

Costar Technologies, Inc.

Letter from the President and Chief Executive Officer



OTC: CSTL.PK
www.costartechnologies.com



Letter from the President and Chief Executive Officer:

November 14, 2014

Dear Stockholders,

Costar Technologies continued to deliver profitable growth in 2013 as we executed on our strategic operating plan. Among other things, we invested in improving our customer service practices and increased our trade show exposure.

Our 2013 financial results reflect the exemplary efforts of our management team and employees. I am proud of our team and their numerous accomplishments, and grateful for their dedication and tireless efforts. The Company generated more than \$2.1 million of EBITDA in 2013, a year-on-year improvement of 109%. In 2013, video sales increased 35% to \$26.5 million from \$19.6 million in 2012, with operating profits increasing to \$1.9 million from \$0.6 million in the prior year. The improvement in EBITDA was primarily due to the increase in revenue and a 32% increase in gross profit margins resulting from significant cost savings and a more favorable product mix of higher margin digital video recorders and network products. SG&A expenses increased 12% as we continued to build our team with the goal of driving an increase in profits next year and for years thereafter.

Our Board of Directors has taken several actions this year to strengthen corporate governance and more closely align stockholder and company interests. Several examples include cumulative voting, a clawback policy for incentive compensation, and the 2014 Omnibus Performance Award Plan that is on the ballot at the annual meeting.

In this environment, companies must invest to grow, while staying competitive and responsive. We upgraded the performance of our existing products and introduced new network video product families to increase our market share. External market research estimates the long-term growth potential for the network video market at 20-25% annually. The network segment of our product line had a 48% CAGR over the last two years. In the early years, large installations were the early adopters of network video and as a result the market was dominated by brand name product. As the market matures, an important factor for growth is expected to be increased penetration in smaller installations which would provide a faster growth path. Key drivers in capturing the smaller installation business are competitive product features, attractive pricing, easy installation, and the ability to retain existing analog components. The Company believes it is well positioned to take advantage of the network video transition.

On June 6, 2014, we acquired the assets of CohuHD, the camera products and video solutions division of Cohu, Inc. CohuHD is a leading provider of video cameras and related products in critical infrastructure environments, specializing in IP video solutions for traffic monitoring, security, surveillance and military applications, and sells to a customer base that includes corporate end-users, state and federal government agencies, original equipment manufacturers, distributors, system integrators and value-added resellers. This has been a great strategic fit for us as we joined with one of the most well respected brands in the industry.

Our business strategy has been, and continues to be, focused on targeted accounts that have a low business acquisition cost. Several of our long-term customers are approaching the mean-time-to-failure of existing equipment and are increasing the rate of replacement. In addition, locations are being completely remodeled with new technology. In the years ahead, we should experience accelerating revenues from these long-term customers as they increase their remodel programs to keep up with their growth in existing locations and transition to a revenue model that is made up of new locations, service and store remodels.

We see signs of improving economic conditions every day but remain cautious. With an improved balance sheet and a strong team in place, we believe the Company has never been healthier or better poised for future growth.

Thank you for your continued support.

Sincerely,

James D. Pritchett
President and Chief Executive Officer

Cautionary Statement Regarding Forward Looking Statements

This document contains forward-looking statements that involve risks and uncertainties, as well as assumptions, that if they never materialize or prove incorrect, could cause the results of the Company to differ materially from those expressed or implied by such forward-looking statements. Forward-looking statements generally are identified by the words “expects,” “anticipates,” “believes,” “intends,” “estimates,” “should,” “would,” “will,” “strategy,” “potentially,” “plan” and similar expressions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements. The risks, uncertainties and assumptions include developments in the marketplace for our products, competition, related products and services and general economic conditions, as well as other risks and uncertainties. Accordingly, we cannot give assurance that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what impact they will have on the results of operations or financial condition of the Company.

DIRECTORS

Rory J. Cowan, *Chairman of the Board*
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COMPANY FINANCIAL INFORMATION

A Copy of our Annual Report is available upon request and will be mailed to you at no charge.
Please send requests to:

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It can also be downloaded from our website at www.costartechnologies.com.