

ICOP DIGITAL, INC
Form 10-K
March 20, 2009
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U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: 001-32560

ICOP Digital, Inc.

(Exact name of registrant as specified in its charter)

Colorado
(State or other jurisdiction of
incorporation or organization)

16801 W. 116th Street, Lenexa, KS 66219

(Address of principal executive offices, including ZIP Code)

84-1493152
(I.R.S. Employer
Identification No.)

Registrant's telephone number including area code: (913) 338-5550

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

Title of each class
Common stock, no par value

Name of each exchange on which registered
The NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of December 31, 2008, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was \$1,125,565. The aggregate market value was determined based on the closing price of the Common Stock on December 31, 2008. At March 17, 2009, 7,506,232 shares of the registrant's common stock were outstanding.

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ICOP DIGITAL, INC.

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PART I

Our trademarks include: *ICOP*[®], *ICOP DIGITAL*[®], *ICOP Model 20/20*[®], *ICOP Model 20/20*[®] -W, *ICOP Model 4000*, *ICOP LIVE*, *ICOP iVAULT*, *ICOP iVAULT MMS*, *ICOP EXTREME Wireless Mic*, *ICOP Solution*, *ICOP Guardian*, *ICOP LIVE Platform*, *ICOP DVMS*, *ICOP Model 20/20 LIVE*, *ICOP Guardian LIVE*, *ICOP PC Viewer*, *ICOP IN-FOCUS*, *ICOP BodyCam*, *BUSCOP*, *IBUS*, *BikeCam*, *TransitCop*, *ICOP Digital Video Management System*, *ICOP 20/20 VISION*, *Advancing Surveillance Technology* and *A Veil of Protection*.

Forward-Looking Statements

The Company makes forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. In some cases, you may identify forward-looking statements by words such as may, should, plan, intend, potential, continue, expect, predict, anticipate and estimate, the negative of these words or other comparable words. These statements are only predictions. One should not place undue reliance on these forward-looking statements. The forward-looking statements are qualified by their terms and/or important factors, many of which are outside our control, involve a number of risks, uncertainties and other factors that could cause actual results and events to differ materially from the statements made. Such factors include, among other things, those described elsewhere in this report and the following:

the *ICOP Model 20/20-W* and the *ICOP Model 4000* not being accepted by the marketplace;

difficulty meeting demand for in-car video technologies at a cost that results in a profit;

our ability to improve our product and to develop other products necessary to compete in the industry;

our ability to bring future products to market;

the *ICOP Model 20/20-W* and the *ICOP Model 4000* being replaced by more advanced technologies and thereby becoming obsolete;

the limited number of product offerings;

budget cuts in the law enforcement industry affecting purchasing levels;

our lack of profitability and operating history;

our limited ability to control interruptions in production by the outside manufacturers of the *ICOP Model 20/20-W* and the *ICOP Model 4000*;

our ability to protect proprietary rights or the possibility that others may bring infringement claims against us;

a highly competitive and fragmented market;

loss of key management personnel;

our ability to manage growth;

criminal procedure court rulings that may exclude evidence collected by our systems;

general economic and business conditions in the United States and other of our markets;

potential warranty or product liability claims;

our exposure to foreign currency exchange fluctuations; and

other factors detailed in our filings with the Securities and Exchange Commission.

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The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, as of the date of this report, taking into account information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, including those events and factors detailed in our filings with the Securities and Exchange Commission, not all of which are known to us. Neither we nor any other person assumes responsibility for the accuracy or completeness of these statements. We undertake no obligation to revise, or publicly release the results of any revision to, these forward-looking statements. Our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements.

As used herein, references to ICOP, we, us or the Company mean ICOP Digital, Inc.

Item 1. Description of Business.

Introduction to Business

Headquartered in Lenexa, Kansas, ICOP Digital, Inc. designs, engineers and markets video surveillance products, for public safety. Our flagship product, the *ICOP Model 20/20*, was designed for the rugged demands of law enforcement agencies, providing video and audio recording technology, as well as a secure chain of custody and integrity of the recorded information. From our first commercial sale in June 2005 through December 31, 2008, we have sold the *ICOP Model 20/20-W* and its predecessor, the *ICOP Model 20/20*, to law enforcement customers in 49 states with Hawaii being the only state where ICOP does not have customers. The *ICOP Model 20/20-W* technology also has applications in other markets where video surveillance is critical in the safety of people and security of property, including the military and other public safety installations. Our product is installed in the dash of the vehicle; therefore, there are no parts in the trunk, under the seat, or overhead, which is critical in considering officer safety and space limitations within patrol cars (an AM/FM radio is built into the *ICOP Model 20/20-W* to replace the AM/FM radio in the dash). The *ICOP Model 20/20-W* provides wireless (W) upload of the recorded video (to the backend server where the video evidence is stored and managed).

Law enforcement has long recognized the value of gathering intelligence and documenting critical events by means of recorded video. Video and audio evidence collected by in-car systems has been used successfully in cases such as driving under the influence, various traffic violations, vehicular pursuits, narcotic enforcement actions, assaults-on-officer incidents and civil litigation involving law enforcement agencies. Information collected by in-car VHS (analog) video systems has also been used to assist agencies in identifying potential threats to homeland security.

The majority of in-car police video systems currently employed, however, rely on outdated analog technology that suffers from inferior quality video and audio, lack of dependability in extreme temperatures, storage and retrieval difficulties and officer safety concerns. The law enforcement industry is currently transitioning from analog to digital technologies for in-car video, and the Company believes that we are well-positioned to exploit this market. The *ICOP Model 20/20-W* is priced competitively to comparable units, yet offers superior video and audio quality, officer safety due to secure and convenient placement in the dashboard, and security for the integrity of the recorded evidence.

The *ICOP DVMS* (Digital Video Management System) is the original backend video management system for the *ICOP Model 20/20-W*. In late 2007, the Company began selling the *ICOP iVAULT MMS* (Media Management System), an enterprise-level software management product, which was developed to serve as a digital evidence locker for law enforcement, enabling storage of multiple file formats. This software is web-enabled, allowing files to be shared within precincts, among precincts or across the nation, using high levels of security.

The *ICOP 20/20 VISION* brings the functionality of the *ICOP Model 20/20-W* to the laptop in the police car, allowing the digital video recorder (DVR) to be installed anywhere in the vehicle. This product was developed in response to industry demand, which grew out of the dramatic growth of laptops in police vehicles.

During the second quarter of 2008, we began selling *ICOP LIVE*, a product that delivers live streaming audio and video. *ICOP LIVE* works in conjunction with the *ICOP Model 20/20-W* enabling live stream audio and video to and from a first responder vehicle over wireless networks including cellular networks, mesh networks, etc., from the *ICOP Model 20/20-W* to police headquarters,

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personnel on the scene and web-enabled mobile devices such as smart phones and PDAs in the field. Early marketing efforts are focused on our existing customer base of first responders. The audio and video live streams to a virtually unlimited number of simultaneous viewers, using secure protocols. To further leverage the marketing of *ICOP LIVE*, ICOP has entered into co-marketing agreements with Sprint Nextel (Sprint), using the implementation of *ICOP LIVE* over the Sprint Mobile Broadband Network, and with Strix Systems (Strix), one of the worldwide leaders in wireless mesh networking, using the implementation of *ICOP LIVE* over Strix mesh networks.

During the fourth quarter of 2008, the Company introduced the *ICOP Model 4000* which is a digital video product designed for school buses, cash transit vehicles, commercial and transit vehicles, including buses and trains. The *ICOP Model 4000* records up to eight cameras simultaneously for surveillance of events aboard first responder, commercial and transit vehicles. It is capable of live streaming video to first responders and dispatch.

The Security Industry

The security industry is generally characterized by a continual evolution of technology that enhances both security and convenience at increasingly lower costs. Government and private industries in the United States and worldwide are actively seeking to develop new products and services that will meet the growing demands for homeland security. Billions of dollars are being appropriated by such governments to cope with growing crime and the threat of terrorism. The private sector is also driving the increased demand for homeland security products and services, including reliable integrated video surveillance technologies and communications solutions.

There are three core market segments for ICOP products:

First responders including law enforcement, fire departments, emergency medical personnel and military; and

Operators of critical assets and public transportation such as mobile security vehicles supporting energy and chemical sites (gas, electric power, water and nuclear power plants), public transportation (transit, rail, road and marine transportation and airports), school buses, cash transit; and

Private industry.

Law enforcement agencies in the United States and around the world are applying video technology to many facets of police operations by equipping vehicles with video recorders, monitoring public areas, and recording bookings and other police procedures. Video recordings are an essential tool for law enforcement agencies in providing an accurate portrayal of traffic violations, citizen and officer behavior, and other events as they occur; documenting police contacts with the public; offering persuasive evidence in court; and allowing for officer performance monitoring and protecting law enforcement agents against false claims of police misconduct. The result is an increased likelihood of criminal prosecutions, reduction of time officers spend in court, improved training, fewer citizen complaints, reduced exposure to civil liability and enhanced officer safety, as well as the potential to improve accountability and trust between the police and the public.

There are more than 440,000 police vehicles currently in service in the U.S., and approximately 70,000 new vehicles are leased or purchased by law enforcement agencies each year. At an average selling price of \$5,200 for the *ICOP Model 20/20-W* and related equipment, there is an estimated potential market of \$2 billion for law enforcement vehicles in the U.S. alone. According to the International Association of Chiefs of Police (IACP), 50% of law enforcement vehicles utilize in-car video systems, representing a significant increase over 2004 which was 40%. The vast majority of the existing in-car video systems are VHS (analog); however, they are gradually being replaced with digital systems.

While the market began transitioning to digital surveillance systems in approximately 2004, the majority of video applications in law enforcement today still rely on VHS technology. Digital in-car video systems, however, are superior to analog systems in many important respects. Digital video produces a higher quality in both imaging and audio. Digital video stores substantially more event information than analog video, including the date and time, officer name, traffic radar output, GPS coordinates, incident identification, status of emergency lights and other event information on every frame. DVDs can be stored in a fraction of the space of VHS cassettes. Many digital systems are continually in the passive recording mode when the power is on, and when the record mode is activated, a pre-event period of ten seconds to five minutes is added to the recording time, often capturing the incident prompting the officer to begin recording. Access to specific digitally recorded information is much faster; rather than having to review a VHS cassette through fast-forwarding and reversing, a scene may be selected from a menu and viewed instantly. Also, digital video may be archived to a server, reducing storage space. Back-end management software can catalog video information which allows for quick and easy retrieval. Another advantage digital video has over VHS is that digital video

recordings will not degrade over time.

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Strategy

Our goal is to become the industry leader in providing video surveillance products and solutions that enhance the safety and effectiveness of first responders. Having established a strong foothold in the U.S. law enforcement industry, which represents an estimated \$2 billion market for digital in-car video, we are expanding our focus to other markets. Such markets include the U.S. and abroad where our technology applications for surveillance and communication are critical to the safety of people and the security of property, including military and government installations, public transportation such as trains, buses and cash transit vehicles. In the future, we plan to continue the development and marketing of innovative surveillance and communication systems for the public and private security markets.

To achieve our goal, we employ a multi-pronged strategy focused on three primary functions: marketing and distribution, product development and manufacturing.

Marketing and distribution:

Establish strategic relationships with key partners, such as Sprint and Strix, OEMs, system integrators, manufacturing representatives and dealers, each providing access to key markets.

Develop additional product applications in the law enforcement as well as other markets where video surveillance and communication are critical to safety and security.

Product development:

Develop technological enhancements that continue to improve the performance of our existing products.

Develop new products to complement the *ICOP Model 20/20-W*, which currently accounts for the majority of our revenues.

Anticipate advances in digital video technologies and identify next generation technologies to serve existing and potential new markets.

Manufacturing:

Work with third-party and high quality manufacturers to reduce manufacturing costs and improve product reliability.

Products

Our suite of product offerings contributes to the overall *ICOP Solution*. The *ICOP Solution* is made up of products designed to secure a community with digital video. The *ICOP Model 20/20-W* is an award-winning digital in-car video system for law enforcement, a ruggedly designed product that records high-quality video. The *ICOP Model 20/20-W* utilizes a highly secured compression technology which provides tamper-resistant video/audio evidence of a kind and quality that is admissible in court. Working with the *ICOP Model 20/20-W*, the *ICOP EXTREME* Wireless Microphone uses Frequency Hopping Spread Spectrum (FHSS) to eliminate the risk of interference from other devices using the same frequency band, and provides secure, private audio recording, at a range of over 2,000 feet (line of sight). *ICOP LIVE* delivers real-time situational awareness (live streaming video) from mobile cameras to multiple viewers and multiple devices simultaneously, such as headquarters, vehicle laptops, smart phones, etc., without requiring special software onto the receiving devices. The *ICOP Model 4000* mobile DVR records video for transit vehicles and schools. Our mission is to deliver video technology solutions that enable effective collection and efficient management of evidentiary information.

ICOP Model 20/20-W

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The Company's flagship product, the *ICOP Model 20/20-W*, is an award-winning digital in-car video recorder which was developed for specific use in law enforcement. Recognized for its ease of use and installation, robust and intuitive functionality, superior audio and video quality, officer safety-conscious design, performance excellence and cost effectiveness, the *ICOP Model 20/20-W* and its predecessor, the *ICOP Model 20/20*, have been adopted by law enforcement agencies in 49 states since the commercial launch of the *ICOP Model 20/20* in mid-2005.

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A key feature of the *ICOP Model 20/20-W* is its ease of installation and servicing. In one hour, the entire system can be installed in the radio slot of a vehicle dashboard, replacing the radio unit (an AM/FM tuner is built into the ICOP product). Unlike competitive products, there are no parts in the trunk, under the seat or overhead—a critical consideration for officer safety and space limitations within a patrol car. The *ICOP Model 20/20-W* provides wireless (W) upload and is designed to be upgradeable to take advantage of higher bandwidth as technology advances.

The rugged *ICOP Model 20/20-W* operates up to three cameras, recording two cameras simultaneously, and records 1/4 VGA, Full VGA, or D1 quality video. The Mark button records exact event location for easy retrieval while also capturing location information using the built-in GPS.

The *ICOP Model 20/20-W* system includes a variety of functions, including wireless 900 MHz transceiver with automatic synchronization and a range of over 2,000 feet; operating capability of up to three cameras, with two recording simultaneously; an Officer HELP button that sends an alert to dispatch detailing GPS coordinates and vehicle ID information; an automatic 60-second pre-record feature that is activated by lights, siren, crash sensor or wireless microphone; 40 GB hard drive enabling up to 16 hours of recording in high-resolution mode; and radar, speedometer and brake connection interface.

In February 2006, we were approved as a federal GSA contractor, making the *ICOP Model 20/20-W* readily available to federal agencies and helping us to facilitate contracting with a broad range of U.S. government agencies.

ICOP DVMS

The *ICOP DVMS* (Digital Video Management System) is the backend solution for the *ICOP Model 20/20-W*, and is our original backend video storage and management system. It archives, searches, copies and displays two video recordings simultaneously, and can burn recorded events to DVD or CD.

ICOP iVAULT MMS

We began selling the *ICOP iVAULT MMS* (Media Management System) in late 2007. The *ICOP iVAULT MMS* archives, searches, copies and displays two video recordings simultaneously, and can burn recorded events to DVD or CD. This enterprise-level software is web-enabled, allowing files to be shared within and among precincts or across the nation via the Internet using high levels of security.

ICOP 20/20 VISION

The *ICOP 20/20 VISION* brings the functionality of the *ICOP Model 20/20-W* to laptops in police cars, allowing the digital video recorder (DVR) to be installed anywhere in the vehicle. This product was developed in response to the dramatic growth of laptops in police vehicles. The *ICOP 20/20 VISION* will begin shipping in March 2009.

ICOP LIVE

During the second quarter of 2008, the Company began shipping *ICOP LIVE*, a fully integrated solution for enabling live streaming video and audio to tactical response managers and coordinators. *ICOP LIVE* consists of a hardware and software component purchased by the customer and installed as an upgrade to our in-car video system.

ICOP LIVE enables video to live stream to and from a first responder vehicle—over wireless networks, including cellular networks, mesh networks, etc., from the *ICOP Model 20/20-W* to police headquarters, other law enforcement vehicles, and other web-enabled devices, such as smart phones, PDAs, etc. The video can live stream from multiple cameras and multiple users simultaneously, using secure protocols.

ICOP Model 4000

During the fourth quarter of 2008, the Company introduced the *ICOP Model 4000*, a digital video recorder designed for school buses, cash transit vehicles, commercial and transit vehicles, including public buses and trains. The *ICOP Model 4000* records up to eight cameras simultaneously aboard such vehicles.

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Sales and Marketing

We market the *ICOP Model 20/20-W* directly to city, county, state and federal law enforcement agencies in the U.S. and abroad. Our marketing efforts include advertising in police magazines, direct mailings to law enforcement agencies, participation in industry trade shows, conferences and seminars, providing articles for publication in leading industry magazines, and releasing electronic press kits to television stations in communities where the *ICOP Model 20/20-W* has been installed. Initially, the Company was marketing the *ICOP Model 20/20-W* and its predecessor primarily to law enforcement agencies. We have since been working on other applications for mobile video, including applications for military, fire trucks, emergency medical technician (EMT) vehicles, school and public buses, and trains.

In addition to our full-time inside sales and regional sales staff, we have established a national Officer Sales Team which consists of police officers across the country who call on local police departments, typically within a 500-mile radius of their homes. These officers are part-time independent contractors. The Company also sells through manufacturer's representatives and dealers in the markets we serve.

Our commitment to provide the leading technical support in our industry has helped to escalate our brand and reputation, and meet the urgent response requirements of our customers.

Typically, our sales cycle, which ranges from six to eighteen months, begins by initiating contact with a law enforcement agency or the receipt of a request for information from a prospective customer. After making the contact or receiving the request for information, we assess the potential customer's needs, make presentations and product demonstrations at the customer's place of business, present a formal proposal, often provide a trial installation of our product, and negotiate a purchase order. The purchase decision is often made by a committee appointed to research the acquisition, and often requires approval by a local city council or state officials.

International Sales

ICOP has agreements with distributors in key international markets where the Company believes opportunities are greatest. ICOP distributors must demonstrate the ability to provide local product installation and our highest level of direct tech support, in addition to the ability to sell to the markets we serve. ICOP has made it possible for the *ICOP Model 20/20-W* to operate in other languages, which is critical to our success and strategic advantage abroad.

Competition

The law enforcement in-car video market is highly competitive. Digital in-car video is a quickly evolving technology, and the market is growing rapidly as digital technology gains widespread acceptance. As new patrol cars are being purchased or leased, the outdated analog video systems are being replaced by digital systems, and many large cities are purchasing in-car video for the first time.

Our major competitors for the *ICOP Model 20/20-W* and the *ICOP 20/20 VISION*, in the law enforcement sector, are L-3 Communications Mobile-Vision, Panasonic, Coban Technologies, Inc., and WatchGuard Video. The primary competitors for the *ICOP Model 4000* include AngelTrax, Honeywell, 24/7 Security, Seon and Safety Vision.

In addition to their existing relationships with law enforcement agencies, some of these competitors have significant advantages over us, including greater financial, technical, marketing and manufacturing resources, preferred vendor status with our existing and potential customer base, more extensive distribution channels, larger customer bases and faster response times to new or emerging technologies and changes in customer requirements. As a result, our competitors may develop superior products or beat us to market with products similar to ours.

We believe that the innovative product design of our products deliver superior quality and value over other products on the market. The market for digital in-car video systems for police and other first responder vehicles is expected to grow rapidly over the next five years, as more vehicles are equipped with video recorders, and as old analog systems are upgraded to digital systems.

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We compete principally on the basis of:

superior product performance and functionality;

price;

superior product quality and reliability; and

customer service and technical support.

Manufacturing and Suppliers

The Company entered into a manufacturing agreement in February 2005, which was amended in March 2008, with a foreign company to produce the *ICOP Model 20/20* and its successor, the *ICOP Model 20/20-W* units through December 31, 2009. Under this agreement, the manufacturer is responsible for purchasing the components and manufacturing the units, and we are required to pay 50% upon placement of the purchase order and the remaining 50% upon shipment. The contract manufacturer has certain intellectual property rights to a method of operating the data compression used in the *ICOP Model 20/20* and the *ICOP Model 20/20-W*. If this method were no longer available to us, another contract manufacturer could produce the unit, but a partial redesign would be required and could result in a production delay.

The Company entered into a license agreement in 2004 with another contract manufacturer. Under this agreement, we are granted the right to design, manufacture, use, sell and distribute products that decode, reconstruct and display video images based on the contractor's proprietary codec technology, and the subcontractor agrees to sell us a supply of semiconductor chips that incorporate the technology. The initial term of this agreement is 10 years.

We also rely on several unaffiliated subcontractors to supply certain components and assemblies that are incorporated in our *ICOP Model 20/20* and *ICOP Model 20/20-W*. Other miscellaneous components are acquired on a purchase order basis and we do not have long-term contracts with these suppliers.

The Company entered into a development and manufacturing agreement in 2008 with a foreign company, pursuant to which the contract manufacturer agreed to produce the *ICOP Model 4000*. The initial term of this agreement is 5 years. Another contract manufacturer could produce the *ICOP Model 4000*, but a partial redesign would be required and could result in a production delay.

The Company has entered into agreements with other manufacturers on an as-needed basis to produce new and additional products, and does not have long-term commitments with these suppliers.

Research and Development

Research and development costs charged to expense were approximately \$1,132,000 and \$1,800,000 in 2008 and 2007, respectively. No research and development expense has been capitalized.

Inventory Systems

Inventory warehousing and shipping are managed from our Lenexa, Kansas facility. We use standard warehousing systems to store, retrieve, monitor and manage our inventory.

Intellectual Property

The Company has filed U.S. patent applications covering aspects of the design and methods of operating the *ICOP Model 20/20-W*, *ICOP LIVE*, and additional new products and applications. No patents have yet issued. As currently drafted, the claims generally describe the use of a digital recording device in an integrated and synchronized video system able to record data from cameras, microphones and global positioning system

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equipment, with the recording media housed in a driver accessible, originally manufactured console opening in the vehicle, such as a vehicle radio slot. The claims also are drafted to cover particular features and capabilities of the *ICOP Model 20/20-W* such as the system's in-dash recorder, back-end searchable database and event marking capability. In addition to trademarks for all of our products, the Company has also secured registered trademarks for ICOP, ICOP Digital and the stylistic use of our logo. We intend to continue to seek formal intellectual property protections to protect our technologies, processes and designs, as we deem necessary or appropriate. We also use confidentiality agreements with employees and key suppliers to ensure the confidentiality of our trade secrets.

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Marketing Alliances

The Company has entered into co-marketing agreements with Sprint and with Strix Systems. While *ICOP LIVE* is able to live stream using any method of transmission, where the bandwidth supports streaming video, the co-marketing relationships with Sprint and Strix afford all parties important marketing message collaboration. With *ICOP LIVE*, it is possible to optimize the response to, and management and outcome of a crisis, security breach or crime-in-progress through the delivery of live streaming video, providing real-time situational awareness. Strix Systems is one of the worldwide leaders in wireless mesh networking, and Sprint is one of the three largest wireless companies in the United States based upon the number of wireless subscribers. Our marketing alliances with Sprint and Strix are intended to promote the *ICOP Solution* to both the public and private sectors. Our marketing alliances do not require Sprint, Strix or ICOP to compensate the other party for the promotion of the other party's products or services.

Employees

As of December 31, 2008, the Company had 50 full-time employees including 6 in management and administration, 16 in sales and marketing, 11 in engineering, 9 in technical support, 4 in shipping/testing and 4 in technology. In addition, we had one independent contractor working in research and development.

Company History

In January 2004, the Company, formerly Vista Exploration Corporation, acquired ICOP Digital, Inc., a Nevada corporation (*ICOP Nevada*), through a reverse merger. ICOP Nevada was formed in May 2002 to engage in the design, development and marketing of an in-car digital video recorder for use in the law enforcement industry. As a result of the merger, our principal business became that of ICOP Nevada, and in November 2004, we changed our name to ICOP Digital, Inc. and became a Colorado corporation. In March 2005, we completed a 10 shares for 1 share reverse split of our stock

Item 1A. Risk Factors

Not required for smaller reporting companies.

Item 1B. Unresolved Staff Comments

None.

Item 2. Description of Property.

Our offices are located in approximately 12,800 square feet of leased office and warehouse space in Lenexa, Kansas with a lease agreement for five years through June 30, 2010. During 2007, we leased an additional 9,400 square feet of office and warehouse space in Olathe, Kansas, through June 30, 2010. Payments under these two leases total \$23,015 per month, plus taxes, common area charges and insurance. In March 2008, we acquired roughly 10 acres of land in Lenexa, Kansas, for possible construction of new corporate facilities when our current leases expire.

Item 3. Legal Proceedings.

On July 11, 2008, the Company was served with a summons and a complaint in which the Company and TriSquare Communications, Inc., a Missouri corporation (*TriSquare*), were named as defendants (a total of eleven defendants were named in this lawsuit) in a patent infringement action commenced by L-3 Communications Mobile-Vision, Inc., a New Jersey corporation (*Mobile-Vision*). According to the complaint, which was filed in the United States District Court for the District of New Jersey, and

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with the United States International Trade Commission (ITC), the wireless microphone and related base station that TriSquare and its affiliates manufacture and import, and the Company incorporates into and sells as components of its *ICOP Model 20/20-W* product, infringe upon a patent held by Mobile-Vision covering a wireless microphone for use with an in-car video system.

Strix's Access/One products are the industry's only modular (chassis-based) mesh systems, delivering the highest throughput, lowest latency, greatest capacity and unparalleled scalability.

In the nearly five months since the ITC investigation commenced, Mobile-Vision has failed to produce any evidence in support of its infringement allegations. Mobile-Vision failed to provide any expert opinion regarding infringement and failed to rebut ICOP's expert, raising serious invalidity questions with respect to its patent. Further, Mobile-Vision refused to produce any witnesses to testify on its behalf. When faced with the prospect of a ruling of non-infringement and likely invalidity, Mobile-Vision moved to withdraw its complaint at the ITC. On January 29, 2009, Mobile-Vision moved to withdraw its complaint filed with the ITC, and the ITC administrative law judge granted the motion.

Mobile-Vision has stated that it intends to continue its lawsuit in the New Jersey District Court, where it faces counterclaims by ICOP of non-infringement, invalidity of its patent, unfair competition, patent misuse and antitrust violations. The Company intends to vigorously defend itself against Mobile-Vision's claims in this case.

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

None

PART II**Item 5. Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities. Market and Price Ranges of Common Stock**

Our common stock is traded on the NASDAQ Capital Market under the symbol ICOP. Below are the price ranges of our common stock for each quarterly period of our last two completed fiscal years:

	HIGH	LOW
2007		
First Quarter	\$ 7.00	\$ 5.72
Second Quarter	9.06	6.56
Third Quarter	8.65	5.26
Fourth Quarter	6.71	3.74
2008		
First Quarter	\$ 4.08	\$ 1.93
Second Quarter	2.64	1.55
Third Quarter	1.75	0.32
Fourth Quarter	1.00	0.11

The last reported sale price of our common stock on the NASDAQ Capital Market on March 17, 2009 was \$0.80 per share. According to the records of our transfer agent, there were approximately 300 holders of record of our common stock as of March 17, 2009.

Table of Contents**Dividend Policy**

We have not declared or paid any dividends and do not intend to pay any dividends in the foreseeable future. We intend to retain any future earnings for use in the operation and expansion of our business. Any future decision to pay dividends on common stock will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements and other factors our board of directors may deem relevant.

Equity Compensation Plans**Equity Compensation Plan Information**

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders			
2002 Stock Option Plan	1,327,500	\$ 4.53	546,161
2005 Employee Stock Purchase Plan		\$ 1.31	154,789
Equity compensation plans Not approved by security holders			
Total	1,327,500		700,950

2002 Stock Option Plan

In June 2002, the Board of Directors and stockholders of ICOP Nevada approved that company's 2002 Stock Option Plan (the "2002 Plan"). The plan authorized the grant and issuance of options, restricted shares and other equity compensation to directors, employees, officers and consultants of ICOP Nevada. Initially, 500,000 shares of ICOP Nevada common stock were reserved for issuance under the 2002 Plan; however, the number of shares reserved automatically increases on each anniversary of the 2002 Plan by an amount equal to 0.5% of the then issued and outstanding shares of ICOP Nevada common stock. When we acquired ICOP Nevada in January 2004, any rights to acquire ICOP Nevada common stock under the 2002 Plan were converted so as to permit acquisition of our common stock instead. Notwithstanding these automatic increases, the 2002 Plan requires that no more than 1,200,000 shares be issued in connection with the exercise of incentive stock options under the 2002 Plan. On August 10, 2008, our Board of Directors and stockholders approved an increase to the number of shares of common stock reserved under the 2002 Plan to 2,073,661 shares.

The 2002 Plan is administered by the Compensation Committee of the Board of Directors. Subject to the provisions of the 2002 Plan, the Committee determines who will receive the options, the number of options granted, the manner of exercise and the exercise price of the options. The term of incentive stock options granted under the 2002 Plan may not exceed ten years, or five years for options granted to an optionee owning more than 10% of our voting stock. The exercise price of an incentive stock option granted under the 2002 Plan must be equal to or greater than the fair market value of the shares of our common stock on the date the option is granted. The exercise price of a non-qualified option granted under the 2002 Plan must be equal to or greater than 85% of the fair market value of the shares of our common stock on the date the option is granted, although the Company expects that the exercise

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price of future grants will be set at or above fair market value. An incentive stock option granted to an optionee owning more than 10% of our voting stock must have an exercise price equal to or greater than 110% of the fair market value of our common stock on the date the option is granted. We also have granted shares of restricted stock to certain of our executive officers under the 2002 Plan. Vesting of these shares was dependent upon the Company meeting a revenue milestone of \$15 million, which was met in September 2007. As of December 31, 2008, options to purchase 1,327,500 shares of common stock remained.

2005 Employee Stock Purchase Plan

In November 2005, the Board of Directors approved the Company's 2005 Employee Stock Purchase Plan (the 2005 ESPP). The 2005 ESPP authorizes eligible employees to subscribe for the periodic purchase of the company's common stock through payroll deductions. The purchases occur during defined purchase periods, and the purchase price is generally 85% of the fair market value of the common stock on the first or last date of a purchase period, whichever is lower. Eligible employees are those who are employed with the Company for more than 20 hours a week, with customary employment for more than five months in a calendar year, and where stock ownership in ICOP will not equal or exceed 5% of the voting power or value of all classes of our stock as a result of purchases under the 2005 ESPP.

The 2005 ESPP is administered by the Board of Directors. As of December 31, 2008, 45,211 shares had been sold under the 2005 ESPP leaving 154,789 available for future sale to employees.

Recent Sales of Unregistered Securities

None.

Item 6. Selected Financial Data

Not required for smaller reporting companies.

Item 7. Management's Discussion and Analysis or Plan of Operation.

Overview

The Company designs, engineers and markets video surveillance products for public safety. Its flagship product, the *ICOP Model 20/20* was designed for the rugged demands of law enforcement agencies, providing superior video and audio recording technology, as well as, a secure chain of custody and integrity of the recorded information. From our first commercial sale in June 2005 through December 31, 2008, we have sold the *ICOP Model 20/20-W* and its predecessor, the *ICOP Model 20/20*, to law enforcement agencies in 49 states. The *ICOP Model 20/20-W* also has applications in other markets where video surveillance is critical to the safety of people and the security of property, including military and other public safety installations. Installed in the dash of the vehicle, there are no parts in the trunk, under the seat or overhead—a critical consideration for officer safety and space limitations within a patrol car, an AM/FM radio is built into our product to replace the AM/FM radio in the dash. The *ICOP Model 20/20-W* provides wireless (W) upload of the recorded video to the backend server where the video evidence is stored and managed.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of the contingent assets and liabilities at the date of the financial statements and revenue and expenses for the period reported. Estimates are based upon historical experience and various other assumptions that are believed to be reasonable under the circumstances. These estimates are evaluated periodically and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenue and expenses. Actual results may differ from these estimates under different assumptions.

Our critical accounting policies are those that we believe are the most important in determining our financial condition and results, and require significant subjective judgment by management. A summary of our significant accounting policies, including the critical accounting policies discussed below, is set out in the notes to the financial statements.

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Revenue Recognition

Revenue is recognized upon shipment, title and risk of loss have transferred to the purchaser, there are no significant vendor obligations, the fees are fixed or determinable and collection is reasonably assured. Cost incurred for shipping and insurance are included in cost of sales at the time the related revenue is recognized. Amounts billed to a customer for shipping and insurance is reported as revenue.

Research and Development Costs

Research and development costs are charged to expense as incurred. No costs are deferred since the requirements that a product under development be clearly defined, have identifiable costs, be technically feasible, and have a clearly defined market or use, are not objectively assured. If the costs associated with the project were deferred, any deferred costs would be recovered as charges against earnings in future periods.

Foreign Currency Translation

We purchase a majority of our inventory from foreign contract manufacturers. One of these foreign manufacturers bills us in their local currency. Liabilities in foreign currencies are translated at exchange rates prevailing at the balance sheet date. Costs and expenses are translated into U.S. dollars at the date of the transaction or at average exchange rates for the period. Gains and losses resulting from translation are accumulated as a component of other comprehensive income (loss). Realized gains and losses from foreign currency transactions are recognized as other income (loss).

Accounting for Income Taxes

Income taxes are accounted for under the assets and liability method. This method gives consideration to the future tax consequences of deferred income or expense items and immediately recognized changes in income tax laws upon enactment. The statements of operations effect is generally derived from changes in deferred income taxes, net of valuation allowances, on the balance sheet as measured by differences in the book and tax bases of our assets and liabilities. We have significant tax loss carryforwards, which are recorded as deferred tax assets. Deferred tax assets realizable in future periods are recorded net of a valuation allowance based on an assessment of our ability to generate sufficient taxable income within an appropriate period. Based on our historical taxable losses, we believe it is unlikely that we will realize the benefits of these deductible differences. As a result, our deferred tax assets are offset entirely by a valuation allowance.

Share-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123R, *Share-Based Payment*, which requires that compensation related to all stock-based awards, including stock options and restricted common stock, be measured based on their estimated grant-date fair value and recognized into expense over the period in which the share-based compensation is earned (requisite service period). We used the modified prospective application method in adopting SFAS No. 123R, whereby the estimated fair value of unvested stock awards granted prior to January 1, 2006 was recognized as compensation expense in periods subsequent to December 31, 2005. We have estimated expected forfeitures, as required by SFAS No. 123R, and are recognizing compensation expense only for those awards expected to vest. We record compensation expense for the grant date fair value of option awards over the service period as the option vests.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet debt, nor have we had any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that may have a material current or future effect on financial conditions, changes in the financial conditions, results of operations, liquidity, capital expenditures, capital resources or significant components of revenue or expenses.

Results of Operations

The Company recorded sales of \$10,859,850 and \$11,842,415 for the years ended December 31, 2008 and 2007, respectively, a decrease of \$982,565 (8.3%) primarily due to a reduction in units sold during the fourth quarter of 2008. The reduction in units sold was mainly due to the negative impact of our announcement of our line of credit being declared in default in August 2008. Cost of sales for the years ended December 31, 2008 and 2007 were \$6,689,758 and \$6,645,018, respectively, remaining flat year over year.

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Cost of sales as a percentage of sales was 62% for 2008 compared to 57% for 2007. The increase of cost of sales as a percentage of sales was due to a special limited time program to sell our new *ICOP EXTREME Wireless Mic* at a discount to certain qualifying customers, which negatively affected gross margin. In addition, the cost of inventory was higher in 2008 as a result of unfavorable foreign currency movements in the U.S. Dollar compared to certain foreign currencies. Gross margin as a percentage of sales was 38% for 2008 compared to 44% for 2007.

Operating expenses were \$9,961,593 and \$10,839,811 for the years ended December 31, 2008 and 2007, respectively, a decrease of \$878,218 (8%). Selling, general and administrative expenses for the twelve months ended December 31, 2008 and 2007 were \$8,830,394 and \$9,040,256, respectively, remaining relatively flat with a decrease of \$209,862. Research and development expenses for the years ended December 31, 2008 and 2007 were \$1,131,199 and \$1,799,555, respectively, a decrease of \$668,356 (37%). The decrease is the result of a declined use of external consultants during 2008 compared to 2007 and due to the completion of product development for certain products. Stock-based compensation expense for the twelve months ended December 31, 2008 and 2007 was \$576,776 and \$1,513,392, respectively, a decrease of \$936,616 (62%). The decrease is due to the expense recorded in 2007 on the restricted stock awards of approximately \$1,000,000 and the expense recorded on stock options granted in the third quarter of 2007 of approximately \$300,000, offset by the cancellations and grants to Mr. Owen, the Company's Chief Executive Officer, and Ms. Owen, the Company's Chief Operating Officer, of approximately \$200,000 during the third quarter of 2008.

Interest income was \$28,589 and \$223,810 for the twelve months ended December 31, 2008 and 2007, respectively, a decrease of \$195,221 (87%). The decrease is mainly due to the decrease in cash and decrease in interest rates. Interest expense was \$125,906 and \$37,802 for the years ended December 31, 2008 and 2007, respectively, an increase of \$88,104 (233%). The increase is due to the draw on the line of credit at the end of the first quarter 2008 used for inventory purchases, the issuance of a note payable of \$780,000 to purchase land, and draws against our purchasing agreement in fourth quarter of 2008.

Comparison of the Years Ended December 31, 2007 and 2006

We recorded \$11,842,415 in revenue and \$5,197,397 in gross profit during the year ended December 31, 2007. Our operating loss for 2007 increased \$2,004,239 to \$5,642,414 as we significantly increased our sales and marketing and research and development activities in 2007, which materially increased our revenue and operating expenses. In addition, we recorded an impairment charge on certain inventory of approximately \$170,000 in 2007. Our net loss of \$5,458,284 in 2007 was higher than the loss in 2006 primarily due to the increased sales and marketing and research and development activities in 2007.

Liquidity and Capital Resources

We have incurred recurring losses and negative cash flows since inception. Historically, we have financed our operations through the issuance of equity securities in private and public offerings, which have provided, in the aggregate, approximately \$26.0 million since we began commercial operations in June 2005. Of this total, we grossed approximately \$5.0 million in an underwritten public offering of shares and warrants that we completed in the fourth quarter of 2006. We intend to utilize our new financing arrangement described below to supplement operating cash and fund operations in the near future. However, our ability to obtain sufficient advances under our new financing arrangement to meet our operating capital requirements for the foreseeable future may be dependent upon our ability to generate increased accounts receivable through higher sales volumes, which cannot be assured. We will need to become profitable in the near future through generating higher revenues or lowering operating costs, or a combination of the two, or raise additional capital or additional debt financing in order to sustain future operations. There can be no assurance we will achieve profitable operations or generate sufficient cash from operations or from debt or equity financing to support operations in the future.

As a result of our two public offerings, we have outstanding 4,315,894 publicly traded warrants, exercisable at \$6.19 per share. These warrants are subject to redemption upon 30 days' notice at \$0.25 per warrant. Our redemption right was subject to a condition that has been satisfied, so we could redeem the warrants at any time, upon giving proper notice. However, it is not in our best interest to call the warrants until our stock price exceeds the exercise price, and we have no plans to do so at this time. Were these warrants exercised in the future, we could raise up to \$26,715,384, although there is no assurance that the warrants will ever be exercised.

Our 2005 Employee Stock Purchase Plan (the 2005 ESPP) enables employees to purchase our common stock at a 15% discount. For the year ended December 31, 2008, we sold 31,331 shares to employees, resulting in proceeds to us of \$51,732.

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On March 3, 2009, the Company renewed its \$780,000 loan agreement with the Bank of Blue Valley by paying the principal down by \$150,000 and entering into a one-year note for \$629,985 in principal amount. The principal bears interest at 8% which is payable monthly. The loan is principally secured by the purchased land.

The Company had a \$3,500,000 line of credit with Equity Bank. On August 20, 2008, the bank had declared the line of credit in default under the general insecurity clause of the loan agreement and our anticipated breach of the \$7.5 million net worth financial covenant. The Company had until October 20, 2008 to refinance or pay off the outstanding balance on the line of credit, which was \$1,425,000 on August 20, 2008. On October 16, 2008, we obtained an extension to pay off the line of credit until December 4, 2008. In connection with the extension, we made a \$600,000 principal payment on the outstanding balance. On November 10, 2008, the entire outstanding balance was repaid on the line of credit with the proceeds of the Purchasing Agreement described below.

On November 10, 2008, we entered into a purchasing agreement (the Purchasing Agreement) with a financing company (the Purchaser) for 18 months to sell all of our accounts receivable at a discount of 0.75% (Purchasing Fee) from the face value of each invoice for every 30 days the invoice is outstanding. We are obligated to sell all of our receivables to the Purchaser, but the Purchaser is not obligated to purchase any receivables or to advance against them. The Purchaser may, in its sole discretion, advance up to 85% of the eligible accounts receivable outstanding for a maximum borrowing of \$5 million. The interest rate on any outstanding advances to us will be 2.5% plus the greater of LIBOR plus 2.75% or the prime rate as published by the Wall Street Journal. In no event shall LIBOR be less than 3%. We are required to sell the Purchaser \$2.4 million in invoices each calendar quarter or pay the minimum Purchasing Fee for any shortfall. We are required to maintain a \$5 million tangible net worth at all times during the term of the Purchasing Agreement. The Purchasing Agreement may be renewed annually after the initial 18-month term unless either party elects not to renew, and it may be terminated by the Purchaser at any time