

JANUARY 2011 DEFAULT CASE STUDY

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Public Firm Default Report: ICOP Digital (ICOPQ)

Default Event

On January 21, 2011, **ICOP Digital Inc**, a developer of mobile video systems for law enforcement, filed for Chapter 11 of US bankruptcy protection. As of the default date, the company had assets of \$6.7 million and debt of \$4.3 million.

Company Profile

What happens in a police car doesn't necessarily remain in a police car – sometimes, it becomes a matter of considerable controversy. In those cases, accurate evidence is vital, and that's where ICOP Digital plays a role. The company designs, engineers, and markets an in-car digital video system, including cameras and a hard disk drive, intended for use primarily by law enforcement agencies. Applications include portrayal of traffic stops and other contacts between police officers and the public, as well as officer-performance monitoring. Chairman and CEO David Owen and president and COO Laura Owen (husband and wife) together own about 15% of the company.

EDF Credit Measure and EDF Drivers

EDF value as of January 21, 2011: 35.00%

Traditional ratings, such as those used by major rating agencies, are currently more commonplace than default probabilities. Therefore, to help facilitate user's understanding, we translate the EDF credit measure into an equivalent Credit Category. ICOP Digital Inc's Credit Category (not an agency rating) at default was C.

Figure 1
One-year ICOP Digital Inc's EDF Values



Figure 1 shows that ICOP Digital Inc's EDF credit measure was rising since July 2010 and reached 35% in December 2010, one month prior to its default.

Figure 2
Drivers of ICOP Digital Inc's EDF Values

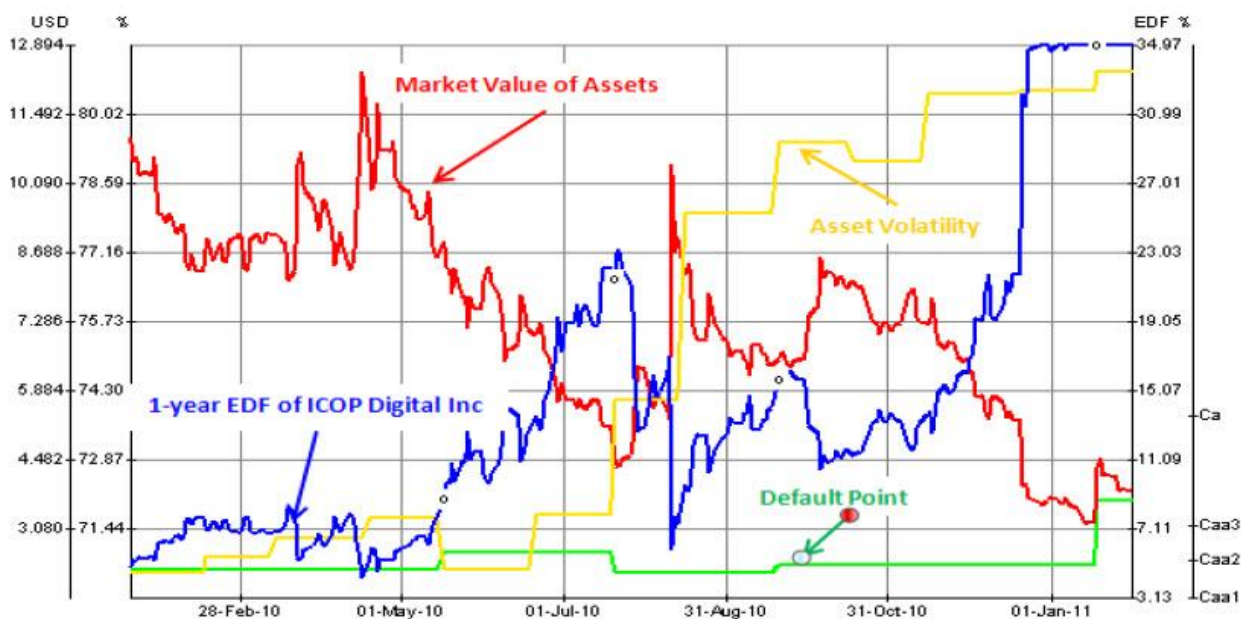


Figure 2 shows time series of EDF values and EDF drivers, which include market value of assets, asset volatility, default point, and market leverage. Table 1 summarizes the definition of EDF drivers.

In May 2010, the market value of assets was \$10 million. Since 2010, the company incurred significant losses and negative cash flow from operations. As a result, the company's market value of assets decreased to \$5 million in December 2010, close to the default point of \$4 million. The company's asset volatility soared to 81% in December 2010 from 71% in February 2010. Shrinking business value and high financial risk led the company to default.

Table 1.

Drivers for EDF Values

EDF DRIVERS	DEFINITION
Market Value of Assets	The market's view of the enterprise value of the firm as determined by the firm's equity value, equity volatility, and liability structure
Default Point	The liabilities that matter in case of default. If the market value of assets falls below this value, it is assumed that the firm will be unable to sell assets or raise additional capital to pay its debt. A firm's default point is a value close to its short term liabilities plus half of its long-term liabilities
Market Leverage	Ratio indicating how much of the market value of assets is financed by debt. It is calculated as the default point/market value of assets
Asset Volatility	Standard deviation of the annual change in the market value of the assets

The two main drivers of EDF values are asset volatility and market leverage. **Figure 3** depicts a meter showing the level of risk on each of the two measures. The levels are relative values computed on the United States and Canada Small & Mid-Size Corporates Group.

Figure 3

United States and Canada Large Corporates Group



- » **Asset Volatility.** EDF credit measures for United States and Canada Small & Mid-Size Corporate issuers such as ICOP Digital Inc reflect an average of asset volatility levels over the past three years. As of the default date, ICOP Digital Inc's asset volatility was 80.91%, within the 75th percentile relative to the US and Canada Small & Mid-Size Corporates Group.
- » **Market Leverage.** ICOP Digital Inc's market leverage is 86.81%, which falls within the 99th percentile of the entire US and Canada Small & Mid-Size Corporates Group.

Relative Analysis

The relative analysis feature allows users to chart EDF, fundamental data, and bond values for a selected company or group relative to other companies and/or groups. Users may manually select their own list of peer companies or groups for comparison, or view a Moody's Analytics predefined peer list, based on an automated algorithm. To determine peers for each company, Moody's Analytics finds all the companies that share the company's Bloomberg Subgroup. Users can also customize and save their own peer company and peer group choices for future use.

Figure 4

One-year ICOP Digital Inc vs. US Household Audio and Video Equipment Group

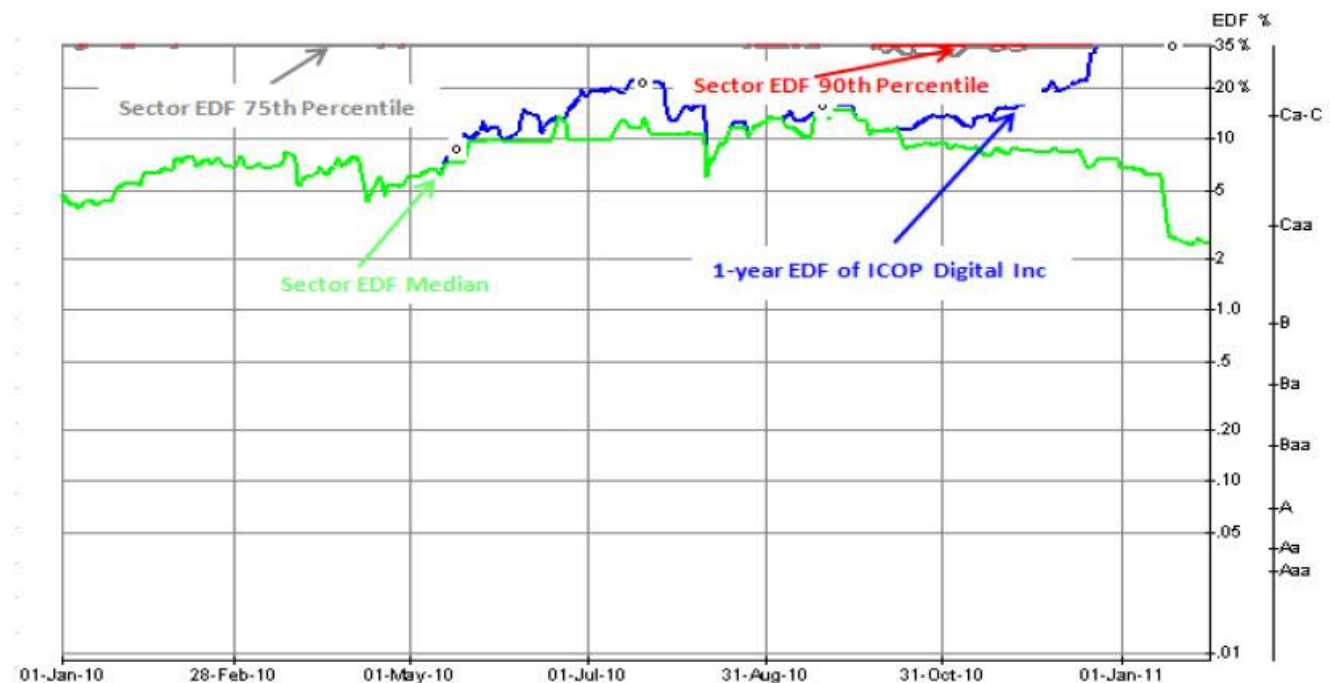


Figure 4 shows ICOP Digital Inc's EDF value had been above the 90th percentiles of the US Household Audio and Video Equipment Group since January 2010. The company bankrupted in December 2010.

Conclusion

ICOP Digital Inc's EDF Credit Measure indicated high default risk before default occurred. Firm EDF values remained above the 90th percentile relative to the peer group of US Household Audio and Video Equipment Group beginning in January 2010. Shrinking business value and high financial risk led the company to default.

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