

**COSTAR TECHNOLOGIES, INC.  
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS  
AND  
INDEPENDENT ACCOUNTANTS' COMPILATION REPORT

JUNE 30, 2013

**Rothstein Kass**

# **COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES**

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# Rothstein Kass

## INDEPENDENT ACCOUNTANTS' COMPILATION REPORT

To Costar Technologies, Inc.

We have compiled the accompanying consolidated balance sheet of Costar Technologies, Inc. and Subsidiaries (collectively, the "Company"), as of June 30, 2013, and the related consolidated statements of operations for the three and six month periods ended June 30, 2013 and 2012 and the consolidated statements of changes in stockholders' equity and cash flows for the six months ended June 30, 2013 and 2012. We have not audited or reviewed the accompanying 2013 consolidated financial statements and, accordingly, do not express an opinion or provide any assurance about whether the consolidated financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements.

Our responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of consolidated financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the consolidated financial statements.

The accompanying consolidated balance sheet of Costar Technologies, Inc. and Subsidiaries, as of December 31, 2012, was previously reviewed by us, and we stated that we were not aware of any material modifications that should be made to the consolidated balance sheet in order for it to be in conformity with accounting principles generally accepted in the United States of America in our report dated March 27, 2013, but we have not performed any procedures in connection with that review engagement since that date.



Dallas, Texas  
August 12, 2013

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	June 30, 2013	December 31, 2012
	(Compiled)	(Reviewed)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 706	\$ 114
Accounts receivable, less allowance for doubtful accounts of \$75 and \$67 in 2013 and 2012, respectively	2,533	2,029
Inventories, net of reserve for obsolescence of \$675 in 2013 and 2012	5,503	4,132
Promissory note - current	172	151
Prepaid expenses	348	381
Total current assets	<u>9,262</u>	<u>6,807</u>
<b>Non-current assets</b>		
Property and equipment, net	87	105
Trade names	925	925
Distribution agreement, net	954	991
Customer relationships, net	90	101
Covenant not to compete	22	30
Promissory note	86	258
Total assets	<u>\$ 11,426</u>	<u>\$ 9,217</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 1,896	\$ 895
Accrued expenses and other	446	109
Lines of credit		170
Total current liabilities	<u>2,342</u>	<u>1,174</u>
<b>Stockholders' Equity</b>		
Common stock	2	2
Additional paid in capital	155,898	155,893
Accumulated deficit	(142,295)	(143,329)
Less common stock held in treasury	(4,521)	(4,523)
Total stockholders' equity	<u>9,084</u>	<u>8,043</u>
Total liabilities and stockholders' equity	<u>\$ 11,426</u>	<u>\$ 9,217</u>

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS (COMPILED) (AMOUNTS SHOWN IN THOUSANDS)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Net revenues</b>	\$ 6,219	\$ 4,709	\$ 13,528	\$ 11,325
<b>Cost of revenues</b>	<u>4,391</u>	<u>3,378</u>	<u>9,550</u>	<u>8,060</u>
<b>Gross profit</b>	1,828	1,331	3,978	3,265
<b>Selling, general and administrative expenses</b>	<u>1,384</u>	<u>1,236</u>	<u>2,929</u>	<u>2,525</u>
<b>Income from operations</b>	<u>444</u>	<u>95</u>	<u>1,049</u>	<u>740</u>
Other income (expenses)				
Interest expense	(40)	(41)	(51)	(99)
Other income and expense, net	<u>34</u>	<u>4</u>	<u>36</u>	<u>8</u>
<b>Total other income (expenses), net</b>	<u>(6)</u>	<u>(37)</u>	<u>(15)</u>	<u>(91)</u>
<b>Net income</b>	<u>\$ 438</u>	<u>\$ 58</u>	<u>\$ 1,034</u>	<u>\$ 649</u>
Per share of common stock				
<b>Net income per share</b>	<u>\$ 0.30</u>	<u>\$ 0.04</u>	<u>\$ 0.71</u>	<u>\$ 0.45</u>
Weighted average shares outstanding	<u>1,454</u>	<u>1,447</u>	<u>1,451</u>	<u>1,447</u>

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (AMOUNTS SHOWN IN THOUSANDS)

For the Six Months Ended June 30, 2013 and 2012

	<u>Common Stock</u>		Additional Paid - In Capital	<u>Treasury Stock</u>		Accumulated Deficit	Total Stockholders' Equity
	<u>Shares</u>	<u>Amount</u>		<u>Shares</u>	<u>Amount</u>		
Balances at December 31, 2011 (reviewed)	1,680	\$ 2	\$ 155,879	233	\$ (4,524)	\$ (143,921)	\$ 7,436
Net income						649	649
Stock based compensation			13				13
Balances at June 30, 2012 (compiled)	1,680	\$ 2	\$ 155,892	233	\$ (4,524)	\$ (143,272)	\$ 8,098
Balances at December 31, 2012 (reviewed)	1,680	\$ 2	\$ 155,893	233	\$ (4,523)	\$ (143,329)	\$ 8,043
Net income						1,034	1,034
Liquidation Treasury Stock				(7)	2		2
Stock based compensation			5				5
Balances at June 30, 2013 (compiled)	1,680	\$ 2	\$ 155,898	226	\$ (4,521)	\$ (142,295)	\$ 9,084

See independent accountants' compilation report and notes to consolidated financial statements.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (COMPILED) (AMOUNTS SHOWN IN THOUSANDS)

For the Six Months Ended June 30,	2013	2012
<b>Cash flows from operating activities</b>		
Net income	\$ 1,034	\$ 649
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	5	13
Depreciation and amortization	76	210
Provision for doubtful accounts	8	20
Changes in operating assets and liabilities:		
Accounts receivable, net	(512)	371
Inventories, net	(1,371)	1,694
Promissory note	151	
Prepaid expenses	33	129
Accounts payable	1,001	(1,532)
Accrued expenses and other	337	38
Net cash provided by operating activities	<u>762</u>	<u>1,592</u>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(2)	(11)
Business purchase related to IVS		(100)
Net cash provided used in investing activities	<u>(2)</u>	<u>(111)</u>
<b>Cash flows from financing activities</b>		
Repayment on lines of credit	(170)	(1,571)
Liquidation of Treasury Stock	2	
Net cash used in financing activities	<u>(168)</u>	<u>(1,571)</u>
<b>Net increase (decrease) in cash</b>	592	(90)
<b>Cash, beginning of period</b>	<u>114</u>	<u>193</u>
<b>Cash, end of period</b>	<u>\$ 706</u>	<u>\$ 103</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for interest	\$ 51	\$ 99
Cash paid during the period for taxes	<u>\$ 30</u>	<u>\$ 33</u>

# **COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)**

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### **1. Nature of operations**

Costar Technologies, Inc. ("Costar Technologies") was incorporated in the State of Delaware in February 1997 under the name "Fairmarket, Inc.". Costar Technologies, and its wholly owned subsidiaries, Costar Video Systems, LLC ("Costar") and LQ Corporation ("LQ") (collectively the "Company"), develops, designs and distributes a range of security solution products such as surveillance cameras, lenses, digital video recorders and high speed domes. The Company also develops, designs and distributes industrial vision products to observe repetitive production and assembly lines, thereby increasing efficiency by detecting faults in the production process.

Effective March 2, 2012, the Company's shares started trading on the OTC Markets Group under the ticker symbol "CSTI" to reflect the Company's new name, Costar Technologies, Inc. The shares formerly traded on the OTC Markets Group under the stock ticker symbol "SLXN". The Company has also changed the address of its website from [www.sieloxinc.com](http://www.sieloxinc.com) to [www.costartechnologies.com](http://www.costartechnologies.com).

Effective April 27, 2012, the Company executed a 1:25 reverse stock split of the Company's common stock. All of the share and per share amounts discussed and shown in the consolidated financial statements and the notes to the consolidated financial statements have been adjusted to reflect the effect of this reverse stock split.

### **2. Summary of significant accounting policies**

#### *Basis of Presentation and Principles of Consolidation*

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of Costar Technologies and its wholly owned subsidiaries, as of June 30, 2013 and December 31, 2012 and for the six months ended June 30, 2013 and 2012. All intercompany balances and transactions have been eliminated in consolidation.

These consolidated financial statements were approved by management and available for issuance on August 12, 2013. Subsequent events have been evaluated through this date.

#### *Use of Estimates*

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### *Cash Equivalents*

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. As of June 30, 2013 and December 31, 2012, the Company had no such cash equivalents.



# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 2. Summary of significant accounting policies (continued)

#### *Accounts Receivable and Allowance for Doubtful Accounts*

Accounts receivable are recorded at net realizable values. The Company maintains an allowance for estimated losses resulting from the failure of customers to make required payments and for anticipated returns. The allowance is based on specific facts and circumstances surrounding individual customers as well as historical experience. Provisions for losses on receivables and returns are charged to income to maintain the allowance at a level considered adequate to cover losses and future returns. Receivables are charged off against the reserve when they are deemed uncollectible and returns are charged off against the reserve when the actual returns are incurred.

#### *Inventories*

Inventories are recorded on the first in first out basis and are stated at the lower of average cost or market. A provision is made to reduce excess or obsolete inventories to their net realizable value. As of June 30, 2013 and December 31, 2012, the Company had \$5,503 and \$4,132 in finished goods, respectively.

#### *Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over estimated useful lives of 3-5 years as follows.

Computer hardware and software	3 years
Furniture and fixtures	5 years
Leasehold improvements	Shorter of lease term or asset useful life

#### *Intangible Assets*

In accordance with GAAP, intangible assets with indefinite lives are not amortized, but instead tested for impairment. Intangible assets are reviewed for impairment at least annually or whenever events or changes in business combinations indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized if the fair value of the intangible asset is less than its carrying value.

Intangible assets with finite lives are amortized over their estimated useful lives. These intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. A loss is recognized in the consolidated statements of operations if it is determined that an impairment exists based on expected future undiscounted cash flows. The amount of the impairment is the excess of the carrying amount of the impaired asset over its fair value.

#### *Long-Lived Assets*

In accordance with GAAP, the Company reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. A loss is recognized on the consolidated statements of operations if it is determined that an impairment exists based on expected future undiscounted cash flows. The amount of the impairment is the excess of the carrying amount of the impaired asset over its fair value.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 2. Summary of significant accounting policies (continued)

#### *Revenue Recognition*

The Company ships and invoices its sales in accordance with signed purchase orders. The Company only recognizes revenue when it is realized and earned. The Company considers its revenue to have been earned when goods are shipped in accordance with signed purchase orders. Any software imbedded in the products sold is considered incidental to the product being sold.

#### *Research and Development*

Expenditures for research, development and engineering of software and hardware products, that are included in selling, general and administrative expenses in the consolidated statements of operations, are expensed as incurred.

#### *Stock Based Compensation*

The Company complies with the accounting and reporting requirements of the Accounting for Stock Based Compensation guidelines which require companies to record compensation expense for share-based awards issued to employees in exchange for services provided. The amount of the compensation expense is based on the estimated fair value of the awards on their grant dates and is generally recognized over the applicable vesting period.

The fair value of stock options is determined using an option-pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, expected dividends, and the risk free interest rate over the expected life of the option.

During the six months ended June 30, 2013 the Company recognized \$5 in stock based compensation expense in its consolidated financial statements relating to the issuance of 2 stock options. The Company recorded \$13 in stock based compensation expense during the six months ended June 30, 2012 relating to the issuance of 29 stock options.

The fair value of the 2013 and 2012 stock options were estimated on the date of grant using the Black-Scholes valuation model based on the following assumptions:

	Six Months Ended June 30,	
	2013	2012
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	57.44%	15.60%
Risk-free interest rate	2.00%	2.00%
Expected life in years	10 years	10 years
Weighted-average fair value of options granted	\$2.22	\$0.45

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 2. Summary of significant accounting policies (continued)

#### *Income Taxes*

The Company complies with GAAP which requires an asset and liability approach to financial reporting for income taxes. Deferred income tax assets and liabilities are computed for differences between the consolidated financial statement and tax bases of assets and liabilities that will result in future taxable or deductible amounts, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized.

The determination of the Company's provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. Accrued interest and penalties related to income tax matters are classified as a component of income tax expense.

In accordance with GAAP, the Company is required to determine whether a tax position is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The Company files an income tax return in the U.S. federal jurisdiction, and may file income tax returns in various U.S. states and foreign jurisdictions. The tax benefit recognized is measured as the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. De-recognition of a tax benefit previously recognized results in the Company recording a tax liability that increases the accumulated deficit. Generally, the Company is no longer subject to income tax examination by major taxing authorities for the years before 2010.

### 3. Property and equipment

Property and equipment at June 30, 2013 and December 31, 2012, were as follows:

	<b>2013</b>	<b>2012</b>
Office furniture and equipment	\$ 396	\$ 408
Demonstration and technical equipment		20
	396	428
Less accumulated depreciation	(309)	(323)
Total property and equipment, net	\$ 87	\$ 105

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 4. Intangible assets

The following is a summary of amortized and unamortized intangible assets at June 30, 2013 and December 31, 2012:

		<b>June 30, 2013</b>	
		<b>Gross Amount</b>	<b>Accumulated Amortization</b>
<b>Amortized intangible assets</b>			
Customer relations - Southern Imaging	\$	1,599	\$ 1,599
Distribution agreement - Southern Imaging		1,468	514
Customer relations – IVS		125	35
Covenant not to compete – IVS		50	28
Total amortized intangible assets		<u>3,242</u>	<u>2,176</u>
<b>Unamortized intangible assets</b>			
Trade name - Costar		800	
Trade name - IVS		125	
Total unamortized intangible assets		<u>925</u>	
Total intangible assets	\$	<u>4,167</u>	<u>\$ 2,176</u>
		<b>December 31, 2012</b>	
		<b>Gross Amount</b>	<b>Accumulated Amortization</b>
<b>Amortized intangible assets</b>			
Customer relations - Southern Imaging	\$	1,599	\$ 1,599
Distribution agreement - Southern Imaging		1,468	477
Customer relations – IVS		125	24
Covenant not to compete – IVS		50	20
Total amortized intangible assets		<u>3,242</u>	<u>2,120</u>
<b>Unamortized intangible assets</b>			
Trade name - Costar		800	
Trade name - IVS		125	
Total unamortized intangible assets		<u>925</u>	
Total intangible assets	\$	<u>4,167</u>	<u>\$ 2,120</u>

The weighted average amortization period for the Company's intangible assets is 12 years. The estimated useful lives for customer relationships, distribution agreements and covenant not to compete are 6, 20 and 3 years, respectively.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 4. Intangible assets (continued)

Amortization expense for the six months ended June 30, 2013 and 2012 was \$55 and \$189, respectively. Future amortization expense, as of June 30, 2013, is as follows:

Year Ending June 30,	
2014	\$ 111
2015	100
2016	94
2017	94
2018	80
Thereafter	<u>587</u>
Total future amortization expense	<u>\$ 1,066</u>

### 5. Lines of credit

Effective as of September 23, 2011, Costar entered into a Loan and Security Agreement with Briar Capital L.P. ("Briar"). The Loan and Security Agreement allows for up to \$3,500 in revolving lines of credit, with a three year maturity. The obligations under the Costar Loan and Security Agreement with Briar are secured by a lien on substantially all accounts receivable, inventory, equipment, general intangibles, including intellectual property, chattel paper, instruments and documents of Costar, as set forth in the Loan and Security Agreement with Briar. The Company is a guarantor of Costar's obligations under the Costar Loan and Security Agreement with Briar pursuant to the guaranty made by the Company in favor of Briar. Borrowings under the Loan and Security Agreement accrue interest at a rate equal to the 30-day LIBOR rate plus 8.25% per annum.

The Costar Loan and Security Agreement with Briar contains customary representations and warranties, events of default and covenants, including, among other things, covenants that restrict the ability of Costar to incur certain additional indebtedness or to issue equity interests. The Costar Loan and Security Agreement with Briar also contain financial covenants restricting capital expenditures of Costar and requiring Costar and the Company to maintain a specific Tangible Net Worth. As of June 30, 2013 and December 31, 2012, approximately \$0 and \$170, respectively, were owed to Briar.

Effective April 1, 2013, Costar entered into a Loan and Security Agreement ("Facility") with BOKF, NA dba Bank of Texas ("Bank of Texas"). The Facility allows for up to \$1,000 in a revolving line of credit, with a one year maturity. The obligation under the Facility with Bank of Texas is secured by a lien on substantially all accounts receivable, inventory, and equipment. The Company is a guarantor of Costar's obligation under the Facility with Bank of Texas pursuant to the guaranty made by the Company in favor of Bank of Texas. Borrowings under the Facility accrue interest at a rate equal to Bank of Texas Prime, currently 4.0% per annum. With the execution of the new Bank of Texas Facility, the Briar loan was paid in full.

The Facility with Bank of Texas contains customary representations and warranties, events of default and covenants, including, among other things, covenants that restrict the ability of Costar to incur certain additional indebtedness or to issue equity interests. The Facility with Bank of Texas also contains financial covenants calculated on a consolidated basis requiring the Company to maintain a certain Debt Service Coverage Ratio, Minimum Profitability, and a Minimum Tangible Net Worth. As of June 30, 2013, \$0 was owed to Bank of Texas.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 6. Deferred income taxes

Deferred tax assets are determined based on the difference between financial statement and tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. The components of the deferred taxes at June 30, 2013 and December 31, 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Net operating loss carryforward	\$ 51,010	\$ 51,361
Valuation allowance	<u>(51,010)</u>	<u>(51,361)</u>
Total net deferred tax asset	<u>\$</u>	<u>\$</u>

In connection with ownership changes, it was determined that certain of the Company's net operating loss carry forwards ("NOL") have been limited. As of June 30, 2013 and December 31, 2012, the Company has approximately \$150,500 and \$151,000 of NOLs that can be utilized in future years. These NOLs, if not used, will expire between 2019 and 2030.

A valuation allowance has been established for the full amount of the tax asset since it is more likely than not that the deferred tax asset will not be realized.

### 7. Stockholders' equity (shown in whole amounts)

At June 30, 2013 and December 31, 2012, the authorized capital stock of the Company consisted of (i) 10,000,000 shares of voting common stock with a par value of \$0.001 per share and (ii) 10,000,000 shares of preferred stock with a par value of \$0.001 per share. As of June 30, 2013 and December 31, 2012, there was no preferred stock issued and outstanding. The Company's Board has the authority to determine the voting powers, designations, preferences, privileges and restrictions of the preferred shares.

Additionally, subsequent to June 30, 2013, the Company was informed that 7,214 treasury shares were escheated to the state of Delaware in 2011. Delaware promptly liquidated the shares for approximately \$2,000, which is owed to the Company. Effective June 30, 2013, the Company reflected these liquidated shares as issued and outstanding and has reflected the \$2,000 as a current asset in the accompanying consolidated financial statements.

### 8. Stock option plan (shown in whole amounts)

The Company's 2000 Stock Option and Incentive Plan (the "2000 Incentive Plan") provides for awards in the form of incentive stock options, non-qualified stock options, restricted stock awards and other forms of awards to officers, directors, employees and consultants of the Company. At June 30, 2013 there were 129,749 share options issued under this plan. At June 30, 2013, there were 130,586 shares available for issuance under the 2000 Incentive Plan.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 8. Stock option plan (shown in whole amounts) (continued)

The Board of Directors of the Company determines the term of each option, the option price, and the number of shares for which each option is granted and the times at which each option vests. For holders of 10% or more of the Company's outstanding common stock, incentive stock options may not be granted at less than 110% of the fair market value of the common stock at the date of grant.

The following table summarizes information about stock options outstanding at June 30, 2013:

Options Outstanding				Options Fully Vested and Exercisable	
Range of Exercise Price Per Share	Number Outstanding	Remaining Contractual Life (In Years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
\$0.725-\$13.69	129,749	5.96	\$3.87	96,332	\$4.59

Stock option activity for the six months ended June 30, 2013 and 2012 is as follows:

	2013		2012	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of period	120,612	\$4.31	123,267	\$6.66
Granted	17,333	\$2.24	29,400	\$1.43
Exercised				
Canceled	8,196	\$6.86	618	\$5.25
Outstanding at period end	129,749	\$3.87	152,049	\$5.69
Options exercisable at period end	96,332	\$4.59	120,046	\$6.81
Weighted average fair value of options granted during the period at fair value		\$1.50		\$0.45

During the six months ended June 30, 2013 the Company recognized \$5,000 in stock based compensation expense in its consolidated financial statements related to the issuance of 17,333 stock options. The Company recorded \$13,000 in stock based compensation expense during the six months ended June 30, 2012 relating to the issuance of 29,400 stock options.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

### 9. Lease agreements

On January 31, 2011 the Company entered into a new lease agreement for certain facilities that will expire in 2018. Rent expense under the agreement for the years ended June 30, 2013 and 2012 were approximately \$91 and \$62, respectively.

Future minimum annual rent payments are approximately as follows:

Year Ending June 30,	
2014	\$ 105
2015	113
2016	121
2017	129
2018	137
Thereafter	<u>36</u>
Total future minimum lease commitments	<u>\$ 641</u>

### 10. Risk concentrations

The Company maintains its cash balances in financial institutions. These balances are insured by the Federal Deposit Insurance Corporation up to \$250 per institution. The Company is subject to credit risk to the extent any financial institution with which it conducts business is unable to fulfill contractual obligations on its behalf. Management monitors the financial condition of such financial institutions and does not anticipate any losses from these financial institutions.

#### *Concentration of Customers*

The Company's security surveillance product line customers include traditional "large box" national retailers and distributors. The Company's industrial vision product line customers include manufacturers that assemble products using automated production lines; these customers use the Company's video systems to monitor activity on the production line. For the six months ended June 30, 2013 and 2012, the Company's largest two customers accounted for \$8,534 and \$5,801, or 63.1% and 51.2% of the Company's total revenue, respectively. The same customers accounted for \$1,308 and \$930, or 51.6% and 46.3% of the outstanding accounts receivable balance, as of June 30, 2013 and December 31, 2012, respectively.

#### *Concentration of Suppliers*

For the six months ended June 30, 2013 and 2012, the Company made purchases from two main suppliers of approximately 58.2% and 45.8% of total purchases, respectively. Amounts owed to one main supplier were approximately 76.6% and 69.1% of the total accounts payable balance, as of June 30, 2013 and December 31, 2012, respectively.



# **COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)**

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### **11. Sale of Assets (Promissory Note)**

During December 2010, the Company entered into an agreement to sell certain assets and liabilities of Sielox, LLC ("Sielox"), an indirect wholly owned subsidiary. One of the agreed conditions of the sale was that Costar would continue to sell its range of security solution products through the Sielox network of approved business partners. The terms and conditions that govern the sale of Costar products are stated in the Master Distribution Agreement (the "Agreement") entered into between Costar and HGW Acquisition Company ("HGW"). The term of the Agreement commences on January 1, 2011, and ends on December 31, 2013. During the term of the Agreement, HGW has agreed to purchase Costar products in the minimum amount of \$5,000. Actual purchases will be measured against a schedule of semi-annual purchase commitments (the "Purchase Commitment"). In furtherance of the Purchase Commitment, HGW delivered to Costar a secured promissory note with an original principal balance in the amount of \$500 and bearing interest on the unpaid balance at a rate equal to 7% per annum. The promissory note is secured by a first priority security interest in HGW's accounts receivable. In the event that HGW fails to purchase Costar products in an amount equal to the Purchase Commitment as of the end of an applicable semi-annual period, HGW will have a period of 30 days to remedy the purchase default. That remedy will be in the form of a payment to Costar, of an amount equal to 25% of the shortfall, plus interest. The balance of the note at June 30, 2013 and December 31, 2012 were approximately \$258 and \$409, respectively.