

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REVIEW REPORT

March 31, 2022

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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Independent Auditor's Review Report

Board of Directors
Costar Technologies, Inc.
Coppell, Texas

We have reviewed the accompanying consolidated financial statements of Costar Technologies, Inc. and its subsidiaries, which comprise the consolidated balance sheet as of March 31, 2022, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the three-month periods ended March 31, 2022 and 2021. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

Our responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

We are required to be independent of Costar technologies, Inc. and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Accountant's Conclusion

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Report on Consolidated Balance Sheet as of December 31, 2021

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 2021, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 31, 2022. In our opinion, the accompanying consolidated balance sheet of the Company as of December 31, 2021, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Emphasis of Matter

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in *Note 2*, the Company entered into a Forbearance Agreement with its bank in February 2022, which extended the forbearance period through July 2022. Management's plans in regard to these matters are also described in *Note 2*. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our conclusion is not modified with respect to this matter.

BKD, LLP

Dallas, Texas
May 12, 2022

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	March 31, 2022 (Reviewed)	December 31, 2021 (Audited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1	\$ 4
Accounts receivable, less allowance for doubtful accounts of \$221 and \$205, respectively	7,720	6,544
Inventories	15,676	15,069
Prepaid expenses and other current assets	3,534	3,562
Total current assets	<u>26,931</u>	<u>25,179</u>
Non-current assets		
Property and equipment, net	110	164
Intangible assets, net	5,031	5,274
Goodwill	5,574	5,574
Right of use assets, net	1,233	1,214
Other non-current assets	117	114
Total non-current assets	<u>12,065</u>	<u>12,340</u>
Total assets	<u>\$ 38,996</u>	<u>\$ 37,519</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 6,871	\$ 6,935
Accrued expenses and other current liabilities	3,852	3,894
Line of credit	11,630	9,337
Current maturities of long-term debt, net of unamortized financing fees	2,610	2,807
Current maturities of lease liabilities	692	732
Total current liabilities	<u>25,655</u>	<u>23,705</u>
Long-Term liabilities		
Deferred tax liability	179	179
Non-current maturities of lease liabilities	645	608
Total long-term liabilities	<u>824</u>	<u>787</u>
Total liabilities	<u>26,479</u>	<u>24,492</u>
Stockholders' Equity		
Preferred stock		
Common stock	3	3
Additional paid-in capital	157,906	157,899
Accumulated deficit	(140,871)	(140,354)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	<u>12,517</u>	<u>13,027</u>
Total liabilities and stockholders' equity	<u>\$ 38,996</u>	<u>\$ 37,519</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (AMOUNTS SHOWN IN THOUSANDS, EXCEPT NET INCOME PER SHARE)

	For the Three Months Ended March 31,	
	2022 (Reviewed)	2021 (Reviewed)
Net revenues	\$ 12,789	\$ 10,782
Cost of revenues	8,688	6,962
Gross profit	4,101	3,820
Selling, general and administrative expenses	3,838	3,601
Engineering and development expense	585	767
	4,423	4,368
Loss from operations	(322)	(548)
Other income (expenses)		
Interest expense	(221)	(245)
Other income, net	34	4
Total other income (expenses), net	(187)	(241)
Loss before taxes	(509)	(789)
Income tax provision	8	10
Net loss	\$ (517)	\$ (799)
<u>Net loss per share:</u>		
Basic	\$ (0.31)	\$ (0.49)
Diluted	\$ (0.31)	\$ (0.49)
<u>Weighted average shares outstanding:</u>		
Basic	1,652	1,643
Diluted	1,652	1,643

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Three Months Ended March 31, 2022 and 2021

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balances at December 31, 2020 (audited)	1,855	\$ 3	\$ 157,686	\$ (144,720)	226	\$ (4,521)	\$ 8,448
Net loss				(799)			(799)
Exercise of stock options	23		35				35
Stock based compensation			4				4
Balances at March 31, 2021 (reviewed)	1,878	\$ 3	\$ 157,725	\$ (145,519)	226	\$ (4,521)	\$ 7,688
Balances at December 31, 2021 (audited)	1,878	\$ 3	\$ 157,899	\$ (140,354)	226	\$ (4,521)	\$ 13,027
Net loss				(517)			(517)
Exercise of stock options	1		3				3
Stock based compensation			4				4
Balances at March 31, 2022 (reviewed)	1,879	\$ 3	\$ 157,906	\$ (140,871)	226	\$ (4,521)	\$ 12,517

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (AMOUNTS SHOWN IN THOUSANDS)

For the Three Months Ended March 31,	2022	2021
	(Reviewed)	(Reviewed)
Cash flows from operating activities		
Net loss	\$ (517)	\$ (799)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock based compensation	4	4
Depreciation and amortization	297	422
Amortization of deferred financing costs		11
Amortization of right of use assets	246	239
Provision for doubtful accounts	16	7
Provision for obsolete inventory	140	364
Changes in operating assets and liabilities		
Accounts receivable	(1,192)	2,804
Inventories	(747)	(574)
Prepaid expenses and other current assets	28	427
Other non-current assets	(3)	
Accounts payable	(64)	525
Lease liabilities	(268)	(256)
Accrued expenses and other	(42)	370
Net cash (used in) provided by operating activities	(2,102)	3,544
Cash flows from financing activities		
Proceeds from (Repayment of) line of credit	2,293	(3,774)
Payment of long-term debt	(197)	(197)
Exercise of stock options	3	35
Net cash provided by (used in) financing activities	2,099	(3,936)
Net change in cash and cash equivalents	(3)	(392)
Cash and cash equivalents, beginning of period	4	480
Cash and cash equivalents, end of period	\$ 1	\$ 88
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 221	\$ 203
Right of use assets obtained in exchange for operating lease liabilities	\$ 265	\$

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

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 its wholly owned subsidiaries Innotech Security, Inc. ("Innotech") and Arecont Vision Costar, LLC ("Arecont Vision"), LQ Corporation ("LQ") and CostarHD, LLC (formerly CohuHD Costar, LLC "CostarHD") (collectively the "Company"), develops, designs and distributes a range of security solution products such as surveillance cameras, lenses, digital video recorders, high speed domes and industrial vision products CostarHD is a leading provider of video cameras and related products, specializing in IP video solutions for traffic monitoring, security, surveillance and military applications; and accessories, such as cables, camera mounts, lenses and data storage devices.

2. Summary of Significant Accounting Policies

Basis of Presentation

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. All material intercompany transactions have been eliminated in consolidation.

These consolidated financial statements were approved by management and available for issuance on May 12, 2022. Subsequent events have been evaluated through this date.

Going Concern

The Company's financial statements for the quarter ended March 31, 2022 have been prepared on a going concern basis. The Company entered into a Forbearance Agreement with its bank in January 2021 which was subsequently extended in April 2021, July 2021 and February 2022. See Footnote 6 Lines of Credit and Long-Term Debt for additional information. In addition, economic uncertainties have arisen which have negatively affected the financial position of the Company as a result of COVID-19. The duration of these uncertainties and ultimate financial effects cannot be reasonably estimated at this time. The Company's ability to continue as a going concern is dependent upon its ability to reach a revised agreement with its existing lender or secure other sources of financing and attain profitable operations.

Commitments and Contingencies

The Company records and/or discloses commitments and contingencies in accordance with ASC 450, Contingencies. ASC 450 applies to an existing condition, situation, or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future events occur or fail to occur. At this time there are no matters that are expected to have an adverse, material effect on the consolidated financial statements.

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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. As of March 31, 2022 and December 31, 2021, the Company had \$1 and \$4 in cash and cash equivalents, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are uncollateralized customer obligations 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 stated at the lower of average cost or net realizable value. A provision is made to reduce excess or obsolete inventories to their net realizable value. Inventories at March 31, 2022 and December 31, 2021 were comprised of the following:

	<u>March 31, 2022</u>	<u>December 31, 2021</u>
Parts, components, and materials	\$ 6,744	\$ 6,826
Work-in-process	28	44
Finished products	<u>8,904</u>	<u>8,199</u>
Total Inventory	<u>\$ 15,676</u>	<u>\$ 15,069</u>

Property and Equipment

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

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

Long-Lived 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 circumstances 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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Long-Lived Assets (continued)

Property and equipment and intangible assets with finite lives are amortized over their estimated useful lives. These assets are reviewed for impairment, at the asset group level, 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.

Goodwill

Goodwill is tested annually for impairment, or sooner when circumstances indicate an impairment may exist. The Company has elected to first perform a qualitative assessment, based on the entity's events and circumstances, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of this qualitative assessment determine whether it is necessary to perform a quantitative impairment test.

During the year ending December 31, 2021 the Company performed step one of the impairment test to estimate fair value for CostarHD and Innotech as a result of multi-year declining revenues and profitability and budgetary shortfalls. The income and market approaches were utilized to determine the fair value of the reporting unit based on the prices of comparable businesses and the present value of free cash flows that the business is projected to produce. The fair value of CostarHD and Innotech exceeded their respective carrying value and no impairment was recognized. There were no impairments recognized during the three month period ended March 31, 2022.

Fair Value Measurements

The Company follows the guidance from FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

Revenue Recognition

Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring distinct goods or providing services to customers. The Company's revenue consists substantially of product sales and is reported net of sales discounts, rebates, incentives, returns and other allowances offered to customers. The Company recognizes revenue when performance obligations under the terms of contracts with its customers are satisfied, which occurs when control passes to a customer to enable them to direct the use and obtain benefit from the product.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

The Company ships and invoices its sales in accordance with signed purchase orders. The satisfaction of the Company's performance obligation is based upon transfer of control over a product to a customer, which results in sales being recognized upon shipment, in accordance with signed purchase orders, rather than upon delivery for the majority of the Company's sales. Any software imbedded in the products sold is considered incidental to the product being sold.

Some of the Company's sales are sold with a right of return and the Company may provide other credits or incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize. We have elected to apply the portfolio practical expedient. We estimate the variable consideration using the expected value method when calculating the returns reserve because the difference in applying it to the individual contract would not differ materially. Returns are estimated based on historical experience and are required to be established and presented at the gross sales value with an asset established for the estimated value of the merchandise returned separate from the refund liability. At March 31, 2022 and December 31, 2021 liabilities for return allowances of \$436 and \$524 are included in accrued expenses and other current liabilities and \$315 and \$376 for the estimated value of the merchandise to be returned is included in prepaid expenses and other current assets on the Consolidated Balance Sheets, respectively.

Revenue includes charges for shipping and handling. Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in cost of goods sold.

The Company offers standard net 30 payment terms, but occasionally offers extended terms. The Company provides an assurance-type warranty that guarantees its product complies with agreed-upon specifications. This requires the Company to remedy deficiencies in quality or performance of our products over a specified period of time, generally twelve to thirty-six months, at no cost to our customers. Warranty liabilities are established at the time the revenue is recognized at levels that represent our estimate of the costs that will be incurred to fulfill those warranty requirements. In addition, the Company maintains reserves for returns and post-invoice sales discounts.

Applying the practical expedient, the Company recognizes incremental costs of obtaining contracts as an expense when incurred when the amortization period of the assets that otherwise would have been recognized is one year or less.

Product Warranties

The Company provides limited warranties on certain products for periods up to three years. The Company records an accrued liability and expense for estimated future warranty claims based upon historical experience and management's estimate of the level of future claims. Changes in the estimated amounts recognized in prior years are recorded as an adjustment to the accrued liability and expense (benefit) in the current year. As of March 31, 2022 and December 31, 2021, the accrued warranty liability was approximately \$1,054 and \$1,214, respectively, and is included in accrued expenses and other current liabilities in the accompanying balance sheets.

Warranty accrual at December 31, 2021	\$	1,214
Warranty expenditures		(89)
Warranty expense (benefit)		(71)
Warranty accrual at March 31, 2022	\$	<u>1,054</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Leases

At contract inception the Company determines if an arrangement is a lease. Operating leases are included in right of use assets and current maturities of lease liabilities and non-current maturities of lease liabilities in the Consolidated Balance Sheets. Financing leases are included in property and equipment, net and other current and non-current liabilities in the Consolidated Balance Sheets. The gross amount of balances recorded related to finance leases was immaterial as of March 31, 2022 and December 31, 2021. Operating lease expense is recognized on a straight-line basis over the lease term.

Operating lease assets and liabilities are recognized at the commencement date, based on the present value of the future minimum lease payments. A certain number of these leases contain rent escalation clauses that are factored into the Company's determination of lease payments. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the lease commencement date to discount payments to the present value. Most operating leases contain renewal options. The exercise of these options is at the Company's discretion. Lease terms include options to extend when it is reasonably certain the Company will exercise that option.

Employee Retention Credit

In the second quarter of 2021 the Company determined eligibility for the Employee Retention Credit ("ERC"). The ERC was created under the CARES Act and modified and extended by the Taxpayer Certainty and Disaster Relief Act of 2020, which was part of the Consolidated Appropriations Act. The ERC was subsequently extended through the third quarter of 2021 by the American Rescue Plan Act of 2021. The estimated refund due of approximately \$1,835 and \$1,866 is included in other current assets in the Consolidated Balance Sheets at March 31, 2022 and December 31, 2021, respectively.

Research and Development

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

Stock Based Compensation (per share amounts shown in whole numbers)

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 three month periods ended March 31, 2022 and 2021 the Company recognized \$4 in stock based compensation expense in its consolidated financial statements relating to the issuance of stock options and stock awards, respectively (See Note 9).

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Basic and Diluted Net Income (Loss) per Share (per share amounts shown in whole numbers)

Basic income (loss) per share is computed by dividing income (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted income (loss) per share reflects the dilution of common stock equivalents, such as options, to the extent the impact is dilutive. As the Company incurred a net loss for the three month periods ended March 31, 2022 and March 31, 2021, potentially dilutive securities have been excluded from the diluted net loss per share computation as their effect would be anti-dilutive.

The following table reconciles the number of shares utilized in the net loss per share calculations for the three month periods ended March 31, 2022 and 2021:

	Three Months Ended March 31,			
	2022		2021	
Net loss	\$	(517)	\$	(799)
Shares				
Weighted average shares outstanding - basic		1,652		1,643
Weighted average dilutive share equivalents from stock options				
Weighted average shares outstanding - diluted		1,652		1,643
Net loss per share - basic	\$	(0.31)	\$	(0.49)
Net loss per share - diluted	\$	(0.31)	\$	(0.49)

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 basis 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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Income Taxes (continued)

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 2018.

Operating Segments

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company recognizes three reportable segments: "Costar Video Systems," "CostarHD" and "Other."

3. Segment Information

Our business segments offer a variety of products (See Note 1) and are managed separately as each business requires different technology and marketing strategies. Our reportable segments are Costar Video Systems (which includes Innotech and Arecont Vision Costar), CostarHD and Other. Costar Video Systems' products and services are largely used in retail security applications whereas CostarHD's products are more focused on transportation, border security and other government applications. The Other segment encompasses the Company's costs associated with income taxes, company-wide financing (including interest expense), executive compensation and other corporate expenses.

Revenues and net income (loss) by reportable segment for the three month periods ending March 31, 2022 and 2021 are as follows:

	Three Months Ended March 31,	
	2022	2021
Revenues		
Costar Video Systems	\$ 10,209	\$ 8,969
CostarHD	2,580	1,813
	<u>\$ 12,789</u>	<u>\$ 10,782</u>
Net Income (Loss)		
Costar Video Systems	\$ 818	\$ 646
CostarHD	(462)	(644)
Other	(873)	(801)
	<u>\$ (517)</u>	<u>\$ (799)</u>

Intercompany sales between the CostarHD and Costar Video Systems operating segments were \$23 and \$0 for the three month periods ending March 31, 2022 and 2021, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

3. Segment Information (continued)

The following table reflects depreciation and intangible amortization expense by business segment for the three month periods ending March 31, 2022 and 2021:

	Three Months Ended March 31,	
	2022	2021
Depreciation		
Costar Video Systems	\$ 45	\$ 73
CostarHD	9	35
	<u>\$ 54</u>	<u>\$ 108</u>
Amortization		
Costar Video Systems	\$ 225	\$ 236
CostarHD	18	78
	<u>\$ 243</u>	<u>\$ 314</u>

Total assets and goodwill by business segment at March 31, 2022 and December 31, 2021 are as follows:

	March 31, 2022	December 31, 2021
Total Assets		
Costar Video Systems	\$ 30,105	\$ 28,491
CostarHD	8,431	8,522
Other	460	506
	<u>\$ 38,996</u>	<u>\$ 37,519</u>
Goodwill		
Costar Video Systems	\$ 3,511	\$ 3,511
CostarHD	2,063	2,063
	<u>\$ 5,574</u>	<u>\$ 5,574</u>

4. Property and Equipment

Property and equipment at March 31, 2022 and December 31, 2021, were as follows:

	March 31, 2022	December 31, 2021
Furniture, equipment and leasehold improvements	\$ 2,519	\$ 2,519
Less accumulated depreciation	<u>(2,409)</u>	<u>(2,355)</u>
Total property and equipment, net	<u>\$ 110</u>	<u>\$ 164</u>

Depreciation expense for the three month periods ended March 31, 2022 and 2021 was \$54 and \$108, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (SEE INDEPENDENT AUDITOR'S REVIEW REPORT)
 (AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets

The following is a summary of amortized and unamortized intangible assets at March 31, 2022:

	March 31, 2022	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Distribution agreement - Southern Imaging	\$ 1,468	\$ 1,156
Customer relationships - CostarHD	779	618
Trade name - Innotech	1,015	533
Customer relations - Innotech	5,762	3,232
Technology - Innotech	469	352
Patents - Innotech	8	6
Trade name - Arecont Vision Costar	243	90
Distribution agreement - Arecont Vision Costar	370	119
Patents - Arecont Vision Costar	208	110
Total amortized intangible assets	10,322	6,216
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CostarHD	2,063	
Goodwill - Innotech	3,511	
Total unamortized intangible assets	6,499	
Total intangible assets	\$ 16,821	\$ 6,216

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets (continued)

The following is a summary of amortized and unamortized intangible assets at December 31, 2021:

	December 31, 2021	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Distribution agreement - Southern Imaging	\$ 1,468	\$ 1,138
Customer relationships - CostarHD	779	600
Trade name - Innotech	1,015	507
Customer relations - Innotech	5,762	3,090
Technology - Innotech	469	335
Patents - Innotech	8	6
Trade name - Arecont Vision Costar	243	84
Distribution agreement - Arecont Vision Costar	370	110
Patents - Arecont Vision Costar	208	103
Total amortized intangible assets	10,322	5,973
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CostarHD	2,063	
Goodwill - Innotech	3,511	
Total unamortized intangible assets	6,499	
Total intangible assets	\$ 16,821	\$ 5,973

The weighted average amortization period for the Company's intangible assets is 11 years. Amortizable intangible assets estimated useful lives are as follows:

Trade names, technology and patents	7 and 10 years
Customer relationships	6 and 10 years
Distribution agreements	20 years
Covenants not to compete	3 and 5 years

Amortization expense for the three month periods ended March 31, 2022 and 2021 was \$243 and \$314, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets (continued)

Future amortization expense is as follows:

Year Ending March 31,	
2023	\$ 967
2024	933
2025	815
2026	763
2027	539
Thereafter	<u>89</u>
Total future amortization expense	<u>\$ 4,106</u>

6. Lines of Credit and Long-Term Debt

In connection with the acquisition of Arecont Vision Costar on July 13, 2018 the Company entered into a Loan Agreement with UMB Bank ("Loan Agreement"). The Loan Agreement allows for up to \$18,000 in a revolving line of credit and a \$5,500 term loan which originally matured on July 6, 2021. The Loan Agreement, as modified through the third amendment to the Forbearance and Loan Modification agreement on February 9, 2022, extended the maturity to June 15, 2022. The term loan is payable in \$66 monthly payments due on the first of the month with the remaining balance due at maturity. The obligations under the Loan Agreement are secured by a lien on substantially all accounts receivable, inventory and equipment.

The Loan Agreement 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 distributions or dividends. The Company is also restricted in its mergers and acquisitions activity. The Loan Agreement contains financial covenants calculated on a consolidated basis requiring the Company to maintain a certain Debt Service Coverage Ratio and to not exceed a maximum Senior Cash Flow Leverage Ratio. The Company maintains zero balance accounts, which are swept daily to the revolving line of credit. The Company entered into a modification agreement with UMB Bank effective May 1, 2019 which adjusted the borrowing base and covenant compliance requirements and modified interest rates. The Company entered into a second modification agreement with UMB Bank effective March 24, 2020 which adjusted the borrowing base and covenant compliance requirements and modified interest rates. As of March 31, 2022 and December 31, 2021 the Company was not in compliance with its debt covenants with UMB bank. The Company entered into a Forbearance and Loan Modification Agreement with UMB Bank effective January 26, 2021 which further adjusted the borrowing base and covenant compliance and reporting requirements and modified interest rates and was effective through April 15, 2021. The Company entered an amendment of the Forbearance and Loan Modification Agreement on April 15, 2021 which extended the forbearance period through July 14, 2021, a second amendment on July 12, 2021 which extended the forbearance period through February 18, 2022 and the third amendment on February 9, 2022 which extended the forbearance period through June 15, 2022.

As of March 31, 2022 the Company was paying interest at 6.50% for the term loan and revolving line of credit.

Future principal payments for the term loan as of March 31, 2022, are as follows:

Year Ending March 31,	
2022	\$ 2,610

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

6. Lines of Credit and Long-Term Debt (continued)

As of March 31, 2022 and December 31, 2021, \$11,630 and \$9,337 was owed to UMB Bank on the revolving line of credit, \$2,610 and \$2,807 on the term loan, respectively.

The Company paid approximately \$154 in various fees associated with securing the UMB Loan Agreement. The fees were treated as a deferred financing costs asset and were amortized over the life of the agreement using the straight-line method for the revolving line of credit portion and the effective-interest method for the term note portion.

7. Income Taxes

Total income tax expense for the three month periods ended March 31, 2022 and 2021 was \$8 and \$10, respectively. The Company's effective tax rate differs from the U.S. federal statutory rate due primarily to changes to the deferred income tax asset valuation allowance and state income and franchise taxes.

8. Stockholders' Equity (shown in whole amounts)

At March 31, 2022 and December 31, 2021, 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 March 31, 2022 and December 31, 2021, 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. As of March 31, 2022 and December 31, 2021, there were 1,653,831 and 1,652,431 shares of common stock outstanding and 1,879,597 and 1,878,197 shares of common stock issued.

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 March 31, 2022 and December 31, 2021, there were 16,000 and 17,000 options outstanding under this plan.

9. Stock Option Plan (shown in whole amounts)

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.

At the Company's annual meeting on December 16, 2014, the Company's stockholders approved and adopted the Company's 2014 Omnibus Performance Award Plan (the "Plan"). The Board adopted the Plan on November 17, 2014, subject to and effective upon its approval by stockholders. With the adoption of the Plan, no new awards will be granted under the 2000 Incentive Plan, although it will remain in effect for options that are currently outstanding in accordance with their terms. The Plan authorizes the grant of awards relating to 150,000 shares of the Company's common stock. At the Company's annual meeting on October 29, 2020, the Company's stockholders approved an additional 150,000 shares under The Plan. As of March 31, 2022 and December 31, 2021 there were 98,000 share options outstanding under this plan, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

9. Stock Option Plan (shown in whole amounts) (continued)

The following table summarizes information about stock options outstanding at March 31, 2022:

Options Outstanding				Options Fully Vested and Exercisable	
Range of Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
\$2.100 - \$13.550	114,000	5.27	\$8.32	114,000	\$8.32

Stock option activity for the three month periods ended March 31, 2022 and 2021 is as follows:

	March 31, 2022		March 31, 2021	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	115,400	\$8.24	142,066	\$9.16
Exercised	(1,400)	\$3.75	(23,333)	\$1.52
Outstanding at period end	114,000	\$8.32	118,733	\$9.16
Options exercisable at period end	114,000	\$8.32	118,733	\$9.16

On October 29, 2020, a grant of 33,000 ("2020 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2020 Awards are subject to a time-vesting schedule and 75% are subject to performance conditions relating to EBITDA growth for the years ending December 31, 2020, December 31, 2021 and December 31, 2022, as stated in the 2020 Awards Agreements. The 25% of the 2020 Awards not subject to performance conditions have a grant date fair value of approximately \$45,000, with the expense recognized over the three year vesting period. The 2020 Awards subject to the performance conditions have a grant date fair value of \$134,000, with the expense recognized over the three year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$4,000 was recognized in the Company's financial statements in relation to the 2020 Awards during the three month periods ending March 31, 2022 and March 31, 2021, respectively. At March 31, 2022, unrecognized stock based compensation related to unvested awards totaled \$55,700 and is expected to be recognized over a weighted average period of 0.5 years.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

10. Lease Agreements and Related Party Transactions

The Company has entered into the following lease agreements:

Financing Leases

The Company has one financing lease for a forklift used at the Innotech facility in Pompano Beach, Florida which expires in July 2022.

Operating Leases

All of the Company's office and warehouse facilities are leased under operating leases. These leases expire between 2022 and 2025 and certain leases contain renewal options for periods ranging from three to five years. Lease payments have an escalating fee schedule with 3% increases each year. Termination of the leases is generally prohibited unless there is a violation under the lease agreement. The Company has a related party lease with a member of management for its facility in Pompano Beach, FL which terminates on December 31, 2022. Rent expense from the related party lease was \$28 for the three month periods ended March 31, 2022 and March 31, 2021, respectively.

The Company also leases certain office equipment under operating leases. Lease costs are included within operating expenses in the Consolidated Statements of Operations.

During the three month periods ended March 31, 2022 and March 31, 2021 lease costs included in operating expenses were as follows:

	<u>Three Months Ended March 31, 2022</u>	<u>Three Months Ended March 31, 2021</u>
Lease cost		
Finance lease cost		
Amortization of right-of-use asset	\$ 1	\$ 1
Interest on lease liabilities		
Operating lease cost	<u>262</u>	<u>271</u>
Total lease cost	\$ 263	\$ 272
	<u>Three Months Ended March 31, 2022</u>	<u>Three Months Ended March 31, 2021</u>
Other information		
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from finance leases	\$ -	\$ -
Financing cash flows from finance leases	1	1
Operating cash flows from operating leases	281	288
Right of use assets obtained in exchange for new finance lease liabilities		
Right of use assets obtained in exchange for new operating lease liabilities	265	

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT AUDITOR'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

10. Lease Agreements and Related Party Transactions (continued)

The weighted-average remaining lease term and weighted-average discount were as follows:

	<u>March 31, 2022</u>	<u>March 31, 2021</u>
Lease term and discount rate		
Weighted-average remaining lease term operating leases	2.5 years	2.7 years
Weighted-average discount rate operating leases	5.9%	5.6%
Weighted-average remaining lease term financing lease	0.3 years	1.3 years
Weighted-average discount rate financing lease	5.6%	5.6%

Future minimum lease payments and reconciliation to the Consolidated Balance Sheet at March 31, 2022 are as follows:

Year Ending March 31,	
2023	\$ 764
2024	347
2025	265
2026	129
2027	
Total lease payments	<u>1,505</u>
Less imputed interest	<u>(168)</u>
Present values of lease liabilities	<u>\$ 1,337</u>

11. Risk Concentrations

Concentration of Cash

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

For the three month periods ended March 31, 2022 and March 31, 2021 two of the Costar Video Systems operating segment's largest customers accounted for approximately \$3,642 or 28.5% and \$2,614 or 24.2% of the Company's total revenue, respectively. Amounts owed by two customers of the Costar Video Systems' operating segment and one customer of the CostarHD operating segment accounted for \$2,728 or 35.3% of the Company's outstanding receivable balance as of March 31, 2022. Amounts owed by two customers of the Costar Video Systems' operating segment accounted for \$1,970 or 30.1% of the Company's outstanding receivable balance as of December 31, 2021.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(SEE INDEPENDENT AUDITOR'S REVIEW REPORT)
(AMOUNTS SHOWN IN THOUSANDS)

11. Risk Concentrations (continued)

Concentration of Suppliers

For the three month periods ended March 31, 2022 and 2021 the Company made purchases from two main supplier of the Costar Video Systems' operating segment of approximately \$3,593 or 33.4% and from one main supplier of the Costar Video Systems' operating segment of \$1,434 or 19.8%, respectively. Amounts owed to two main suppliers of the Costar Video Systems' operating segment accounted for \$2,754 or 40.1% and one main supplier of the Costar Video Systems' operating segment accounted for \$2,281 or 32.9% of the Company's accounts payable balance as of March 31, 2022 and December 31, 2021, respectively.