2008 and March 31, 2009 (in thousands):

		December 31, 2008			March 31, 2009		
	Useful lives (years)	Gross carrying amount	Accumulated amortization	Net amount	Gross carrying amount	Accumulated amortization	Net amount
Backlog	<1	$ 260	$ 260	$	$ 260	$ 260	$
Customer relationships	3	1,500	333	1,167	1,500	458	1,042
Non-compete agreement	3	400	89	311	400	122	278
Patents	5	750	550	200	750	588	162
Total		$ 2,910	$ 1,232	$ 1,678	$ 2,910	$ 1,428	$ 1,482

Amortization expense for intangible assets with finite lives was $38,000 and $196,000 for the three months ended March 31, 2008 and 2009, respectively.

Estimated amortization expense for the next five years is expected to be $587,000 for the remainder of 2009, $683,000 in 2010, $212,000 in 2011 and zero in 2012. As of March 31, 2009, the Company had intangible assets not subject to amortization in the amount $2.9 million which relates to goodwill from the Company s April 2008 acquisition of the Security Solutions Division (the SSD Division) of MAXIMUS, Inc.

Note 5 Share-Based Compensation

Share-based compensation expense included in the Company s results of operations was as follows:

	Three months ended March 31, 2008	Three months ended March 31, 2009
	(in thousands)	
Cost of product revenues	$ 109	$ 138
Cost of maintenance and services revenues	136	165
Research and development expenses	222	250
Selling and marketing expenses	252	230
General and administrative expenses	202	193
	$ 921	$ 976

The Company has two stock option plans, the 2000 Stock Option Plan and the 2004 Equity Incentive Plan, which authorize the issuance of stock options, nonvested shares and other share-based instruments to employees.

Stock Options

During the three months ended March 31, 2008 and 2009, zero and 12,000 stock options were granted, respectively. The fair values of each award granted under the Company s stock option plans during the three months ended March 31, 2009 were estimated at the date of grant using the Black-Scholes option pricing model and the following weighted average assumptions:

Volatility	46%
Risk-free interest rate	2.0%
Dividend yield	0.00%

Expected life (years)	6.1

The weighted average estimated grant date fair value of options granted under the Company s stock option plans for the three months ended March 31, 2009 was $4.69. As of March 31, 2009, there was approximately $1.3 million of total unrecognized compensation cost related to non-vested share-based compensation that is expected to be recognized over a weighted average period of 1.5 years.

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The options outstanding as of March 31, 2009 have generally been granted with a 10-year term, vest 25% at the completion of the first year and vest quarterly thereafter over the remaining three-year period. A summary of option activity under the plans for the three months ended March 31, 2009 is as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2008	1,433,415	$ 8.16
Granted	12,000	10.13
Exercised	(25,762)	2.53
Canceled or forfeited	(30,421)	15.11
Outstanding, March 31, 2009	1,389,232	$ 8.13
Exercisable at March 31, 2009	1,163,173	$ 5.90

A total of 2,362,206 options remain available for grant under the Company s share-based compensation plans at March 31, 2009.

The following tables further describe stock options outstanding at March 31, 2009.

Range of Exercise Prices		Options Outstanding Number Outstanding at March 31, 2009	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Options Exercisable Number Exercisable at March 31, 2009	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
$ 0.30	$ 0.60	61,252	1.7	$ 0.37	$ 706	61,252	1.7	$ 0.37	$ 706
0.75	0.75	199,080	4.0	0.75	2,220	199,080	4.0	0.75	2,220
1.00	1.00	184,520	4.8	1.00	2,011	184,520	4.8	1.00	2,011
4.50	8.50	379,901	5.2	4.77	2,709	379,901	5.2	4.77	2,709
11.00	34.43	564,479	7.2	16.17	190	338,420	6.6	17.82	58
0.30	34.43	1,389,232	5.6	$ 8.13	$ 7,836	1,163,173	5.2	$ 5.90	$ 7,704
Vested or expected to vest		1,359,844	5.6	$ 7.03	$ 7,819				

The Company defines in-the-money options at March 31, 2009 as options that had exercise prices that were lower than the $11.90 market value of its common stock at that date. The aggregate intrinsic value of options outstanding at March 31, 2009 is calculated as the difference between the exercise price of the underlying options and the market value of the Company s common stock for the 1.0 million shares that were in-the-money at that date. There were 0.9 million in-the-money options exercisable at March 31, 2009. The total intrinsic value of options exercised during the three months ended March 31, 2008 and 2009 was $847,000 and $246,000, respectively, determined as of the date of exercise. The Company has recognized an income tax benefit for stock-based compensation arrangements of $93,000 and $43,000 in the condensed consolidated statements of income for the three months ended March 31, 2008 and 2009, respectively.

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Nonvested Shares

Beginning in 2007, the Compensation Committee of the Company s Board of Directors has issued awards of nonvested shares to certain of the Company s employees and executive officers under the Company s 2004 Equity Incentive Plan. These nonvested share awards are grants that entitle the holder to shares of common stock subject to certain terms and, generally, vest in 25% increments each year on the anniversary of the grant date throughout a four year vesting period. The nonvested share awards are valued based on the closing market price on the date of award. Nonvested share compensation is to be amortized and charged to operations on a straight-line basis over the four year vesting period. A summary of nonvested share activity for the three months ended March 31, 2009 is as follows:

	Shares	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands)
Nonvested shares outstanding at December 31, 2008	941,975	$ 11.28	$ 12,783
Granted	26,400	10.79	
Vested	(1,188)	10.01	
Cancelled or forfeited	(5,275)	10.59	
Nonvested shares outstanding at March 31, 2009	961,912	$ 11.27	$ 11,447

As of March 31, 2009, there was approximately $8.9 million of total unrecognized compensation cost related to nonvested share-based compensation that is expected to be recognized over a weighted-average period of 3.6 years.

Note 6. Investments in Marketable Securities

The Company has investments classified as available-for-sale securities included in short-term and long-term investments, categorized as follows:

March 31, 2009

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Type of Security				
Short-term instruments	$ 19,798	$	$	$ 19,798
Corporate debt securities with maturities of less than one year	129,920	305	(1,327)	128,898
Municipal securities with maturities of less than one year	2,278	6		7,284
U.S. government securities with maturities of less than one year	80,060	343	(12)	80,391
Total short-term investments	237,056	654	(1,339)	236,371
Corporate debt securities with maturities between one and three years	80,388	405	(201)	80,592
Municipal securities with maturities through October 2017	37,429	322		37,751
U.S. government securities with maturities between one and three years	112,692	1,096	(31)	113,757
Total long-term investments	230,509	1,823	(232)	232,100
	$ 467,565	$ 2,477	$ (1,571)	$ 468,471

December 31, 2008

Type of Security				
Short-term instruments	$ 18,433	$	$	$ 18,433
Corporate debt securities with maturities of less than one year	145,835	277	(1,778)	144,334
Municipal securities with maturities of less than one year	3,091	6		3,097
U.S. government securities with maturities of less than one year	110,872	698		111,570
Total short-term investments	278,231	981	(1,778)	277,434
Corporate debt securities with maturities between one and three years	64,709	220	(438)	64,491
Municipal securities with maturities through October 2017	14,603	175		14,778
U.S. government securities with maturities between one and two years	86,946	1,391	(6)	88,331
Total long-term investments	166,258	1,786	(444)	167,600
	$ 444,489	$ 2,767	$ (2,222)	$ 445,034

The Company s short-term instruments consist primarily of money market funds, certificates of deposit and commercial paper. These available-for-sale securities are accounted for at their fair value, and unrealized gains and losses on these securities are reported as a separate component of stockholders equity. The accumulated unrealized gain on available-for-sale securities at December 31, 2008 and March 31, 2009 was as follows:

	December 31, 2008	**March 31, 2009**
	(in thousands)	
Accumulated unrealized gain	$ 545	$ 906

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The Company utilizes specific identification in computing realized gains and losses on the sale of investments. The Company recorded no realized gain or loss for the three months ended March 31, 2008 and 2009.

Note 7. Fair Value Measurements

As indicated in Note 2, the Company adopted the provisions of SFAS 157 for financial assets and liabilities effective January 1, 2008. SFAS 157 clarifies the definition of fair value as an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes, in descending order, the inputs used in measuring fair value as follows:

Level 1 Observable inputs such as quoted prices in active markets

Level 2 Inputs other than the quoted prices in active markets that are observable either directly or indirectly

Level 3 Unobservable inputs in which there is little or no market data, which require us to develop our own assumptions.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including its marketable securities. The Company s investment instruments, except for auction rate securities, listed below are classified within Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Company s auction rate securities are classified as Level 3 of the fair value hierarchy due to the limited market data for pricing these securities.

As of March 31, 2009	**Fair value**	**Level 1**	**Level 2**	**Level 3**
		(in thousands)		
Short-term instruments	$ 19,798	$	$ 19,798	$
Corporate debt securities	209,490		206,913	2,577
Municipal securities	45,035		43,364	1,671
U.S. government securities	194,148		194,148	
	$ 468,471	$	$ 464,223	$ 4,248

As of March 31, 2009, the Company s investments included $4.2 million of auction rate securities which are classified as long-term investments in marketable securities. Auction rate securities are generally long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, generally every 28 days. This mechanism generally allows existing investors to rollover their holdings and continue to own their respective securities or liquidate their holdings by selling their securities at par value. Since February 2008, uncertainties in the credit markets have prevented the Company and other investors from liquidating investments in auction rate securities as, in recent auctions, the amount of securities submitted for sale has exceeded the amount of purchase orders. Based on this analysis of impairment factors, including but not limited to, whether the credit ratings of the issuers deteriorate, or the collateral of the securities deteriorates, the Company s auction rate securities are not deemed to be impaired as of March 31, 2009.

The following table sets forth a reconciliation of changes in the fair value of financial assets classified as Level 3 in the fair value hierarchy:

	Fair Value Measurements Using Significant Unobservable Inputs Level 3 (in thousands)
Balance at January 1, 2009	$ 4,248
Total gains or losses (realized or unrealized)	

Included in earnings		
Included in comprehensive income		
Purchases, issuances, and settlements		
Transfers in and/or out of Level 3		
Balance at March 31, 2009	$	4,248

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Note 8. Inventory and Contract Related Costs

Inventory and contract related costs consist of the following:

	December 31, 2008	March 31, 2009
	(in thousands)	
Materials and components	$ 6,126	$ 7,575
Inventory and costs related to long-term contracts	679	57
Deferred costs of revenue	11,723	15,313
	$ 18,528	$ 22,945

Materials and components are stated at the lower of cost or market determined using the first-in, first-out method. Inventoried costs relating to long-term contracts are stated at actual production costs incurred to date reduced by amounts identified with revenue recognized on progress completed. Deferred costs of revenue relate to contracts for which revenue has been deferred, and such costs are stated at actual production costs incurred to date, which primarily include materials, labor and subcontract costs which are directly related to the contract. Deferred costs of revenue are amortized to costs of revenue at the time revenues are recognized.

Note 9. Net Income Per Share

Basic net income per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted net income per common share reflects the effects of potentially dilutive securities, which consist of stock options and nonvested shares. A reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share follows:

	Three months ended March 31, 2008	2009
	(in thousands, except per share data)	
Numerator:		
Net income available to common stockholders	$ 14,428	$ 8,950
Denominator:		
Denominator for basic net income per share weighted average shares	91,508	89,579
Dilutive potential common stock options and nonvested shares	1,238	922
Denominator for diluted net income per share adjusted weighted average shares	92,746	90,501
Basic net income per share	$ 0.16	$ 0.10
Diluted net income per share	$ 0.16	$ 0.10

During the three months ended March 31, 2008 and 2009, options to purchase 582,588 and 423,354 shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares for each of these respective periods.

Note 10. Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes in equity that are excluded from net income. Specifically, cumulative foreign currency translation adjustments, the effect of the foreign exchange translation for the Company s foreign tax liabilities and unrealized gains or losses on the Company s investments in marketable securities are included in accumulated other comprehensive income (loss).

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2009
	(In thousands)	
Net income	$ 14,428	$ 8,950
Other comprehensive income (loss):		
Change in unrealized gain (loss), net of tax	227	251
Change in foreign currency translation adjustment	(271)	85
Total comprehensive income	$ 14,384	$ 9,286

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Note 11. Income Taxes

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109, (FIN 48). FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision whether to file or not to file in a particular jurisdiction. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

As of March 31, 2009 the Company had cumulative unrecognized tax benefits of $8.8 million. Included in this balance is approximately $7.0 million related to items that would affect other tax accounts, primarily deferred income taxes, if recognized. The company believes that it is reasonably possible that a decrease of up to $5.4 million in unrecognized tax benefits related to temporary federal tax exposures may be necessary within the next 12 months.

The Company continues to recognize accrued interest and penalties related to unrecognized tax benefits in the income tax provision. As of December 31, 2008, the total amount of accrued income tax-related interest and penalties before tax benefits was $1.5 million. During the three months ended March 31, 2009, an additional $124,000 of interest before tax benefits was accrued.

The Company files Federal income tax returns, as well as multiple state, local and foreign jurisdiction tax returns. With few exceptions, the Company is no longer subject to examination for its U.S. Federal and state, foreign and local jurisdictions for years prior to 2003. The Internal Revenue Service completed its examination of the Company s Federal consolidated tax returns for 2004 and 2005 and issued a no change letter. The California Franchise Tax Board completed its examination of the Company s California tax returns for 2005 and 2006 and issued a no change letter.

Note 12. Deferred Revenues and Deferred Costs

In December 2007, the Company settled its lawsuit with Northrop Grumman (See Note 3). As of March 31, 2009, deferred revenue related to the agreements entered in connection with the settlement of the lawsuit was $30.0 million.

In November 2007, the Company entered into a contract to provide a turnkey AFIS to certain law enforcement agencies in Spain for $11.0 million. The new turnkey AFIS will provide a broader range of functional capabilities than the current system. In December 2007, the Company recorded $6.0 million in deferred revenue representing a scheduled billing under the contract. The system was accepted in the fourth quarter of 2008 and $3.7 million of revenue related to this contract was recognized. Deferred revenue related to the contract was $5.4 million as of March 31, 2009. The deferred balance as of March 31, 2009 consists primarily of unamortized maintenance revenue which will be recognized over the remaining contract period of 5.7 years.

In August 2006, the Company entered into a contract with a law enforcement agency in Maryland to provide an integrated AFIS system as well as provide other services to re-engineer some of their clearance and record maintenance systems. As of March 31, 2009, the Company has $6.1 million in deferred revenue which represents billing for services rendered over the contract period.

Note 13. Stock Repurchase Program

On November 1, 2007, the Company announced that its Board of Directors authorized a program to repurchase up to $100 million of its common shares over a 12 month period expiring in October 2008. On November 13, 2008, the Company announced that its Board of Directors had extended the expiration date of the repurchase program to November 12, 2009 and increased the amount of common stock that may be repurchased under the program to an aggregate of up to $150 million. Acting pursuant to this program, the Company repurchased a total of 6,039,077 shares during 2007 and 2008 at an aggregate cost of $59.4 million. The Company did not purchase any shares under the program during the three months ended March 31, 2009.

Shares are purchased pursuant to this program in the open market using the Company s cash resources. The authorized amount remaining available for share repurchase as of March 31, 2009 is $90.6 million. The share repurchase program may be suspended or discontinued at any time without prior notice. Previously, shares purchased pursuant to this program were held in treasury, and these shares were cancelled in the three months ended March 31, 2009.

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Note 14. Segment Information

The Company considers its business activities to constitute a single segment. A summary of the Company s revenues by geographic area follows (in thousands):

	Three months ended March 31, 2009				
	Americas	Europe	Asia	Other	Total
Revenues:					
Product revenues	$ 18,386	$ 2,187	$ 93	$	$ 20,666
Maintenance and services revenues	8,597	1,193	240	338	10,368
Total	$ 26,983	$ 3,380	$ 333	$ 338	$ 31,034

	Three months ended March 31, 2008				
	Americas	Europe	Asia	Other	Total
Revenues:					
Product revenues	$ 14,217	$ 422	$ 116	$ 2,649	$ 17,404
Maintenance and services revenues	6,395	623	154	55	7,227
Total	$ 20,612	$ 1,045	$ 270	$ 2,704	$ 24,631

At December 31, 2008 and March 31, 2009, the Company s property and equipment, net of accumulated depreciation and intangible assets net of amortization was as follows (in thousands):

	December 31, 2008	March 31, 2009
Property and equipment, net of accumulated depreciation in the United States	$ 34,281	$ 34,293
Property and equipment, net of accumulated depreciation in other countries	2,911	3,176
	$ 37,192	$ 37,469
Intangible assets, net of accumulated amortization in the United States	$ 4,602	$ 4,406

Note 15. Equity Investment in ANP

Effective January 2008, Cogent and ANP Technologies, Inc. (ANP), a biological detection company producing nano-assays entered into an agreement whereby Cogent obtained 20% of the outstanding shares of ANP in exchange for $3 million in cash and the transfer of Cogent s reader technology, applicable only for the biological market. In addition, Cogent entered into an agreement pursuant to which Cogent will develop and supply a variety of readers to ANP. Cogent s investment in ANP is accounted for under the equity method in accordance with Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock (APB 18). The Company s share of its equity in earnings of the investee, which totaled $114,000 and $25,000 during the three months ended March 31, 2009 and 2008, respectively, are reported in the Other, net line item in the Company s condensed consolidated statement of income.

Note 16. Commitments and Contingencies

The Company evaluates all pending or threatened contingencies and any commitments, if any, which are reasonably likely to have a material adverse effect on its operations or financial position. The Company assesses the probability of an adverse outcome and determines if it is remote, reasonably possible or probable as defined in accordance with the provisions of SFAS No. 5, Accounting for Contingencies. If information available prior to the issuance of the Company s financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the Company s financial statements, and the amount of the loss, or the range of probable loss can be reasonably estimated, then such loss is accrued and charged to operations. If no accrual is made for a loss contingency because one or both of the conditions pursuant to SFAS No. 5 are not met, but the probability of an adverse outcome is at least reasonably possible, the Company will disclose the nature of the contingency and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

During the normal course of business, the Company may be subject to litigation involving various business matters. Management believes that an adverse outcome of any such known matters would not have a material adverse impact on the Company.

Note 17. Subsequent Event

The Company s revolving line of credit with a U.S. bank was amended in April 2009 to extend the expiration date to May 2010 and to increase the amount available for advances for trade finance transactions and working capital requirements from $9 million to $20 million. Borrowings under the line of credit bear interest at the bank s reference rate (4.0% at March 31, 2009). The line of credit is secured by Company assets consisting of equipment, inventory and accounts receivable. There were no outstanding borrowings under this line at December 31, 2008 and March 31, 2009. Covenants in connection with the agreement impose restrictions and requirements related to, among other things, maintenance of certain insurance requirements, limitations on outside indebtedness, and use of proceeds for business operations.

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

This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we, nor any other person, assume responsibility for the accuracy and completeness of the forward-looking statements. We are under no obligation to update any of the forward-looking statements after the filing of this Quarterly Report to conform such statements to actual results or to changes in our expectations.

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Quarterly Report. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made in Item 1A of Part II of this Quarterly Report under the Caption Risk Factors and under the captions Management s Discussion and Analysis of Financial Condition and Results of Operations, and Risk Factors and in our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2008, previously filed with the Securities and Exchange Commission (SEC).

Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to: changes in government policies; uncertain political conditions in international markets; deriving a significant portion of revenues from a limited number of customers; deriving a significant portion of revenues from the sale of solutions pursuant to government contracts; failure of the biometrics market to experience significant growth; failure of our products to achieve broad acceptance; potential fluctuations in quarterly and annual results; changes in our effective tax rate; failure to successfully compete; failure to comply with government regulations; failure to accurately predict financial results due to long sales cycles; negative publicity and/or loss of clients due to security breaches resulting in the disclosure of confidential information; loss of export licenses or changes in export laws; failure to manage projects; rapid technology change in the biometrics market; loss of a key member of management team; termination of backlog orders; loss of limited source suppliers; negative audits by government agencies; failure to protect intellectual property; and exposure to intellectual property and product liability claims.

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Overview

We are a leading provider of advanced Automated Fingerprint Identification Systems, (AFIS), and other fingerprint biometrics solutions to governments, law enforcement agencies and other organizations worldwide. We were incorporated and commenced operations in 1990. We have been researching, designing, developing and marketing AFIS and other fingerprint biometrics solutions since inception. During most of our operating history, we have achieved positive income and cash flows from operations. From the fourth quarter of 2003 through the year ended December 31, 2005, we experienced significant increases in our revenues and net income as the market for our AFIS solutions expanded primarily due to increased demand by the Department of Homeland Security, or DHS, as well as the National Electoral Council of Venezuela, or CNE. We experienced a decline in revenues during the year ended December 31, 2006 due to the completion of a number of significant contracts, the timing of revenue recognition related to contracts entered into in previous periods and slowdowns in the procurement process at the U.S. government. In 2008 our revenues improved over 2007 levels as we recorded revenue from an increased number of customers. We believe it will be possible to experience an increase in revenues in 2009 over 2008 levels as we expect to recognize revenue from previously announced contracts with customers including Maryland, Northrop Grumman, Egypt and the DHS, as well as from new contracts with customers such as the DHS, the Bureau of Census, the County of Los Angeles and various programs in Europe.

Sources of Revenue

We generate product revenues principally from sales of our AFIS solutions, which typically consist of our Programmable Matching Accelerator (PMA) servers and other AFIS equipment, including workstations and live-scans, bundled with our proprietary software. Also included in product revenues are fees generated from design and deployment of our AFIS solutions. We generate maintenance revenues from maintenance contracts that are typically included with the sale of our AFIS solutions. Maintenance contracts for technical support and software updates generally cover a period of one year, and after contract expiration, our customers have the right to purchase maintenance contract renewals, which generally cover a period of one year. Revenues from maintenance contracts are deferred and amortized on a straight-line basis over the life of the maintenance obligation. We generate services revenues from engineering services and AFIS system operation services that are not an element of an arrangement for the sale of products. These services are typically performed under fixed-price and time-and-material agreements.

We market our solutions primarily to U.S. and foreign government agencies and law enforcement agencies. In a typical contract with a government agency for an initial AFIS deployment, we agree to design the AFIS, supply and install equipment and software and integrate the AFIS within the agency s existing network infrastructure. These initial deployment contracts frequently require significant modification or customization of our solution as part of our integration services. These contracts provide for billings up to a fixed price total contract value upon completion of agreed milestones or deliveries, with each milestone or delivery typically having a value specified in the contract. These customers usually impose specific performance and acceptance criteria that must be satisfied prior to invoicing for each milestone or delivery. When customers purchase AFIS solutions that do not require significant modification or customization of our software, whether as an initial deployment or as an expansion of an existing AFIS, we typically agree to deliver the products and perform limited installation services subject to customer-specific acceptance criteria. Certain of our customers, including the DHS, submit purchase orders under blanket purchase order agreements. Blanket purchase order agreements set out the basic terms and conditions of our arrangement with the customer and simplify the procedures for ordering our products to avoid administrative processes that would otherwise apply, particularly with the federal government. The billing of these contracts is generally tied to delivery and acceptance of specific AFIS equipment, usually our PMA servers or live-scans. Most of our contracts for AFIS solutions also include an ongoing maintenance obligation that we honor over a term specified in the deployment contract or the blanket purchase order agreement. The nature of our business and our customer base is such that we negotiate a set of unique terms for each contract that are based upon the purchaser s standard form of documentation.

The most significant portion of our revenues in the most recent three fiscal years has been derived form sales to the DHS. The DHS uses our solutions in connection with the implementation of the United States Visitor and Immigrant Status Indicator Technology, or US-VISIT, program. We anticipate that the DHS will account for a significant portion of our revenues for the foreseeable future. We do not have any long-term contracts with any of our customers, including the DHS, for the sale of our products, and our future sales will depend upon the receipt of new orders. Any delay or other change in the rollout of US-VISIT or any failure to obtain new orders from the DHS could cause our revenues to fall short of our expectations.

We also expect to experience continued demand from a number of other governments as they deploy AFIS solutions at points of entry and exit, including borders, seaports and airports, and in connection with national identification programs. For example, in Belgium, we have been awarded an initial contract to provide a palm and fingerprint identification system to the Belgium National Police. Another example is the contract we recently won to provide integrated biometric collection services to U.K. Post Office Limited. The quantity and timing of orders from both U.S. and foreign government entities depends on a number of factors outside of our control, such as the level and timing of budget appropriations. Government contracts for security solutions, at points of entry and exit and in connection with national identification programs are typically awarded in open competitive bidding processes. Therefore, our future level of sales of AFIS solutions for deployments and at points of entry and exit may vary substantially, and will depend on our ability to successfully compete for this business.

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Cost of Revenues and Operating Expenses

Cost of Revenues. Cost of product revenues consists principally of compensation costs incurred in designing, integrating, installing and customizing AFIS solutions, the costs associated with manufacturing, assembling and testing our AFIS solutions and utilizing subcontractors. A substantial portion of these costs represents components, such as servers, integrated circuits, workstations, live-scans and other hardware. Cost of product revenues also includes related overhead, compensation, final assembly, quality-assurance, inventory management, support costs and payments to contract manufacturers that perform assembly functions. Cost of maintenance and services revenues consists of customer support costs and training and professional service expenses, including compensation. Cost of revenues also includes share-based compensation allocable to personnel performing services related to cost of revenues. We expect our gross margin to be affected by many factors, including our mix of products and the amount of third party hardware included in our AFIS solutions. Other factors that may affect our gross margin include changes in selling prices of our products, maintenance and services, fluctuations in demand for our products, the timing and size of customer orders, fluctuations in manufacturing volumes, changes in costs of components and new product introductions by us and our competitors and agreements entered into with our subcontractors.

Research and Development. Research and development expenses consist primarily of salaries and related expenses for engineering personnel, fees paid to consultants and outside service providers, depreciation of development and test equipment, prototyping expenses related to the design, development, testing and enhancements of our products, and the cost of computer support services. We expense all research and development costs as incurred. Under our customer contracts, we typically obtain the rights to use any improvements to our technology developed on a particular customer deployment on other customer deployments. As a result, we have historically been able to moderate our research and development expenses by leveraging the improvements developed by our personnel working on customer engagements. Research and development expenses also include share-based compensation allocable to personnel performing services related to research and development.

Selling and Marketing. Selling and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales, public relations and advertising, along with promotional and trade show costs and travel expenses. Sales and marketing expenses also include share-based compensation allocable to personnel performing services related to sales and marketing.

General and Administrative. General and administrative expenses include salaries and related expenses for personnel engaged in finance, human resources, insurance, information technology, administrative activities and legal and accounting fees. General and administrative expenses also include share-based compensation allocable to personnel performing general and administrative services.

Settlement of Claims against Northrop

In April 2005, we initiated a lawsuit against Northrop Grumman in California State Court (Cogent Systems, Inc. vs. Northrop Grumman Corporation, Northrop Grumman Technology Overseas, Inc., et al., Superior Court of the State of California, in and for the County of Los Angeles, Case No. BC 332199) based on claims of breach of contract, conversion, misappropriation of trade secrets and other claims (the Action). On December 5, 2007, we and Northrop entered into a definitive Settlement Agreement and Mutual Release of Claims (the Settlement). Pursuant to the terms of the Settlement, we and Northrop formally settled and released all claims and causes of action alleged in the Action. Under the Settlement, we entered into four agreements with Northrop (collectively, the Agreements):

1. The Settlement Agreement, pursuant to which Northrop agreed to pay Cogent $25 million, of which $15 million was paid in January 2008 and $10 million was paid in January 2009;

2. The Software License Agreement, pursuant to which Northrop will pay Cogent $15 million over three years for a non-exclusive license to use certain of Cogent s automated fingerprint identification software in certain existing programs, of which $5 million was paid in each of January 2008 and January 2009;

3. The Product and Services Agreement, pursuant to which Northrop will pay Cogent a minimum of $20 million for products and services over the five year term of the agreement, of which $5 million was paid in January 2009; and

4. The Strategic Alliance Agreement, pursuant to which Cogent and Northrop will meet semiannually over the three year term of the agreement to discuss business opportunities and proposal efforts for the design, development, sale and support of biometric identification solutions.

Our total proceeds under the agreements will be $60.0 million. We have accounted for the agreements as one multiple element arrangement. The contract values for each of the agreements do not necessarily represent the fair value of each agreement. The Strategic Alliance Agreement was determined not to be an element requiring accounting recognition. We determined that the $20 million in proceeds scheduled under the Product and Services Agreement includes both a guaranteed payment component valued at $1.0 million and a component for the purchase of products and services valued at $19.0 million using VSOE of fair value in

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accordance with SOP 97-2, Software Revenue Recognition . We determined the fair value of the Software License Agreement and the guaranteed payment component of the Product and Services Agreement to be $30.0 million and $1.0 million, respectively, based on generally accepted valuation techniques. The residual method was used to derive the $10.0 million fair value for the Settlement Agreement.

Accounting for the Software License Agreement is subject to the guidance of SOP 97-2. However, the provision of the AFIS software under the Software License Agreement did not represent a stand-alone arm s length transaction. Rather, the revenue amount was determined based on a valuation. Thus, we did not believe it appropriate to apply our standard maintenance VSOE rate to this amount and we could not determine the fair value of the associated maintenance commitment. We will recognize revenue under the Software License Agreement and the Products and Services Agreement, on a combined basis, based on the lowest proportion of revenue recognizable under the contracts. While we were not able to establish VSOE of the maintenance commitment, we believe our standard maintenance rate represents a reasonable basis for the allocation of revenues recognized under the Software License Agreement, between product and maintenance, as the revenues are recognized over the term of the Software License Agreement. We will therefore allocate a portion of the revenues representing our standard annual maintenance renewal rate (based on VSOE), to maintenance revenues, in accordance with Rule 5-03(b)(1) of Regulation S-X. The remainder will be recorded as product revenues. The $1.0 million value of the guaranteed payment will be recognized as income on a pro-rata basis (i.e. each dollar of revenue under the Products and Services Agreement will result in ninety-five cents of revenue and five cents of Income from settlement of lawsuit). The residual value allocated to the Settlement Agreement is presented as Income from settlement of lawsuit in the accompanying condensed consolidated statement of income for the three months ended March 31, 2008.

Due to the risks associated with extended payment terms, recognition of the revenues and the gain on settlement of litigation will be limited to the amounts collected from Northrop. Since the recognition of revenues from several elements is limited due to risks associated with the extended payment terms, we will allocate cash collections to each element on a basis consistent with their relative fair value.

Application of Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. 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. On an on-going basis, we evaluate these estimates, including those related to percentage-of-completion, bad debts, investments, income taxes, share-based compensation, commitments, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed 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.

We consider the following accounting estimates to be both those most important to the portrayal of our results of operations and financial condition and those that require the most subjective judgment:

- revenue recognition;
- commitments and contingencies;
- allowance for doubtful accounts;
- investments in marketable securities;
- accounting for taxes; and
- accounting for share-based compensation.

Revenue Recognition. Because our proprietary software is essential to the functionality of our AFIS solutions and other biometrics products, we apply the provisions of Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. For arrangements that require significant production, modification, or customization of software, we apply the provisions of Accounting Research Bulletin (ARB) No. 45, Long-Term Construction-Type Contracts, and SOP 81-1, Accounting for Performance of Construction-Type and Production Type Contracts. To the extent an element within our software arrangements falls within a level of accounting literature that is higher than SOP 97-2, we record revenue on such element in accordance with the relevant authoritative literature. For arrangements that contain the lease of equipment, we account for the lease element in accordance with Statement of Financial Accounting Standards (SFAS) No. 13 Accounting for Leases and account for the remaining elements in the arrangement in accordance with SOP 97-2. For arrangements that contain a non-software deliverable such as hardware, we apply the provisions of Emerging Issues Task Force (EITF) 03-05 Applicability of AICPA Statement of Position 97-2 to Non- Software Deliverables in an Arrangement Containing More-Than-Incidental Software and recognize revenue when all other revenue recognition criteria are met. For multiple element arrangements not subject to accounting under SOP 97-2, we account for these arrangements in accordance with

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EITF No. 00-21 Revenue Arrangements with Multiple Deliverables . The application of the appropriate accounting principle to our revenue is dependent upon the specific transaction and whether the sale includes systems, software and services or a combination of these items. As our business evolves, the mix of products and services sold will impact the timing of when revenue and related costs are recognized. Additionally, revenue recognition involves judgments, including estimates of costs to complete contracts accounted for using the percentage of completion method of accounting and assessments of the likelihood of nonpayment. We analyze various factors, including a review of specific transactions, the credit-worthiness of our customers, our historical experience and market and economic conditions. Changes in judgments on these factors could materially impact the timing and amount of revenue and costs recognized.

Product Revenues

The timing of product revenues recognition is dependent on the nature of the product sold.

Revenues associated with AFIS solutions that do not require significant modification or customization of our software, exclusive of amounts allocated to maintenance for which we have VSOE are recognized upon installation and receipt of written acceptance of the solution by the customer when required by the provisions of the contract, provided all other criteria for revenue recognition have been met. For example, we recognize revenue in this manner from sales of our PMA servers to the DHS under our blanket purchase agreement with the DHS. Revenue resulting from arrangements for which VSOE of the maintenance element does not exist is recognized ratably over the maintenance period.

Revenues associated with AFIS solutions that require significant modification or customization of our software, are recognized using the percentage-of-completion method as described by SOP 81-1. The percentage-of-completion method reflects the portion of the anticipated contract revenue which has been earned, equal to the ratio of labor effort expended to date to the anticipated final labor effort, based on current estimates of total labor effort necessary to complete the project. The amount subject to the percentage-of-completion method is exclusive of the maintenance, the fair value of which is established by VSOE. Material differences may result in the amount and timing of our revenue for any period if actual results differ from our judgments and estimates. We recognize revenue in this manner from sales of significant initial AFIS deployments. Revenue resulting from arrangements for which VSOE of the maintenance element does not exist is recognized ratably over the contractual maintenance period or until the time when such VSOE is established. There were no revenues recognized under such arrangements for the three months ended March 31, 2008 and 2009, respectively.

Revenue associated with the sale of our application specific integrated circuit, or ASIC applications, stand-alone live-scans and other biometric products, excluding maintenance when applicable, is recognized upon shipment to the customer provided (i) persuasive evidence of an arrangement exists, (ii) title and risk of ownership has passed to the buyer, (iii) the fee is fixed or determinable and (iv) collection is deemed probable.

Revenue associated with service offerings where we maintain and operate a portion of the AFIS systems on an outsourced application-hosting basis is recognized on a per transaction basis provided (i) persuasive evidence of an arrangement exists, (ii) the fee is fixed or determinable and (iii) collection is deemed probable.

Revenue associated with contracts where sufficient VSOE cannot be established for the allocation of revenue to the various elements of the arrangement is deferred until the earlier of the point at which (i) such sufficient VSOE does exist or (ii) all elements of the arrangement have been delivered.

Cash received from customers in advance of recognition of the related revenue is recorded as deferred revenue.

Maintenance Revenues

Maintenance revenue consists of fees for providing technical support and software updates on a when-and-if available basis. We recognize all maintenance revenue ratably over the applicable maintenance period. We determine the amount of maintenance revenue to be deferred through reference to substantive maintenance renewal provisions contained in a particular arrangement or, in the absence of such renewal provisions, through reference to VSOE of maintenance renewal rates. We consider substantive maintenance provisions to be provisions where the stated maintenance renewal as a percentage of the product fee is comparable to our normal pricing for maintenance only renewals. In the event that maintenance included in an AFIS solutions contract does not have VSOE, the entire arrangement fee, including the contractual amount of the maintenance obligation, is included in product revenues and recognized ratably over the term of the maintenance period.

Services Revenues

Professional services revenue is primarily derived from engineering services and AFIS system operation and maintenance services that are not an element of an arrangement for the sale of products. These services are generally billed on a time-and-materials basis. The majority of our professional services are performed either directly or indirectly for U.S. government organizations. Revenue from such services is recognized as the services are provided.

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Consistent with EITF Issue No. 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent, the amount of revenue recognized from commissions where we are acting as an agent is the net amount after payments are made to the primary obligor responsible for delivering the services.

Revenue Recognition Criteria

We recognize revenue when persuasive evidence of an arrangement exists, the element has been delivered, the fee is fixed or determinable and collection of the resulting receivable is probable.

Persuasive evidence of an arrangement: We use either contracts signed by both the customer and us or written purchase orders issued by the customer that legally bind us and the customer as evidence of an arrangement.

Product delivery: We deem delivery to have occurred when AFIS solutions are installed and, when required under the terms of a particular arrangement, upon acceptance by the customer. Shipments of our ASICs, stand-alone live-scans and other biometric products are recognized as revenue when shipped and title and risk of ownership has passed to the buyer.

Fixed or determinable fee: For product arrangements not accounted for using the percentage-of-completion method, we consider the fee to be fixed or determinable if the fee is not subject to refund or adjustment and the payment terms are within normal established practices. If the fee is not fixed or determinable, we recognize the revenue as amounts become due and payable.

Collection is deemed probable: We conduct a credit review for all significant transactions at the time of the arrangement to determine the credit-worthiness of the customer. Collection is deemed probable if we expect that the customer will pay amounts under the arrangement as payments become due.

Deferred Revenue. Our deferred revenue balance results primarily from payments received from customers in advance of recognition of the related revenue and, to a lesser extent, from invoicing of customers prior to recognition of the related revenue. Certain customers make upfront payments resulting in cash collected prior to our recognition of revenue. These payments can be significant. We record this upfront payment as deferred revenue and reduce the deferred revenue balance as revenue is recognized. As a result, our deferred revenue balance fluctuates from quarter to quarter because it is a function of the timing of (i) the receipt of cash payments from those customers who pay in advance of revenue recognition, (ii) invoicing of customers in advance of revenue recognition and (iii) amortization of deferred revenues into revenues. Deferred revenues also consist of payments received in advance from our customers for maintenance agreements, under which revenues are recognized ratably over the term of the maintenance period. However, the fluctuation in the deferred revenue balance from quarter to quarter is generally not significantly affected by the deferred maintenance revenue. Because the mix of customers who pay or are invoiced in advance of revenue recognition changes from period to period, fluctuations in our deferred revenue balance are not a reliable indicator of total revenue to be recognized in any future period. Our cash flow from operations is also affected each quarter as a result of fluctuations in the deferred revenue balance.

Commitments and Contingencies. We periodically evaluate all pending or threatened contingencies and commitments, if any, that are reasonably likely to have a material adverse effect on our operations or financial position. We assess the probability of an adverse outcome and determine if it is remote, reasonably possible or probable as defined in accordance with the provisions of SFAS No. 5, Accounting for Contingencies. If information available prior to the issuance of our financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of our financial statements, and the amount of the loss, or the range of probable loss can be reasonably estimated, then such loss is accrued and charged to operations. If no accrual is made for a loss contingency because one or both of the conditions pursuant to SFAS No. 5 are not met, but the probability of an adverse outcome is at least reasonably possible, we will disclose the nature of the contingency and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

Allowances for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which results in a provision for bad debt expense. We determine the adequacy of this allowance by evaluating individual customer accounts receivable, through consideration of the customer s financial condition, credit history and current economic conditions. If the financial condition of our customers was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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Investments in Marketable Securities. Our investments in marketable securities consist of money market funds, certificates of deposit and commercial paper, U.S. Treasury securities, government-sponsored enterprise securities, municipal bonds, foreign government bonds and corporate bonds and notes. We account for our investments in debt and equity securities under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, (FAS 115). Marketable securities are classified as available-for-sale securities and are accounted for at their fair value. We have the intent, ability and history of holding these securities until maturity. Under FAS 115, unrealized holding gains and losses are excluded from earnings and reported net of the related tax effect in other comprehensive income (OCI) as a separate component of stockholders equity. When the fair value of an investment declines below its original cost, we evaluate the investment in accordance with FASB Staff Position (FSP) 115-1 and 124-1 The Meaning of Other-Than-Temporary Impairment and Its Applications to Certain Investments which addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. When the fair value of an investment declines below its original cost, we consider all available evidence to evaluate whether the decline is other-than-temporary. Among other things, we consider the duration and extent of the decline and economic factors influencing the markets. If a decline in fair value is judged to be other-than-temporary, the cost basis of the individual security is written down to fair value as a new cost basis and the amount of the write-down is included in earnings (that is, accounted for as a realized loss). The new cost basis is not to be changed for subsequent recoveries in fair value. Subsequent increases in the fair value of available-for-sale securities are included in OCI; subsequent decreases in fair value, if not an other-than-temporary impairment, also are included in OCI. The determination of whether a loss is other than temporary is highly judgmental and may have a material impact on our results of operations.

Management makes decisions relating to our marketable securities in accordance with the criteria, policies and guidelines set forth in a written investment policy adopted by our Board of Directors. The primary goal of our investment policy is to invest cash balances in a manner that ensures the preservation and liquidity of those funds. We are not permitted to invest or trade in securities for short-term speculative purposes, or otherwise hold investments in speculative debt or equity.

The investment policy sets forth eligible investments and mandates the following with respect to our investment portfolio:

- The maximum maturity for each issue is three years, and the maximum weighted average maturity of our investment portfolio is no more than two years;

- Investments (other than direct obligations of the U.S. Government and securities of U.S. Government-sponsored agencies) must have a short-term rating of at least A-1/SP-1 by Standard & Poor s or P-1/MIG 1 by Moody s. If there is no short-term rating the issuer must have a long-term rating of single A or better by Standard & Poor s or Moody s. Investments in longer term issues must have a rating of at least single A by Standard & Poor s and/or Moody s; and

- Positions in all investments may not exceed 5% per issuer; provided that there is no limitation with regard to money market sweep funds, direct obligations of the U.S. Government or securities of U.S. Government-sponsored agencies.

Accounting for Taxes. In preparing our consolidated financial statements, we estimate our income tax liability in each of the jurisdictions in which we operate by estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and financial statement purposes. As of March 31, 2009, our net deferred tax assets were $40.7 million. Management judgment is required in assessing the realizability of our deferred tax assets. In performing this assessment, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In the event that actual results differ from our estimates or we adjust our estimates in future periods, we may need to make or adjust valuation allowances with respect to our deferred tax assets, which could materially impact our financial position and results of operations. Our income tax provision is based on calculations and assumptions that may be subject to examination by the Internal Revenue Service and other tax authorities. Should the actual results differ from our estimates, we would have to adjust the income tax provision in the period in which the facts that give rise to the revision become known. Tax law and rate changes are reflected in the income tax provision in the period in which such changes are enacted.

We generate a significant portion of our revenues from contracts with foreign government agencies. Each country with which we do business has its own particular rules to determine the point at which our activities within such country will become subject to taxes, if any. To the extent our contracts with foreign government agencies are subject to income taxes and we do not generate adequate foreign tax credits for purposes of our Federal income tax return, our effective tax rate may be impacted.

Effective January 1, 2007, we adopted FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48). FIN 48 requires significant judgment in determining what constitutes an individual tax position as well as assessing the outcome of each tax position. Changes in judgment as to recognition or measurement of tax positions can materially affect the estimate of the effective tax rate and consequently, affect our operating results.

Accounting for Share-Based Compensation. The calculation of share-based employee compensation expense involves estimates that require management s judgment. These estimates include the fair value of each of our stock option awards, which is estimated on the date of grant using a Black-Scholes option-pricing model as discussed in Note 5 of our condensed consolidated financial statements included elsewhere in this report. The fair value of our stock option awards is expensed on a straight-line basis over the vesting life of the options. We estimate the volatility of our common stock at the date of grant based on the implied volatility of publicly traded 30-day to 270-day options on our common stock, consistent with SFAS 123R and SEC Staff Accounting Bulletin No. 107. Our decision to use implied volatility was based upon the availability of actively traded options on our common stock and our belief that implied volatility is more representative of future stock price trends than historical volatility. We base the risk-free interest rate that we use in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms. We do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model. SFAS 123R requires us to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted before January 1, 2006, we amortize the fair value on an accelerated basis. For options granted on or after January 1, 2006, we amortize the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

Beginning in 2007, the Compensation Committee of the Company s Board of Directors has issued awards of nonvested shares to certain of the Company s employees and executive officers under the Company s 2004 Equity Incentive Plan. These nonvested share awards are grants that entitle the holder to shares of common stock subject to certain terms and, generally, vest in 25% increments each year on the anniversary of the grant date throughout a four year vesting period. The nonvested share awards are valued based on the closing market price on the date of award. Nonvested share compensation is to be amortized and charged to operations on a straight-line basis over the four year vesting period.

Results of Operations

The following table sets forth selected statements of income data for each of the periods indicated expressed as a percentage of total revenues:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2009
Consolidated Statements of Income Data:		
Revenues:		
Product revenues	70.7%	66.6%
Maintenance and services revenues	29.3	33.4
Total revenues	100.0	100.0
Cost of revenues:		
Cost of product revenues	20.2	17.9
Cost of maintenance and services revenues	10.4	13.7
Total cost of revenues	30.6	31.6
Gross profit	69.4	68.4
Operating expenses:		
Research and development	12.9	12.0
Selling and marketing	10.9	10.2
General and administrative	12.0	9.7
Income from settlement of lawsuit	(40.6)	0.0
Total operating expenses (income)	(4.8)	31.9
Operating income	74.2	36.5
Interest income	20.2	10.5

Other, net	(0.1)	0.1
Income before income taxes	94.3	47.1
Income tax provision	35.7	18.3
Net income	58.6%	28.8%

Comparison of Results for the three months ended March 31, 2009 and 2008

Revenues. Revenues were $31.0 million for the three months ended March 31, 2009, compared to $24.6 million for the three months ended March 31, 2008. Product revenues were $20.7 million for the three months ended March 31, 2009, compared to $17.4 million for the three months ended March 31, 2008. The $3.3 million increase in product revenues was driven primarily by our continued strong sales to the DHS, as well as sales to Spain, Pennsylvania, and Romania.

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Maintenance and services revenues increased to $10.4 million for the three months ended March 31, 2009 from $7.2 million for the three months ended March 31, 2008. The increase of $3.2 million or 43.5%, was primarily due to (i) an increase in maintenance renewals and engineering services associated with product sales in prior periods, (ii) an increase in services provided to the DHS and (iii) contribution from our Security Solutions Division, which we acquired in April 2008 (the SSD Division).

Gross Profit. Gross profit as a percentage of revenues was 68.4% for the three months ended March 31, 2009, compared to 69.4% for the three months ended March 31, 2008. Product gross margins were 73.1% for the three months ended March 31, 2009, compared to 71.4% for the three months ended March 31, 2008. The improvement in margins on product revenues was primarily due to a change in the mix of products sold during the three months ended March 31, 2009; our software intensive solutions typically have higher margins than our hardware intensive solutions.

Costs of maintenance and service revenues increased $1.7 million or 66.4%, to $4.3 million for the three months ended March 31, 2009 from $2.6 million for the three months ended March 31, 2008. This increase was the result of the increase in maintenance and support services provided during the period. Margins on maintenance and services decreased from 64.6% during the three months ended March 31, 2008 to 58.9% during the three months ended March 31, 2009 primarily due to an increase in the number of personnel engaged in providing maintenance and support services, as we expand capacity in response to increasing demand. In addition, the decrease in margins on maintenance and services were partially due to the SSD Division, which has lower gross margins than our historic service gross margins.

Research and Development. Research and development expenses increased $557,000, or 17.6%, to $3.7 million for three months ended March 31, 2009, compared to $3.2 million for the three months ended March 31, 2008. As a percentage of revenues research and development expenses remained relatively consistent at approximately 12.0% of revenues for the three months ended March 31, 2009 compared to 12.9% of revenues for the three months ended March 31, 2008. The increase in research and development expenses was primarily due to an increase in expenses related to our efforts to develop new products for our customers.

Selling and Marketing. Selling and marketing expenses increased $464,000, or 17.2%, to $3.2 million for the three months ended March 31, 2009, compared to $2.7 million for the three months ended March 31, 2008. As a percentage of revenues such expenses remained relatively consistent at 10.2% for the three months ended March 31, 2009, compared to 10.9% for the three months ended March 31, 2008. The increase in selling and marketing expenses was primarily due to management continuing to expand its marketing and business development capabilities in 2009, which resulted in an increase in compensation expenses of $269,000 driven by an increase in headcount and an increase in consulting fees of $195,000.

General and Administrative. General and administrative expenses were $3.0 and $2.9 million for the three months ended March 31, 2009 and 2008, respectively. As a percentage of revenues, general and administrative expenses decreased to 9.7% for the three months ended March 31, 2009 compared to 12.0% for the three months ended March 31, 2008. This decrease as a percent of revenues was primarily due to higher revenues realized in the first quarter of 2009 compared to 2008 associated with our relatively fixed general and administrative costs.

Interest Income. We earned interest income of $3.3 million during the three months ended March 31, 2009, compared to $5.0 million during the three months ended March 31, 2008. The decrease in interest income was primarily due to a decrease in interest rates partially offset by a higher average cash and investment balances as a result of cash generated from operations.

Income Tax Provision. We recognized an income tax provision of $5.7 million during the three months ended March 31, 2009. Our effective tax rate of 38.8% for the three months ended March 31, 2009 represents federal, state and foreign taxes on our income reduced primarily as a result of the production activities deduction as well as state research and development credits and benefits resulting from the disqualifying disposition of incentive stock options. We recognized an income tax provision of $8.8 million, with an effective tax rate of 37.9%, during the three months ended March 31, 2008.

Liquidity and Capital Resources

Since our inception we have financed our operations by generating cash from operations. Since September 2004 we have supplemented our cash resources through public offerings of our common stock, raising $228.6 million in our initial public offering in September 2004 and $96.8 million in a subsequent public offering in June 2005. As of March 31, 2009, we had $37.9 million in cash and $468.5 million in investments in marketable securities.

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Cash provided by operations

In addition to our net income, the key drivers of our cash flows from operations are changes in accounts receivable, inventory, deferred revenues and deferred income taxes and taxes payable. The effect of these key drivers on our cash provided by operations for the three months ended March 31, 2008 and 2009 was as follows:

	Three Months Ended March 31,	
	2008	2009
	(in thousands)	
Key Drivers of Cash Provided by Operations		
Net income	$ 14,428	$ 8,950
Changes in:		
Billed and unbilled accounts receivable	7,827	7,275
Inventory and contract related costs	(3,958)	(4,420)
Deferred revenues	10,090	5,866
Deferred income taxes and taxes payable	8,020	5,008
Net other activity	2,563	5,644
Net cash provided by operating activities	$ 38,970	$ 28,323

A substantial portion of our revenues represents sales of multiple element software based solutions. Elements of our software based solutions may be delivered immediately or may be delivered over several years. The timing for the recognition of our revenues, and the related costs, is dependent on the nature of the products and services sold and does not necessarily coincide with cash collections. On the other hand, the timing of cash collections depends on our customers budgeting processes, the length and terms of each arrangement and the competitive bidding process.

Cash provided by operating activities was reduced by $10.6 million primarily due to the decrease in net income affected by income taxes as well as the decrease in deferred revenue. We experienced strong cash collections on our accounts receivable balances during the three months ended March 31, 2008 and 2009, which contributed to the cash provided by operations during both of these periods.

The $5.9 million increase in deferred revenues during the three months ended March 31, 2009 was primarily due to an increase in deferred revenue of $15.0 million from Northrop under the settlement and software license agreements previously discussed. This increase was partially offset by approximately $13.6 million of revenue recognized under DHS orders that were included in deferred revenues as of December 31, 2008. Various contracts including Los Angeles County, and the Bureau of Census, as well as additional orders for our Fusion devices contributed approximately $4.5 million to the overall increase of deferred revenues for the three months ended March 31, 2009.

Our effective tax rates have been impacted by the disqualifying disposition of incentive stock options, which reduce our income taxes payable and result in positive cash flow. Our cash flows from income taxes could be impacted depending on the timing of disqualifying dispositions. To the extent we have previously recorded share-based compensation expense related to incentive stock options we record the benefit from the disqualifying disposition of incentive stock options as a reduction to our provision for income taxes.

Cash Provided by (Used In) Investing Activities

Net cash provided by (used in) investing activities was $4.3 million and ($25.5) million for the three months ended March 31, 2008 and 2009, respectively. Investing activities consisted primarily of purchases and sales of available-for-sale securities and capital expenditures, which generally consisted of computer equipment and software for our engineering, service and information technology departments. Cash provided by (used in) of $7.8 million and ($24.7) million during the three months ended March 31, 2008 and 2009, respectively, represented the net change in the balance of investments due to purchases and sales of available-for-sale securities. Capital expenditures, which consisted primarily of computer equipment and software for our engineering, service and information technology departments, were $485,000 and $825,000 for the three months ended March 31, 2008 and 2009, respectively.

Cash (Used in) Provided by Financing Activities

Cash (used in) provided by financing activities was ($36.5) million and $160,000 for the three months ended March 31, 2008 and 2009, respectively. Proceeds from the exercise of stock options were $103,000 and $63,000 during the three months ended March 31, 2008 and 2009, respectively. In accordance with SFAS 123R, we classified the cash flows resulting from the excess tax benefits from share-based compensation as financing cash flows.

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On November 1, 2007, we announced that our Board of Directors had approved a stock repurchase program. Pursuant to this program, beginning on November 5, 2007, we were authorized to repurchase up to $100 million of our common stock. The initial expiration date of the program was October 29, 2008. On November 13, 2008, we announced that our Board of Directors had extended the expiration date of the repurchase program to November 12, 2009 and increased the amount of common stock that may be repurchased under the program to an aggregate of up to $150 million. We are not obligated to purchase any shares. Depending on market conditions, shares may be repurchased from time to time at prevailing market prices through open market or negotiated transactions. Subject to applicable securities laws, repurchases may be made at such times and in such amounts as our management deems appropriate. Purchases under the program can be discontinued at any time our management feels additional purchases are not warranted. The authorized amount remaining available under our repurchase program for share repurchases was $90.6 million as of March 31, 2009. We did not purchase any shares pursuant to the repurchase program during the three months ended March 31, 2009.

We currently have no material cash commitments, except our normal recurring trade payables, expense accruals and operating leases, all of which are currently expected to be funded through existing working capital and future cash flows from operations. We believe that our cash and cash equivalent balances will be sufficient to satisfy our cash requirements for at least the next twelve months. Although we cannot accurately anticipate the effect of inflation or foreign exchange markets on our operations, we do not believe these external economic forces have had, or are likely in the foreseeable future to have, a material impact on our liquidity or capital resources.

At March 31, 2009, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, special purpose, or variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage in trading activities involving non-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have material relationships and transactions with persons or entities that derive benefits from their non-independent relationship with us or our related parties.

Commitments and contingencies as discussed in the Notes to the Condensed Consolidated Financial Statements do not include payments that could be made related to our unrecognized tax benefits liability, which amounted to $8.8 million as of March 31, 2009. The timing and amount of any future payments is not reasonably estimable, as such payments are dependent on the completion and resolution of examinations with tax authorities.

Recent Accounting Pronouncements

The disclosure requirements of SFAS No. 157, Fair Value Measurements, which took effect on January 1, 2008, are presented in Note 7. On January 1, 2009, we implemented the previously deferred provisions of SFAS No. 157 for nonfinancial assets and liabilities recorded at fair value, which had no impact on our financial statements.

The accounting requirements of SFAS No. 141(R), Business Combinations, which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

The accounting and presentation requirements of SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51, which took effect on January 1, 2009, had no impact on our financial statements.

In April 2009, the FASB issued Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume or Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have significantly decreased and requires that companies provide interim and annual disclosures of the inputs and valuation technique(s) used to measure fair value. FSP 157-4 is effective for us beginning April 1, 2009. We are still assessing the impact of FSP 157-4 on our consolidated financial position and results of operations.

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In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP 115-2/124-2). FSP 115-2/124-2 provides additional guidance designed to create greater clarity and consistency in accounting and presenting impairment losses on securities. FSP 115-2/124-2 is intended to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. FSP 115-2/124-2 also requires increased and more timely disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. FSP 115-2/124-2 is effective beginning for us beginning April 1, 2009. We are still assessing the impact of FSP 115-2/124-2 on our consolidated financial statements.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP 107-1). FSP 107-1 requires disclosures about fair value of financial instruments in financial statements for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 is effective for us beginning April 1, 2009. We are still assessing the impact of FSP 107-1 on our consolidated financial position and results of operations.

Other new pronouncements issued but not effective until after March 31, 2009, are not expected to have a significant effect on our consolidated financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Although we generally bill for our products and services mostly in U.S. dollars, our financial results could be affected by factors such as changes in foreign currency rates or weak economic conditions in foreign markets. A strengthening of the dollar could make our products and services less competitive in foreign markets and therefore could reduce our revenues. We are billed by and pay substantially all of our vendors in U.S. dollars. In the future, an increased portion of our revenues and costs may be denominated in foreign currencies. To date, exchange rate fluctuations have had little impact on our operating results. We do not enter into derivative instrument transactions for trading or speculative purposes.

Fixed income securities are subject to interest rate risk. The fair value of our investment portfolio would not be significantly impacted by either a 100 basis point increase or decrease in interest rates due mainly to the short-term nature of the major portion of our investment portfolio. The portfolio is diversified and consists primarily of investment grade securities to minimize credit risk.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) under the Exchange Act, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing evaluation, our principal executive officer and our principal financial officer concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective at the reasonable assurance level.

There were no changes in our internal controls over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are not currently aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

Item 1A. Risk Factors

You should consider each of the following factors as well as the other information in this Quarterly Report in evaluating our business and our prospects. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impair our business operations. If any of the following risks actually occur, our business and financial results could be harmed. In that case, the trading price of our common stock could decline. You should also refer to the other information set forth in this Quarterly Report, including our financial statements and the related notes.

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Our business could be adversely affected by significant changes in the contracting or fiscal policies of governments and governmental entities.

We derive substantially all of our revenues from contracts with international, federal, state and local governments and government agencies, and subcontracts under federal government prime contracts, and we believe that the success and growth of our business will continue to depend on our successful procurement of government contracts either directly or through prime contractors. Accordingly, changes in government contracting policies or government budgetary constraints could directly affect our financial performance. Among the factors that could adversely affect our business are:

- changes in fiscal policies or decreases in available government funding;
- changes in government funding priorities;
- changes in government programs or applicable requirements;
- the adoption of new laws or regulations or changes to existing laws or regulations;
- changes in political or social attitudes with respect to security and defense issues;
- potential delays or changes in the government appropriations process; and
- delays in the payment of our invoices by government payment offices.

These and other factors could cause governments and governmental agencies, or prime contractors that use us as a subcontractor, to reduce their purchases under existing contracts, to exercise their rights to terminate contracts at-will or to abstain from exercising options to renew contracts, any of which could have an adverse effect on our business, financial condition and results of operations. Many of our government customers are subject to stringent budgetary constraints. The award of additional contracts from government agencies could be adversely affected by spending reductions or budget cutbacks at these agencies.

In 2008 and for the three months ended March 31, 2009, we derived 57% and 56% respectively, of our revenues from a limited number of customers.

In each fiscal period we have derived, and we believe that in each future fiscal period we will continue to derive, a significant portion of our revenues from a limited number of customers. In 2008, the DHS accounted for 57% of revenues. In the three months ended March 31, 2009, the DHS accounted for 56% of revenues. We do not have any long-term contracts with any of our customers, including the DHS, for the sale of our products, and our future sales will depend upon the receipt of new orders. To the extent that any significant customer, like the DHS, reduces or delays its purchases from us or terminates its relationship with us, our revenues would decline significantly and our financial condition and results of operations would suffer substantially. For example, a delay in the rollout of US-VISIT, or the completion of the implementation of that program, resulting in a decrease or cessation of orders for our products from the DHS, would materially affect our business.

In 2008 and for the three months ended March 31, 2009, we derived 80% and 83% respectively, of our revenues from the sale of our solutions either directly or indirectly to U.S. government entities pursuant to government contracts, which involve competitive bidding and may be subject to cancellation or delay without penalty, any of which may produce volatility in our revenues and earnings.

Our performance in any one reporting period is not necessarily indicative of future operating performance because of our reliance on a small number of customers, the majority of which are government entities. Government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted, and typically impose provisions that permit cancellation in the event that necessary funds are unavailable to the public agency. In many cases, unsuccessful bidders for government agency contracts are provided the opportunity to formally protest certain contract awards through various agency, administrative and judicial channels. The protest process may substantially delay a successful bidder s contract performance, result in cancellation of the contract award entirely and distract management. We may not be awarded contracts for which we bid, and substantial delays or cancellation of purchases may even follow our successful bids as a result of such protests.

In addition, local government agency contracts may be contingent upon availability of matching funds from federal or state entities. Also, law enforcement and other government agencies are subject to political, budgetary, purchasing and delivery constraints which may cause our quarterly and annual revenues and operating results to fluctuate in a manner that is difficult to predict.

If the biometrics market does not experience significant growth or if our products do not achieve broad acceptance both domestically and internationally, we will not be able to achieve our anticipated level of growth.

Our revenues are derived from sales of our biometrics solutions. We cannot accurately predict the future growth rate or the size of the biometrics market. The expansion of the biometrics market and the market for our biometrics solutions depends on a number of factors, such as:

- the cost, performance and reliability of our solutions and the products and services offered by our competitors;
- customers perceptions regarding the benefits of biometrics solutions;

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- the development and growth of demand for biometric solutions in markets outside of government and law enforcement;
- public perceptions regarding the intrusiveness of these solutions and the manner in which organizations use the biometric information collected;
- public perceptions regarding the confidentiality of private information;
- proposed or enacted legislation related to privacy of information;
- customers satisfaction with biometrics solutions; and
- marketing efforts and publicity regarding biometrics solutions.

Even if biometrics solutions gain wide market acceptance, our solutions may not adequately address market requirements and may not continue to gain market acceptance. If biometrics solutions generally or our solutions specifically do not gain wide market acceptance, we may not be able to achieve our anticipated level of growth and our revenues and results of operations would suffer.

Our financial results often vary significantly from quarter to quarter and may be negatively affected by a number of factors.

Since individual orders can represent a meaningful percentage of our revenues and net income in any single quarter, the deferral or cancellation of or failure to close a single order in a quarter can result in a revenue and net income shortfall that results in our failing to meet securities analysts expectations for that period. We base our current and future expense levels on our internal operating plans and sales forecasts, and our operating costs are to a large extent fixed. As a result, we may not be able to sufficiently reduce our costs in any quarter to adequately compensate for an unexpected near-term shortfall in revenues, and even a small shortfall could disproportionately and adversely affect financial results for that quarter.

In addition, our financial results may fluctuate from quarter to quarter and be negatively affected by a number of factors, including the following:

- the lack or reduction of government funding and the political, budgetary and purchasing constraints of our government agency customers;
- the terms of customer contracts that affect the timing of revenue recognition;
- the size and timing of our receipt of customer orders;
- significant fluctuation in demand for our solutions;
- price reductions or adjustments, new competitors, or the introduction of enhanced solutions from new or existing competitors;
- cancellations, delays or contract amendments by government agency customers;

- protests of federal, state or local government contract awards by competitors;
- unforeseen legal expenses, including litigation and/or administrative protest costs;
- expenses related to acquisitions or mergers;
- potential effects of providing services as a prime contractor that may not carry gross margins as high as those of our core solutions;
- impairment charges arising out of our assessments of goodwill and intangibles; and
- other one-time financial charges.

We face intense competition from other biometrics solutions providers, including diversified technology providers, alternative solutions providers and providers of biometric products.

A significant number of established companies have developed or are developing and marketing software and hardware for fingerprint biometrics products and applications that currently compete with or will compete directly with our offerings. Our offerings also compete with non-biometric technologies such as public key infrastructure solutions, smart card security solutions and traditional key, card surveillance and password systems. We believe that additional competitors will enter the biometrics market and become significant long-term competitors, and that, as a result, competition will increase. In certain instances, we compete with third parties who are also our suppliers or prime contractors. Companies competing with us may introduce solutions that are competitively priced, have increased performance or functionality or incorporate technological advances we have not yet developed or implemented. Our current principal competitors include:

- diversified technology providers such as NEC and Safran Group (through its wholly owned subsidiary Sagem Morpho) that offer integrated AFIS solutions to governments, law enforcement agencies and other organizations;

- companies that are AFIS component providers, such as Cross Match Technologies and L-1 Identity Solutions;

- prime government contractors that develop integrated information technology products and services that include biometrics-related solutions that are frequently delivered in partnership with diversified technology providers and biometrics-focused companies; and

- companies focused on other fingerprint biometric solutions, such as AuthenTec, Dermalog and UPEK.

We expect competition to intensify in the near term in the biometrics market. Many current and potential competitors have substantially greater financial, marketing, research and manufacturing resources than we have. To compete effectively in this environment, we must continually develop and market new and enhanced solutions and technologies at competitive prices and must have the resources available to invest in significant research and development activities. Our failure to compete successfully could cause our revenues and market share to decline.

We are subject to extensive government regulation, and our failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.

We are affected by and must comply with various government regulations that impact our operating costs, profit margins and the internal organization and operation of our business. Furthermore, we may be audited to assure our compliance with these requirements. Our failure to comply with applicable regulations, rules and approvals could result in the imposition of penalties, the loss of our government contracts or our disqualification as a U.S. government contractor, all of which could adversely affect our business, financial condition and results of operations.

Among the most significant regulations affecting our business are:

- the Federal Acquisition Regulations, or the FAR, and agency regulations supplemental to the FAR, which comprehensively regulate the formation and administration of, and performance under government contracts;

- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;

- the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under cost-based government contracts;

- the Foreign Corrupt Practices Act; and

- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

These regulations affect how our customers and we can do business and, in some instances, impose added costs on our business. Any changes in applicable laws and regulations could restrict our ability to conduct our business. Any failure by us to comply with applicable laws and regulations could result in contract termination, price or fee reductions or suspension or debarment from contracting with the federal government generally.

Our lengthy and variable sales cycle will make it difficult to predict financial results.

Our AFIS solutions often require a lengthy sales cycle ranging from several months to sometimes over a year before we can receive approvals for purchase. The length of the sales cycle depends on the size and complexity of the solutions, the customer s budgeting process, the customer s in-depth evaluation of our solutions and a competitive bidding process. As a result, we may incur substantial expense before we earn associated revenues, since a significant portion of our operating expenses is relatively fixed. The lengthy sales cycles of our solutions make forecasting the volume and timing of sales difficult. In addition, the delays inherent in lengthy sales cycles raise additional risks that customers may cancel contracts or change their minds. If customer cancellations occur, they could result in the loss of anticipated sales without allowing us sufficient time to reduce our operating expenses.

Security breaches in systems that we sell or maintain could result in the disclosure of sensitive government information or private personal information that could result in the loss of clients and negative publicity.

Many of the systems we sell manage private personal information and protect information involved in sensitive government functions. A security breach in one of these systems could cause serious harm to our business as a result of negative publicity and could prevent us from having further access to such systems or other similarly sensitive areas for other governmental clients.

As part of our service offerings, we agree from time to time to maintain and operate a portion of the AFIS systems of our customers on an outsourced application hosting basis. Our ability to continue this service is subject to a number of risks. For example, our systems may be vulnerable to physical or electronic break-ins and service disruptions that could lead to interruptions, delays, loss of data or the inability to process user requests. If any such compromise of our security were to occur, it could be very expensive to

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cure, could damage our reputation and could discourage potential customers from using our services. Although we have not experienced attempted break-ins, we may experience such attempts in the future. Our systems may also be affected by outages, delays and other difficulties. Our insurance coverage may be insufficient to cover losses and liabilities that may result from such events.

If we are unable to continue to obtain U.S. government authorization regarding the export of our products, or if current or future export laws limit or otherwise restrict our business, we could be prohibited from shipping our products to certain countries, which could cause our business, financial condition and results of operations to suffer.

We must comply with U.S. laws regulating the export of our products. In some cases, explicit authorization from the U.S. government is needed to export our products. The export regimes and the governing policies applicable to our business are subject to changes. We cannot assure you that such export authorizations will be available to us or for our products in the future. In some cases where we act as a subcontractor, we rely upon the compliance activities of our prime contractors, and we cannot assure you that they have taken or will take all measures necessary to comply with applicable export laws. If we or our prime contractor partners cannot obtain required government approvals under applicable regulations, we may not be able to sell our products in certain international jurisdictions.

Failure to properly manage projects may result in costs or claims against us, and our financial results could be adversely affected.

Deployments of our solutions often involve large-scale projects. The quality of our performance on such projects depends in large part upon our ability to manage relationships with our customers and to effectively manage the projects and deploy appropriate resources, including our own project managers and third party subcontractors, in a timely manner. Any defects or errors or failures to meet clients expectations could result in reputational damage or even claims for substantial monetary damages against us. In addition, we sometimes guarantee customers that we will complete a project by a scheduled date or that our solutions will achieve defined performance standards. If our solutions experience a performance problem, we may not be able to recover the additional costs we will incur in our remedial efforts, which could materially impair profit from a particular project. Moreover, 8% of our revenues in 2008 and 6% of our revenues for the three months ended March 31, 2009 were derived from fixed price contracts. Changes in the actual and estimated costs and time to complete fixed-price, time-certain projects may result in revenue adjustments for contracts where revenue is recognized under the percentage of completion method. Finally, if we miscalculate the amount of resources or time we need to complete a project for which we have agreed to capped or fixed fees, our financial results could be adversely affected.

The biometrics industry is characterized by rapid technological change and evolving industry standards, which could render our existing solutions obsolete.

Our future success will depend upon our ability to develop and introduce a variety of new capabilities and enhancements to our existing solutions in order to address the changing and sophisticated needs of the marketplace. Frequently, technical development programs in the biometrics industry require assessments to be made of the future direction of technology, which is inherently difficult to predict. Delays in introducing new products and enhancements, the failure to choose correctly among technical alternatives or the failure to offer innovative products or enhancements at competitive prices may cause customers to forego purchases of our solutions and purchase our competitors solutions. We may not have adequate resources available to us or may not adequately keep pace with appropriate requirements in order to effectively compete in the marketplace.

We are dependent on our management team, particularly Ming Hsieh, our founder and Chief Executive Officer, and the loss of any key member of our team may impair our ability to operate effectively and may harm our business.

Our success depends largely upon the continued services of our executive officers and other key personnel, particularly Ming Hsieh, our founder and Chief Executive Officer. The relationships that our key managers have cultivated with our customers makes us particularly dependent upon their continued employment with us. We are also substantially dependent on the continued services of our existing engineering and project management personnel because of the highly technical nature of our solutions. We do not have employment agreements with any of our executive officers or key personnel obligating them to provide us with continued services and therefore, they could terminate their employment with us at any time without penalty. We do not maintain key person life insurance policies on any of our employees. The loss of one or more members of our management team could seriously harm our business.

Termination of all or some of our backlog of orders could negatively affect our sales.

We record an item as backlog when we receive a contract, purchase order or other notification indicating the specific products and/or services to be purchased, the purchase price, specifications and other customary terms and conditions. Our backlog includes deferred revenue reflected on our consolidated balance sheet. There can be no assurance that any of the contracts comprising our backlog will result in actual revenue in any particular periods or that the actual revenue from such contracts will equal our backlog estimates. Furthermore, there can be no assurance that any contract included in our estimated backlog that actually generates revenue will be profitable. These estimates are based on our experience under such contracts and similar contracts and may not be accurate.

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Loss of limited source suppliers may result in delays or additional expenses.

We obtain hardware components and complete products from a limited group of suppliers, and we do not have any long term agreements with any of these suppliers obligating them to continue to sell components or products to us. Our reliance on them involves significant risks, including reduced control over quality, price, and delivery schedules. Moreover, any financial instability of, or consolidation among, our manufacturers or contractors could result in our having to find new suppliers. We may experience significant delays in manufacturing and shipping our products to customers if we lose these sources or if the supplies from these sources are delayed, or are of poor quality or supplied in insufficient amounts. As a result, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. It may take several months to locate alternative suppliers, if required, or to re-tool our products to accommodate components from different suppliers. We cannot predict if we will be able to obtain replacement components within the time frames we require at an affordable cost, or at all. Any delays resulting from suppliers failing to deliver components or products on a timely basis, in sufficient quantities and of sufficient quality or any significant increase in the price of components from existing or alternative suppliers could disrupt our ability to meet customer demands or reduce our gross margins.

Our business could be adversely affected by negative audits by government agencies, and we could be required to reimburse the U.S. government for costs that we have expended on our contracts, and our ability to compete successfully for future contracts could be materially impaired.

Government agencies may audit us as part of their routine audits and investigations of government contracts. As part of an audit, these agencies may review our performance on contracts, cost structures and compliance with applicable laws, regulations and standards. These agencies may also review the adequacy of, and our compliance with, our internal control systems and policies, including our purchasing, property, estimating, compensation and management information systems. If any of our costs are found to be improperly allocated to a specific contract, the costs may not be reimbursed and any costs already reimbursed for such contract may have to be refunded. An audit could materially affect our competitive position and result in a material adjustment to our financial results or statement of operations. If a government agency audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with the federal government. In addition, we could suffer serious reputational harm if allegations of impropriety were made against us. If we were suspended or debarred from contracting with the federal government generally, or if our reputation or relationships with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenues and prospects would be materially harmed.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology which could have a material adverse effect on our business, financial condition and results of operations, and on our ability to compete effectively.

The core technology used in our products and solutions is not the subject of any patent protection, and we may be unable to obtain patent protection in the future. Although we have patent protection on some of our technology related to optical sensors and image reconstruction for the commercial market, we rely primarily on trade secrets and confidentiality procedures to protect our proprietary technology, and cannot assure you that we will be able to enforce the patents we own effectively against third parties. Despite our efforts, these measures can only provide limited protection. Unauthorized third parties may try to copy or reverse engineer portions of our products or otherwise obtain and use our intellectual property. If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology, and our business would thus be harmed. In addition, defending our intellectual property rights may entail significant expense. Any of our trademarks or other intellectual property rights may be challenged by others or invalidated through administrative processes or litigation. In addition, our patents, or any patents that may be issued to us in the future, may not provide us with any competitive advantages, or may be challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which we market our solutions. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and domestic and international mechanisms for enforcement of intellectual property rights may be inadequate. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property or otherwise gaining access to our technology.

We may be required to expend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any such litigation, whether or not it is ultimately resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel. For example, in April 2005 we initiated a lawsuit against Northrop Grumman which asserted that Northrop caused us harm by misappropriating our trade secrets. Our management devoted a significant amount of time to, and we spent a significant amount of funds in connection with, this lawsuit, which was settled in 2007.

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We may be sued by third parties for alleged infringement of their proprietary rights.

As the size of our market increases, the likelihood of an intellectual property claim against us increases. Our technologies may not be able to withstand third-party claims against their use. Any intellectual property claims, with or without merit, could be time-consuming and expensive to litigate or settle, and could divert management attention away from the execution of our business plan. In addition, we may be required to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling in such a claim. An adverse determination could also prevent us from offering our solutions to others.

Ming Hsieh controls a majority of our outstanding stock, and this may delay or prevent a change of control of our company or adversely affect our stock price.

Ming Hsieh, our Chief Executive Officer, controlled a majority of our outstanding common stock as of March 31, 2009. As a result, he is able to exercise control over matters requiring stockholder approval, such as the election of directors and the approval of significant corporate transactions. These types of transactions include transactions involving an actual or potential change of control of our company or other transactions that the non-controlling stockholders may deem to be in their best interests and in which such stockholders could receive a premium for their shares. We are a controlled company under the NASDAQ corporate governance rules, and therefore we are entitled to exemptions from certain of the NASDAQ corporate governance rules. These requirements are generally intended to increase the likelihood that boards will make decisions in the best interests of stockholders. Specifically, we are not required to have a majority of our directors be independent or to have compensation, nominating and corporate governance committees comprised solely of independent directors. We do not intend to avail ourselves of the controlled company exemptions, but our intentions may change and in such event, if our stockholders interests differed from those of Mr. Hsieh, our stockholders would not be afforded the protections of these NASDAQ corporate governance requirements.

Because competition for highly qualified project managers and technical personnel is intense, we may not be able to attract and retain the managers we need to support our business plan.

To execute our business plan, we must attract and retain highly qualified project managers. Competition for hiring these managers is intense, especially with regard to engineers with high levels of experience in designing, developing and integrating biometrics solutions. We may not be successful in attracting and retaining qualified managers. Many of the companies with which we compete for hiring experienced managers have greater resources than we have. In addition, in making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the equity incentives they are to receive in connection with their employment. Significant volatility in the price of our stock may, therefore, adversely affect our ability to attract or retain key managers. If we fail to attract new personnel or fail to retain and motivate our current managers, our business and future growth prospects could be severely harmed.

Competition for skilled personnel in our industry is intense and companies such as ours sometimes experience high attrition rates with regard to their skilled employees. In addition, we often must comply with provisions in federal government contracts that require employment of persons with specified levels of education and work experience. The loss of any significant number of our existing key technical personnel or our inability to attract and retain key technical employees in the future could have a material adverse effect on both our ability to win new business and our financial results.

International uncertainties and fluctuations in the value of foreign currencies could harm our profitability.

In 2008 and for the three months ended March 31, 2009, revenues outside of the Americas accounted for approximately 14% and 13%, respectively, of our total revenues. We also currently have international operations, including offices in Austria, Canada, China, Taiwan and the United Kingdom. Our international revenues and operations are subject to a number of material risks, including, but not limited to:

- difficulties in building and managing foreign operations;
- regulatory uncertainties in foreign countries;
- difficulties in enforcing agreements and collecting receivables through foreign legal systems and other relevant legal issues;

longer payment cycles;

foreign and U.S. taxation issues;

potential weaknesses in foreign economies;

fluctuations in the value of foreign currencies;

general economic and political conditions in the markets in which we operate; and

unexpected domestic and international regulatory, economic or political changes.

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Our sales, including sales to customers outside the United States, are primarily denominated in U.S. dollars, and therefore downward fluctuations in the value of foreign currencies relative to the U.S. dollar may make our solutions more expensive than local solutions in international locations. This would make our solutions less price competitive than local solutions, which could harm our business. We do not currently engage in currency hedging activities to limit the risks of currency fluctuations. Therefore, fluctuations in the value of foreign currencies could harm our profitability.

If biometrics solutions and products based on biometrics other than fingerprints become predominant or more significant in the biometrics market, our business, financial condition and results of operations could suffer materially.

Our current business and products are based primarily on fingerprint biometrics. It is possible that other biometrics solutions could become predominant or more significant in the future, such as biometrics based on face or iris recognition. In such event, we cannot assure you that we would be able to develop and market successful products and solutions based on these other biometrics or that any such products or solutions we develop would be as successful as our fingerprint biometric solutions.

Our products and solutions could have unknown defects or errors, which may give rise to claims against us or divert application of our resources from other purposes.

Products and solutions as complex as those we offer frequently develop or contain undetected defects or errors. Despite testing, defects or errors may arise in our existing or new products and solutions, which could result in loss of revenue or market share, failure to achieve market acceptance, diversion of development resources, injury to our reputation and increased service and maintenance costs. Defects or errors in our products and solutions might discourage customers from purchasing future products and services.

Potential future acquisitions could be difficult to integrate, divert the attention of key management personnel, disrupt our business, dilute stockholder value and adversely affect our financial results.

As part of our business strategy, we intend to consider acquisitions of companies, technologies and products that we feel could accelerate our ability to compete in our core markets or allow us to enter new markets. Acquisitions involve numerous risks, including:

- difficulties in integrating operations, technologies, accounting and personnel;
- difficulties in supporting and transitioning customers of our acquired companies;
- diversion of financial and management resources from existing operations;
- risks of entering new markets;
- potential loss of key employees; and
- inability to generate sufficient revenues to offset acquisition costs.

Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairments in the future that could harm our financial results. In addition, if we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted, which could affect the market price of our stock. As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate.

Our charter documents and Delaware law may deter potential acquirers of our business and may thus depress our stock price.

Our amended and restated certificate of incorporation and our bylaws contain provisions that could delay or prevent a change of control of our company that our stockholders might consider favorable. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may discourage, delay or prevent certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our charter documents may make it more difficult for stockholders or potential acquirers to initiate actions that are opposed by the then-current board of directors, including delaying or impeding a merger, tender offer, or proxy contest or other change of control transaction involving our company. Any delay or prevention of a change of control transaction could cause stockholders to lose a substantial premium over the then current market price of their shares.

The trading price of our common stock is volatile.

The trading prices of the securities of technology companies have historically been highly volatile. Accordingly, the trading price of our common stock is likely to be subject to wide fluctuations. Factors affecting the trading price of our common stock may include:

- variations in our financial results;

announcements of technological innovations, new solutions, strategic alliances or significant agreements by us or by our competitors;

recruitment or departure of key personnel;

changes in the estimates of our financial results or changes in the recommendations of any securities analysts that elect to follow our common stock; and

market conditions in our industry, the industries of our customers and the economy as a whole.

In addition, if the market for biometrics or other technology stocks or the stock market in general experiences continued or greater loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business or financial results. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

Future sales of shares by existing stockholders could cause our stock price to decline.

All of our outstanding shares are eligible for sale in the public market, subject in certain cases to volume limitations under Rule 144 of the Securities Act of 1933, as amended. Also, shares subject to outstanding options and rights under our 2000 Stock Option Plan and 2004 Equity Incentive Plan are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements and Rules 144 and 701 under the Securities Act. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

In addition, Ming Hsieh, who was our sole stockholder prior to our initial public offering, continues to hold a substantial number of shares of our common stock. Sales by Mr. Hsieh of a substantial number of shares, or the expectation that such sales may occur, could significantly reduce the market price of our common stock.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results. As a result, current and potential stockholders could lose confidence in our financial reporting, which would harm our business.

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our operating results could be misstated, our reputation may be harmed and the trading price of our stock could be negatively affected. There can be no assurance that our controls over financial processes and reporting will be effective in the future.

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Item 6. Exhibits

Exhibit Number	Description of Documents
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURE

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

Cogent, Inc.

By: /s/ Paul Kim

Paul Kim
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: May 8, 2009