

ICOP DIGITAL, INC
Form 10QSB
August 15, 2005

U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2005

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

Commission file number: 000-27321

ICOP Digital, Inc.

(Name of small business issuer in its charter)

Colorado
(State or other jurisdiction of
incorporation or organization)

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

16801 W. 116th Street, Lenexa, KS 66219

(Address of principal executive offices, including ZIP Code)

Issuer's telephone number: (913) 338-5550

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N.A.

(Former name, address and fiscal year, if changed since last report)

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

Transitional Small Business Disclosure Format Yes No

The issuer had 4,658,862 shares of its common stock issued and outstanding as of August 12, 2005, the latest practicable date before the filing of this report.

ICOP DIGITAL, INC.

PART I - FINANCIAL INFORMATION

Forward-Looking Statements

This report on Form 10-QSB contains forward-looking statements that concern our business. Such statements are not guarantees of future performance and actual results or developments could differ materially from those expressed or implied in such statements as a result of certain factors, including those factors set forth in Item 2 - Plan of Operation and elsewhere in this report. All statements, other than statements of historical facts, included in this report that address activities, events or developments that we expect, believe, intend or anticipate will or may occur in the future, including the Company's ability to successfully maintain its existence while it identifies potential business opportunities, are forward looking statements.

These statements are based on certain assumptions and analyses made by us in light of our experience and our product research. Such statements are subject to a number of assumptions including the following:

risks and uncertainties;

general economic and business conditions;

the business opportunity that may be presented to and pursued by us;

changes in laws or regulations and other factors, many of which are beyond our control; and

ability to obtain financing on favorable conditions.

The cautionary statements contained or referred to in this report should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no obligation to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

ITEM 1. FINANCIAL STATEMENTS

ICOP DIGITAL, INC.

Balance Sheet (Unaudited)

	June 30, 2005 <u>(Unaudited)</u>
Assets	
Current assets:	
Cash	\$ 367,426
Accounts receivable, net	302,035
Merchandise inventory, at cost	197,052
Prepaid expenses	157,181
	<u>1,023,694</u>
Total current assets	1,023,694
Property and equipment, less accumulated depreciation of \$63,627	214,580
Other assets:	
Deferred patent costs	61,480
Deferred offering costs	334,878
Deposits	60,000
	<u>1,694,632</u>
Liabilities and Shareholders Deficit	
Current liabilities:	
Accounts payable	\$ 1,231,195
Accrued payroll	412,833
Notes and loans payable - Related party (Note 2)	425,174
Notes payable (Note 3)	3,200,000
Current maturities of long-term debt	15,920
Accrued interest payable	70,592
	<u>5,355,714</u>
Total current liabilities	5,355,714
Long-term debt, net of current maturities	59,777
	<u>5,415,491</u>
Total liabilities	5,415,491
Shareholders' deficit (Note 4):	
Preferred stock, no par value; 5,000,000 shares authorized, 21,165 shares issued and outstanding	1,270,000
Common stock, no par value; 50,000,000 shares authorized, 1,668,862 shares issued and outstanding	3,451,266
Accumulated other comprehensive income, net of tax	11,957
Retained deficit	(8,454,082)
	<u>(3,720,859)</u>
Total shareholders' deficit	(3,720,859)
	<u>\$ 1,694,632</u>

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See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Statements of Operations (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, (Unaudited)		June 30, (Unaudited)	
	2005	2004	2005	2004*
				(Restated)
Sales, net of returns	\$ 327,394		\$ 327,394	\$
Cost of sales	238,903		238,903	
Gross profit	88,491		88,491	
Operating expenses:				
Selling, general and administrative	532,517	409,357	866,566	859,512
Research and development	144,502	112,816	261,728	605,620
Total operating expenses	677,019	522,173	1,128,294	1,465,132
Loss from operations	(588,528)	(522,173)	(1,039,803)	(1,465,132)
Other income (expense):				
Realized loss on foreign currency translation	(56,306)		(56,306)	
Unusual item:				
Gain on restructure of trade debt		485,482		485,482
Interest expense	(55,622)	(361)	(84,803)	(1,019)
Loss before income taxes	(700,456)	(37,052)	(1,180,912)	(980,669)
Income tax provision (Note 5)				
Net loss	\$ (700,456)	\$ (37,052)	\$ (1,180,912)	\$ (980,669)
Net loss available to common shareholders after beneficial conversion feature	\$ (700,456)	\$ (37,052)	\$ (1,180,912)	\$ (1,480,669)
Loss per share available to common shareholders *	\$ (0.42)	\$ (0.02)	\$ (0.71)	\$ (0.92)
Weighted average common shares outstanding *	1,668,862	1,584,311	1,667,444	1,609,518

* Restated see note 6

See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Statements of Cash Flows (Unaudited)

	Six Months Ended	
	June 30, (Unaudited)	
	2005	2004
Cash flows from operating activities:		
Net loss	\$ (1,180,912)	\$ (980,669)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation	25,447	13,197
Book value of equipment retired		1,734
Gain on restructured trade debt		(485,482)
Changes in operating liabilities:		
(Increase) decrease in accounts receivable and prepaid expenses	(578,269)	5,400
Increase (decrease) in accounts payable and accrued liabilities	(706,415)	574,295
Net cash used in operating activities	(2,440,149)	(871,525)
Cash flows from investing activities:		
Purchases of property and equipment	(82,730)	(26,678)
Deferred patent costs		(47,866)
Investment in Subsidiary		(450,000)
Deposits	(60,000)	3,000
Net cash used in investing activities	(142,730)	(521,544)
Cash flows from financing activities:		
Proceeds from issuance of notes payable	3,306,108	225,000
Principal payments on notes payable	(25,167)	(319,523)
Proceeds from the sale of preferred stock		1,099,998
Proceeds from the sale of common stock		275,000
Payment of offering costs	(334,878)	
Net cash provided by financing activities	2,946,063	1,280,475
Net change in cash	363,184	(112,594)
Cash, beginning of period	4,242	118,780
Cash, end of period	\$ 367,426	\$ 6,186
Supplemental disclosure of cash flow information:		
Income taxes	\$	\$
Interest	\$ 17,862	\$ 3,568
Non-cash investing and financing transactions:		
Subsidiary divested for stock	\$	\$ (700,000)
Preferred stock converted to common	\$ (229,998)	\$
Foreign currency translation	\$ 129,552	\$ (37,703)
Equipment acquired with notes payable	\$ 38,000	\$ 72,408

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See accompanying notes to consolidated financial statements.

ICOP DIGITAL, INC.

Notes to Financial Statements

Note A: Basis of Presentation

The financial statements presented herein have been prepared by the Company in accordance with the accounting policies in its audited financial statements for the period ended December 31, 2004, included in its annual report on Form 10KSB/A as filed July 7, 2005, and should be read in conjunction with the notes thereto. The Company entered the development stage in accordance with Statement of Financial Accounting Standard (SFAS) No. 7 on May 24, 2002. It emerged from the development stage in June 2005 with the beginning of substantial revenue and now is an enterprise engaged in the design, development and marketing of an in-car video recorder system for use in the law enforcement industry.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary to provide a fair presentation of operating results for the interim period presented have been made. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the year.

Interim financial data presented herein are unaudited. The unaudited interim financial information presented herein has been prepared by the Company in accordance with the policies in its audited financial statements for the period ended December 31, 2004 and should be read in conjunction with the notes thereto.

The accompanying statements of operations and cash flows reflect the six-month period ended June 30, 2005. The comparative figures for the six-month period ended June 30, 2004 have been included in the accompanying statements of operations and cash flows for comparison on an unaudited basis.

Note 1: Nature of Operations, Merger, and Summary of Significant Accounting Policies

Operations and Merger

ICOP Digital, Inc. was incorporated in May 2002 in Nevada and merged into a wholly owned subsidiary of the Company as of December 31, 2003. The Company, formerly named Vista Exploration Corporation, subsequently changed its name to ICOP Digital, Inc. The Company was a development stage enterprise until June 2005 when substantial sales began. It is engaged in the design, development and marketing of in-car video recorder systems for use in the law enforcement industry. The Company's offices are located in Lenexa, Kansas.

Certain changes have been made to the prior year's financial statements in order to conform to the current year's presentation. On February 28, 2005, the Company's shareholders approved a reverse stock split that exchanged one new share of stock for ten existing shares effective March 10, 2005. All share and per share amounts in this document have been changed to reflect the effect of this change.

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The 2004 financial statements have been restated to record a deemed dividend of \$500,000 during the first quarter of 2004 to the Company's preferred shareholders for the value of their right to convert shares of preferred stock to common stock. This non-cash dividend in the first quarter of 2004 did not effect net capital but increased the net loss to common shareholders. In addition, the financial statements have been restated to record a non-cash operating expense of \$400,000 in the fourth quarter of 2004 as a result of issuing 6,667 shares of convertible preferred stock to settle a dispute.

In February 2003, the Company purchased all the issued and outstanding common stock of McCoy's Law Line, Inc. (McCoy's) to obtain access to McCoy's marketing organization and permit ICOP to sell and distribute law enforcement-related products in addition to the ICOP in-car digital video recording system. The purchase price consisted of 70,000 shares of ICOP common stock valued at \$10.00 per share. In March 2004, ICOP determined to develop a different system to market its products and sold its investment in McCoy's. The sale price consisted of the 70,000 shares of ICOP common stock valued at \$10.00 per share that had been paid for the purchase.

Effective December 31, 2003, ICOP Digital, Inc. (ICOP) exchanged 100 percent of its outstanding shares of common stock for 1,457,700 shares of the common stock of Vista Exploration Corporation (Vista) After January 2004, the two companies were consolidated. The acquisition has been treated as a recapitalization of ICOP, with Vista the legal surviving entity. Since Vista had, prior to the recapitalization of ICOP, no assets and net liabilities (consisting principally of accounts payable) and no operations, the recapitalization has been accounted for as the sale of 179,000 shares of ICOP common stock for the net liabilities of Vista. The historical financial statements presented herein have been restated and are those of ICOP. Costs of the transaction have been charged to the period. In November 2004, the Company changed its name from Vista to ICOP Digital, Inc. In June 2005, ICOP was merged into the Company, and the Company was the sole surviving entity.

Going Concern Basis

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying financial statements, the Company has suffered significant losses since inception. This factor, among others, may indicate that the Company will be unable to continue as a going concern.

The Company completed a public offering of its common stock in July 2005 with net proceeds of approximately \$10 million and believes these proceeds will provide capital for inventory, marketing and sales, research and development and general operations for the coming twelve months. In the longer term, the Company plans to expand its acquired operations, continue to pursue sales of its products and become profitable. There is no assurance that the Company's products will gain market acceptance or that the Company will attain profitability.

The financial statements do not include any adjustments relating to the recoverability and classification of assets and/or liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to meet its obligations on a timely basis and, ultimately, to attain profitability.

Note 2: Related Party Transactions

Notes and loans payable to related parties consisted of unsecured advances made to the Company under promissory note and loan agreements for working capital purposes and pay no interest. The notes payable are due on demand. During the six months ended June 30, 2005, shareholders and affiliates were repaid \$20,000 on existing notes. In April 2005, a director loaned \$300,000 to the Company to allow the Company to accelerate manufacturing of inventory. This note was due on closing of a secondary stock offering or in October 2005 and accrued interest at approximately 8% per annum. All notes and loans were repaid on completion of the secondary offering in July 2005.

Note 3: Notes Payable

In March 2005, the Company completed the sale of \$2,200,000 in secured promissory notes and related common stock warrants. These notes were sold to accredited investors and were repaid when the public offering was completed in July 2005 along with accrued interest at a rate of 8% per annum.

In June 2005, the Company issued a non-interest bearing note payable to Paulson Investment Company in the amount of \$600,000. This note was repaid when the public offering was completed in July 2005.

In June 2005, the Company obtained a one-year line of credit from a bank in the amount of \$600,000 secured by customer purchase orders. Interest on this note is payable monthly at the rate of 2% over the bank index rate. At June 30, 2005 the balance outstanding on this note was \$400,000.

Note 4: Shareholders' Equity

Preferred Stock converted to common stock

In January 2005, a shareholder converted 1,333 shares of the Company's Class A preferred shares having a value of \$79,998 into 10,664 shares of the Company's no par common stock. In April 2005, a shareholder converted 2,500 shares of the Company's Class A preferred shares having a value of \$150,000 into 20,000 shares of the Company's no par common stock.

Note 5: Income Taxes

The Company records its income taxes in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes. The Company incurred net operating losses during the periods shown on the condensed financial statements resulting in a deferred tax asset, which was reserved, therefore the net benefit and expense resulted in \$0 income taxes.

Note 6: Restatement of Financial Statements

The Company has restated its financial statements for the year ended December 31, 2004 and for the quarter ended March 31, 2005 to correct errors identified as a result of a regulatory review of the Company's financial statements and reflect the corresponding changes described below. There was no net change to cash provided by financing activities, cash used in operating or investing activities or net capital as a result of these errors. The comparative statement of operations for the six months ended June 30, 2004 has been restated to record a deemed dividend of \$500,000 to increase the net loss available to common shareholders as a result of these changes.

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During the first quarter of 2004, the Company received subscriptions for 25,000 post-split shares of convertible preferred stock and received payments totaling \$1,099,998 for 18,333 of those post-split shares. In December 2004, the Company issued another 6,667 post-split shares for no additional consideration to one of the original subscribers to settle a dispute. The Company originally recorded these transactions as the sale of 25,000 post-split shares of preferred stock for proceeds of \$1,099,998. This restatement separates the sales of preferred stock completed early in 2004 and records a deemed dividend for the benefit provided by the included conversion feature. The restatement next reports the December issuance as a separate transaction and records an expense for the settlement of the dispute.

For the first component, we revised our analysis of the beneficial conversion feature using as comparable fair value of our common stock the price received for most of the sales of common stock during 2003 and 2004, \$10.00 per post-split share. A share of the preferred stock can be converted into eight shares of common stock, so the \$60.00 per post-split share price is equivalent to a common stock price of \$7.50 per post-split share, a difference of \$2.50 per post-split common share. On an as converted basis, for the 200,000 post-split common shares, this calculation results in a value of the beneficial conversion feature of \$500,000. The preferred stock is immediately convertible to common stock, so this value was immediately recorded as a deemed dividend to increase the net loss available to common shareholders for the year ended December 31, 2004.

For the second component, the investor had subscribed for 13,334 post-split preferred shares during the first quarter of 2004. The investor paid half of the subscription price or \$400,000, at that time. A dispute subsequently arose over the terms of payment for the remaining shares subscribed. The Company issued an additional 6,667 post-split shares to the investor to settle this dispute during the fourth quarter of 2004. The Company has re-stated its financial statements by recording an operating expense equal to the unpaid subscription price of \$400,000 and increasing paid in capital by the same amount. Originally, the Company had booked the sale of the entire 13,334 post-split shares of convertible preferred stock for \$400,000, the total amount of cash received for the shares.

The following table shows the effect of the restatement:

	As Previously	
	Reported	As Restated
	<u> </u>	<u> </u>
For the six months ended June 30, 2004:		
Net Loss	\$ (980,669)	\$ (980,669)
Deemed dividend - beneficial conversion feature		(500,000)
Net loss available to common shareholders after beneficial conversion	(980,669)	(1,480,669)
Loss per share available to common shareholders	(0.61)	(0.92)

Note 7: Subsequent Events

In July 2005, the Company completed an equity offering including a total of 2,990,000 shares of common stock and warrants to purchase another 2,990,000 shares of common stock for net proceeds of approximately \$10.5 million, after deducting transaction costs of approximately \$1.8 million. The warrants allow the holder to acquire common stock at a price of \$6.19 per share for a period of five years. Immediate application of the proceeds were to reduce current liabilities by approximately \$3.8 million, increase inventory approximately \$1.3 million and retain approximately \$5.4 million in cash. In conjunction with this offering all preferred stock outstanding has been converted to common stock.

ITEM 2. PLAN OF OPERATION

During the three months ended June 30, 2005, the Company reported sales of \$327,394 and cost of sales of \$238,903, incurred \$144,502 in research and development expenses and \$532,517 in general and administrative expense, resulting in an operating loss of \$588,528. During the three months ended June 30, 2004, the Company reported no sales and incurred \$112,816 in research and development expenses and \$409,357 in general and administrative expense, resulting in an operating loss of \$522,173. The increased level of expense is the result of completion of product development and the focus on sales and marketing as the Company anticipates equity funding and accelerates its business plan. Funding provided by the bridge loans and the subsequently completed secondary offering should permit expansion of sales, service and engineering personnel, facilitate acceleration of product manufacturing and help the Company to achieve operating breakeven over the coming twelve months.

During the six months ended June 30, 2005, the Company reported sales of \$327,394 and cost of sales of \$238,903, incurred \$261,728 in research and development expenses and \$866,566 in general and administrative expense, resulting in an operating loss of \$1,128,294. During the six months ended June 30, 2004, the Company had no sales and incurred \$605,620 in research and development expenses and \$859,512 in general and administrative expense, resulting in an operating loss of \$1,465,132. The reduced level of expense is the result of completion of product development and the change in focus to sales and marketing as the Company executes its business plan and pursues funding for expansion. Funding provided by the bridge loans and the subsequently completed secondary offering should permit expansion of sales, service and engineering personnel, facilitate acceleration of product manufacturing and help the Company to achieve operating breakeven over the coming twelve months.

Liquidity and Capital Resources

On June 30, 2005, the Company had \$367,426 in cash and a total of \$5,355,714 in current liabilities, primarily related to the research and development costs and the bridge loans obtained in conjunction with the subsequently completed secondary offering. Net cash used in operating activities for the six months ended June 30, 2005 was \$2,440,149 compared to cash used in operating activities of \$871,525 for the six months ended June 30, 2004. Net cash used in investing activities for the six months ended June 30, 2005 was \$142,730. Net cash provided by financing activities was \$2,946,063 for the six months ended June 30, 2005, which came substantially from the bridge loans and was offset by payment of offering costs for the subsequently completed secondary offering.

Our auditors included an explanatory paragraph in their opinion on our financial statements for the year ended December 31, 2004, to state that our losses since inception and our net capital deficit at December 31, 2004 raise substantial doubt about our ability to continue as a going concern. In July 2005 we completed a secondary offering of common stock and warrants that generated net proceeds of approximately \$10.5 million dollars which we believe will provide the working capital necessary for the coming year.

Our ability to continue as a going concern is ultimately dependent upon achieving profitable operations. We cannot assure you that our plan of operation will be successful in addressing this issue.

Our Capital Requirements

We believe that with the completion of the secondary offering in July 2005 we have adequate funds to finance our planned operations during the next 12 months.

Employees

We have seventeen full time employees at June 30, 2005.

ITEM 3. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

In connection with the preparation of this Quarterly Report on Form 10-QSB, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the CEO and CFO, as of June 30, 2005 of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, the CEO and CFO concluded that, as of June 30, 2005, the Company's disclosure controls and procedures were effective.

The Company has restated its previously issued financial statements for the year ended December 31, 2004 and for the three months ended March 31, 2005 as described more fully in those filings.

Changes in Internal Control over Financial Reporting

There have not been changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the second quarter of 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting,

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The following exhibits are furnished as part of this report:

- Exhibit 3(ii) Second Amended and Restated Bylaws (incorporated by reference to Exhibit 99.1 to the Form 8-K filed on July 1, 2005).
- Exhibit 10.1 Promissory Note dated April 7, 2005 to Roger L. Mason (incorporated by reference to Exhibit 10.20 to the Form SB-2/A registration statement filed April 22, 2005).
- Exhibit 10.2 Commercial Lease Agreement (incorporated by reference to Exhibit 10.22 to the Form SB-2/A registration statement filed July 6, 2005).
- Exhibit 10.3 Promissory Note dated June 30, 2005 to Paulson Investment Company, Inc. (incorporated by reference to Exhibit 99.1 to the Form 8-K filed July 1, 2005).
- Exhibit 10.4 Line of Credit Note dated June 23, 2005 to Frontier Bank (incorporated by reference to Exhibit 99.1 to the Form 8-K filed July 1, 2005).
- Exhibit 31.1 Certification required by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 Certification required by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.1 Certification required by Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.2 Certification required by Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Securities and Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ICOP DIGITAL, INC.

Date: August 12, 2005

By: /s/ David C. Owen
David C. Owen, President
Chief Executive Officer
Principal Executive Officer

Date: August 12, 2005

By: /s/ John C. Garrison
John C. Garrison
Chief Financial Officer
Principal Accounting Officer