

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT ACCOUNTANT'S REVIEW REPORT

June 30, 2018

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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Independent Accountant's Review Report

Board of Directors
Costar Technologies, Inc.
Coppell, Texas

We have reviewed the consolidated financial statements of Costar Technologies Inc. and its subsidiaries (collectively, the Company), which comprise the consolidated balance sheet as of June 30, 2018, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the three-month and six-month periods ended June 30, 2018.

Management's Responsibility

Management is responsible for the preparation and fair presentation of the financial information in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the financial information referred to above for it to be in accordance with accounting principles generally accepted in the United States of America.

Report on Consolidated Balance Sheet as of December 31, 2017

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, 2017, 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 April 9, 2018. In our opinion, the accompanying consolidated balance sheet of the Company as of December 31, 2017, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Report on the Consolidated Financial Statements for the three-month and six-month periods ended June 30, 2017

The consolidated statements of operations, changes in stockholders' equity, and cash flows of the Company for the three-month and six-month periods ended June 30, 2017, were reviewed by other accountants whose report dated August 15, 2017, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

Dallas, Texas
August 15, 2018

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	June 30, 2018 (Reviewed)	December 31, 2017 (Audited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 62	\$ 196
Accounts receivable, less allowance for doubtful accounts of \$669 and \$97 in 2018 and 2017, respectively	6,878	7,246
Inventories, net of reserve for obsolescence of \$1,057 and \$815 in 2018 and 2017, respectively	11,489	9,529
Prepaid expenses	1,911	790
Total current assets	<u>20,340</u>	<u>17,761</u>
Non-current assets		
Property and equipment, net	830	861
Deferred financing costs, net	20	26
Deferred tax asset, net	2,916	2,916
Trade names, net	2,498	2,667
Distribution agreement, net	587	624
Customer relationships, net	5,242	5,600
Covenant not to compete, net	109	126
Patents, net	6	7
Technology, net	369	402
Goodwill	5,574	5,574
Other non-current assets	109	96
Total non-current assets	<u>18,260</u>	<u>18,899</u>
Total assets	<u>\$ 38,600</u>	<u>\$ 36,660</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 4,130	\$ 3,829
Accrued expenses and other	2,232	2,532
Line of credit	2,983	
Current maturities of long-term debt	991	740
Contingent purchase price	606	346
Current maturities of notes payable, related party	779	753
Total current liabilities	<u>11,721</u>	<u>8,200</u>
Long-Term liabilities		
Long-term debt, net of current maturities	3,731	4,476
Contingent purchase price, net of current portion	502	1,101
Notes payable, related party, net of current maturities	409	805
Total long-term liabilities	<u>4,642</u>	<u>6,382</u>
Total liabilities	<u>16,363</u>	<u>14,582</u>
Stockholders' Equity		
Preferred stock		
Common stock	3	3
Additional paid-in capital	156,914	156,767
Accumulated deficit	(130,159)	(130,171)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	<u>22,237</u>	<u>22,078</u>
Total liabilities and stockholders' equity	<u>\$ 38,600</u>	<u>\$ 36,660</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(Reviewed)	(Reviewed)	(Reviewed)	(Reviewed)
Net revenues	\$ 11,987	\$ 10,282	\$ 22,904	\$ 19,853
Cost of revenues	<u>7,192</u>	<u>5,903</u>	<u>13,974</u>	<u>11,760</u>
Gross profit	4,795	4,379	8,930	8,093
Selling, general and administrative expenses	3,772	3,209	7,063	6,338
Engineering and development expense	853	671	1,542	1,315
Transaction and related expense	64		64	68
Change in fair value of contingent purchase price		184		184
	<u>4,689</u>	<u>4,064</u>	<u>8,669</u>	<u>7,905</u>
Income from operations	<u>106</u>	<u>315</u>	<u>261</u>	<u>188</u>
Other income (expenses)				
Interest expense	(103)	(124)	(192)	(247)
Other income (expense), net	(2)			3
Total other expenses, net	<u>(105)</u>	<u>(124)</u>	<u>(192)</u>	<u>(244)</u>
Income (loss) before taxes	1	191	69	(56)
Income tax provision (benefit)	<u>39</u>	<u>79</u>	<u>57</u>	<u>(9)</u>
Net income (loss)	<u>\$ (38)</u>	<u>\$ 112</u>	<u>\$ 12</u>	<u>\$ (47)</u>
Net income (loss) per share:				
Basic	\$ (0.02)	\$ 0.07	\$ 0.01	\$ (0.03)
Diluted	\$ (0.02)	\$ 0.07	\$ 0.01	\$ (0.03)
Weighted average shares outstanding				
Basic	1,546	1,509	1,546	1,509
Diluted	1,546	1,567	1,589	1,509

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Six Months Ended June 30, 2018 and 2017

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balances at December 31, 2016 (audited)	1,719	\$ 3	\$ 156,409	\$ (129,800)	226	\$ (4,521)	\$ 22,091
Net loss				(47)			(47)
Exercise of stock options	10		24				24
Stock based compensation	21		134				134
Balances at June 30, 2017 (reviewed)	1,750	\$ 3	\$ 156,567	\$ (129,847)	226	\$ (4,521)	\$ 22,202
Balances at December 31, 2017 (audited)	1,758	\$ 3	\$ 156,767	\$ (130,171)	226	\$ (4,521)	\$ 22,078
Net income				12			12
Exercise of stock options	6		35				35
Stock based compensation	21		112				112
Balances at June 30, 2018 (reviewed)	1,785	\$ 3	\$ 156,914	\$ (130,159)	226	\$ (4,521)	\$ 22,237

See independent accountant's review report and notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (AMOUNTS SHOWN IN THOUSANDS)

For the Six Months Ended June 30,	2018 (Reviewed)	2017 (Reviewed)
Cash flows from operating activities		
Net income (loss)	\$ 12	\$ (47)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Loss on asset disposal		10
Stock based compensation	112	134
Depreciation and amortization	788	748
Amortization of deferred financing costs	12	13
Provision for doubtful accounts	572	12
Provision for obsolete inventory	242	175
Change in fair value of contingent purchase price		184
Changes in operating assets and liabilities		
Accounts receivable, net	(204)	(1,055)
Inventories, net	(2,202)	(203)
Prepaid expenses	(1,121)	165
Other non-current assets	(13)	
Accounts payable	301	(483)
Accrued expenses and other	(300)	(1,052)
Net cash used in operating activities	<u>(1,801)</u>	<u>(1,399)</u>
Cash flows from investing activities		
Purchase of property and equipment	(145)	(141)
Refund of purchase price on the acquisition of Innotech		19
Proceeds from the sale of property and equipment	3	
Net cash used in investing activities	<u>(142)</u>	<u>(122)</u>
Cash flows from financing activities		
Payment of contingent purchase price	(339)	
Proceeds from line of credit	2,983	323
Proceeds from long-term debt		700
Repayment of long-term debt	(500)	(250)
Repayment of notes payable, related party	(370)	(345)
Exercise of stock options	35	24
Net cash provided by financing activities	<u>1,809</u>	<u>452</u>
Net decrease in cash and cash equivalents	(134)	(1,069)
Cash and cash equivalents, beginning of period	<u>196</u>	<u>1,083</u>
Cash and cash equivalents, end of period	<u>\$ 62</u>	<u>\$ 14</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 168</u>	<u>\$ 153</u>
Cash paid during the period for taxes	<u>\$ 105</u>	<u>\$ 32</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT ACCOUNTANT'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 subsidiary Innotech Security, Inc. ("Innotech"), LQ Corporation ("LQ") and CohuHD Costar, LLC ("CohuHD Costar") (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 as well as industrial vision products to observe repetitive production and assembly lines, thereby increasing efficiency by detecting faults in the production process. CohuHD Costar 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.

On December 29, 2016 Costar purchased Innotech, a value-added manufacturer of customized video, security surveillance systems and components for major U.S. retailers, restaurant chains and public venues requiring high quality, surveillance security (See Note 4).

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"), except that certain information and notes have been condensed or omitted, 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 should be read in conjunction with our consolidated financial statements for the year ended December 31, 2017. The accompanying unaudited financial statements reflect all adjustments that are in the opinion of the Company's management, necessary to fairly present the financial position, results of operations and cash flows of the Company. Those adjustments consist only of normal recurring adjustments. The results of operations for the period are not necessarily indicative of the results to be expected for the full year.

These consolidated financial statements were approved by management and available for issuance on August 15, 2018. Subsequent events have been evaluated through this date.

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 ACCOUNTANT'S REVIEW REPORT) (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

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, 2018 and December 31, 2017, the Company had \$62 and \$196 in 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 recorded on the first in first out basis and are stated at the lower of average cost, standard cost or net realizable value. A provision is made to reduce excess or obsolete inventories to their net realizable value. The reserve for inventory obsolescence was \$1,057 and \$815 as of June 30, 2018 and December 31, 2017, respectively. Inventories at June 30, 2018 and December 31, 2017 were comprised of the following:

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Parts, components, and materials	\$ 3,969	\$ 3,690
Work-in-process	39	195
Finished products	<u>7,481</u>	<u>5,644</u>
Total Inventory	<u>\$ 11,489</u>	<u>\$ 9,529</u>

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 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 ACCOUNTANT'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 an impairment test. There were no impairments recognized during the six month periods ending June 30, 2018 and 2017 or for the year ending December 31, 2017.

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. This accounting standard does not require any new 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 (See Note 5).

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 when the following criteria are met: there is evidence of an agreement; delivery has occurred; the selling price is fixed or determinable; and collectability is reasonably assured. The Company considers criteria to have been met 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.

Recent Accounting Pronouncements

In May 2017 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2017-09 (ASU 2017-09): Compensation – Stock Compensation which provides clarity and reduces both the diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation – Stock Compensation to a change to the terms or conditions of a share-based payment award. ASU 2017-09 is effective in fiscal years beginning after December 15, 2017. The Company adopted and applied ASU 2017-09 which did not have a material impact on the consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In January 2017 the FASB issued Accounting Standards Update No. 2017-04 (ASU 2017-04): Intangibles – Goodwill and Other, which eliminates step two from the annual goodwill impairment test. ASU 2017-04 is effective in fiscal years beginning after December 15, 2021. The Company is currently evaluating the impact of the pending adoption of ASU 2017-04 on the consolidated financial statements.

In August 2016 the FASB issued Accounting Standards Update No. 2016-15 (ASU 2016-15): Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, a consensus of the Emerging Issues Task Force. ASU 2016-15 provides guidance on how certain transactions are classified in the statement of cash flows. ASU 2016-15 clarifies the classification of debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments subsequent to a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate and bank-owned life insurance policies, distributions received from equity method investments, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle in the statement of cash flows. ASU 2016-15 requires retrospective application and is effective for financial statements issued for fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of the pending adoption of ASU 2016-15 on the consolidated financial statements.

In May 2016 the FASB issued Accounting Standards Update No. 2016-12 (ASU 2016-12): Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. In April 2016 the FASB issued Accounting Standards Update No. 2016-10 (ASU 2016-10): Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing. In March 2016 the FASB issued Accounting Standards Update No. 2016-08 (ASU 2016-08): Revenue from Contracts with Customers: Principal versus Agent Considerations. These amendments provide additional clarification and implementation guidance on the previously issued Accounting Standards Update No. 2014-09: Revenue from Contracts with Customers. ASU 2016-12 provides clarifying guidance on assessing collectability, noncash consideration, presentation of sales taxes and transition. ASU 2016-10 provides additional guidance on materiality of performance obligations, evaluating distinct performance obligations, treatment of shipping and handling costs and determining whether an entity's promise to grant a license provides a customer with either a right to use or access an entity's intellectual property. ASU 2016-08 clarifies how an entity should identify the specified good or service for the principal versus agent evaluation and how it should apply the control principle to certain types of arrangements. ASU 2016-10 and ASU 2016-08 are effective in connection with ASU 2014-09.

In March 2016 the FASB issued Accounting Standards Update No. 2016-09 (ASU 2016-09): Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting, effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. ASU 2016-09 simplifies several aspects of the stock compensation guidance including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows, expected term of awards and the intrinsic value election for liability-classified awards. The amendments in ASU 2016-09 are to be applied differently upon adoption with certain amendments being applied prospectively, retrospectively and under a modified retrospective transition method. The Company adopted and applied ASU 2016-09 during the year ended December 31, 2017 which did not have a material impact on the consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In February 2016 the FASB issued Accounting Standards Update No. 2016-02 (ASU 2016-02): Leases, effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-02 was issued in three parts: Section A, "Leases: Amendments to the FASB Accounting Standards Codification," Section B, "Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification," and Section C, "Background Information and Basis for Considerations." The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases. Other changes in the new guidance include: (a) defining initial direct costs to only include those incremental costs that would not have been incurred if the lease had not been entered into, (b) requiring related party leases to be accounted for based on their legally enforceable terms and conditions, (c) eliminating the additional requirements that must be applied today to leases involving real estate and (d) revising the circumstances under which the transfer contract in a sale-leaseback transaction should be accounted for as the sale of an asset by the seller-lessee and the purchase of an asset by the buyer-lessor. In addition, leases are subject to new disclosure requirements. The Company is currently evaluating the impact of the pending adoption of ASU 2016-02 on the consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11 (ASU 2015-11): Simplifying the Measurement of Inventory, effective for annual and interim periods beginning after December 15, 2016. ASU 2015-11 changes the inventory measurement principle for entities using the first-in, first out (FIFO) or average cost methods. For entities utilizing one of these methods, the inventory measurement principle will change from lower of cost or market to the lower of cost and net realizable value. The Company adopted and applied ASU 2015-11 during the year ended December 31, 2017 which did not have a material impact on the consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09 (ASU 2014-09): Revenue from Contracts with Customers (Topic 606), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity is expected to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each performance obligation. ASU 2014-09 is effective for the Company in the first quarter of fiscal year 2019, with early adoption permitted, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. The Company has selected the modified retrospective transition method and is currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

Research and Development

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

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 six months ended June 30, 2018 and 2017 the Company recognized \$112 and \$134 in stock based compensation expense in its consolidated financial statements relating to the issuance of stock options and stock awards, respectively (See Note 11).

The fair value of the stock options granted during the six month period ending June 30, 2017 was estimated on the date of grant using the Black-Scholes valuation model based on the following assumptions:

	Six Months Ended June 30, 2017
Expected dividend yield	0.00%
Expected stock price volatility	67.75%
Risk-free interest rate	2.00%
Expected life	10 years
Weighted-average fair value of options granted	\$7.44

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 attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted income per share reflects the dilution of common stock equivalents such as options to the extent the impact is dilutive. As the Company generated net income for the six month period ended June 30, 2018 and the three month period ended June 30, 2017 potentially dilutive securities have been included in the diluted net income per share computations and any potentially anti-dilutive shares have been excluded and are shown in the table below. As the Company incurred net loss for the three month period ended June 30, 2018 and the six month period ended June 30, 2017, potentially dilutive securities have been excluded from the diluted net loss per share computation, as their effect would be anti-dilutive.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (SEE INDEPENDENT ACCOUNTANT'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) (continued)

The following table reconciles the number of shares utilized in the net income (loss) per share calculations for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	\$ (38)	\$ 112	\$ 12	\$ (47)
Shares				
Weighted average shares outstanding - basic	1,546	1,509	1,546	1,509
Weighted average dilutive share equivalents from stock options		58	43	
Weighted average shares outstanding - diluted	1,546	1,567	1,589	1,509
Net income (loss) per share - basic	\$ (0.02)	\$ 0.07	\$ 0.01	\$ (0.03)
Net income (loss) per share - diluted	\$ (0.02)	\$ 0.07	\$ 0.01	\$ (0.03)

The number of potentially dilutive shares from stock options excluded from the diluted net income (loss) per share calculation as of June 30, 2018 and 2017 was 40 and 28, respectively.

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.

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 2014.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

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," "CohuHD Costar" 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), CohuHD Costar and Other. Costar Video Systems' products and services are largely used in retail security applications whereas CohuHD Costar'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 and six month periods ending June 30, 2018 and 2017 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Costar Video Systems	\$ 6,399	\$ 6,004	\$ 12,271	\$ 11,363
CohuHD Costar	5,588	4,278	10,633	8,490
	<u>\$ 11,987</u>	<u>\$ 10,282</u>	<u>\$ 22,904</u>	<u>\$ 19,853</u>
Net Income (Loss)				
Costar Video Systems	\$ 488	\$ 453	\$ 1,183	\$ 943
CohuHD Costar	192	323	261	239
Other	(718)	(664)	(1,432)	(1,229)
	<u>\$ (38)</u>	<u>\$ 112</u>	<u>\$ 12</u>	<u>\$ (47)</u>

Intercompany sales totaled \$29 and \$5 for the three months ending June 30, 2018 and 2017 and \$34 and \$20 for the six months ending June 30, 2018 and 2017 and have been eliminated upon consolidation.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

3. Segment Information (continued)

The following table reflects depreciation and amortization expense by business segment for the three and six month periods ending June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Depreciation				
Costar Video Systems	\$ 20	\$ 21	\$ 41	\$ 42
CohuHD Costar	66	38	132	71
	<u>\$ 86</u>	<u>\$ 59</u>	<u>\$ 173</u>	<u>\$ 113</u>
Amortization				
Costar Video Systems	\$ 227	\$ 237	\$ 454	\$ 474
CohuHD Costar	81	80	161	161
	<u>\$ 308</u>	<u>\$ 317</u>	<u>\$ 615</u>	<u>\$ 635</u>

Total assets and goodwill by business segment at June 30, 2018 and December 31, 2017 are as follows:

	June 30,	December 31,
	2018	2017
Total Assets		
Costar Video Systems	\$ 21,759	\$ 20,986
CohuHD Costar	12,670	11,992
Other	4,171	3,682
	<u>\$ 38,600</u>	<u>\$ 36,660</u>
Goodwill		
Costar Video Systems	\$ 3,511	\$ 3,511
CohuHD Costar	2,063	2,063
	<u>\$ 5,574</u>	<u>\$ 5,574</u>

4. Acquisition

Effective December 29, 2016, Costar completed the acquisition of Innotech (the "Acquisition"), a value-added manufacturer of customized video, security surveillance systems and components for major U.S. retailers, restaurant chains and public venues, pursuant to the transactions contemplated by the Share Purchase Agreement ("Purchase Agreement"), dated December 29, 2016, by and among Costar Technologies, Inc., Costar Video Systems, LLC, and the shareholders of Innotech Security, Inc. Results from operations for Innotech have been included in the Company's consolidated financial statements since December 29, 2016.

Total consideration for the Acquisition was approximately \$12,779, consisting of a cash payment of \$6,900, net of an estimated working capital holdback of \$100, assumption of \$2,500 in subordinated seller notes and deferred consideration of up to \$6,000 in cash, contingent upon Innotech Security achieving certain EBITDA targets. The fair value of the seller notes and deferred consideration was estimated to be \$2,260 and \$3,519 at December 31, 2016. During the second quarter of 2017 the estimated working capital holdback was settled for the final total of \$81 which resulted in the recognition of a measurement period adjustment to goodwill for \$19.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

4. Acquisition (continued)

The Company acquired Innotech to expand its footprint in the security and surveillance industry, cross-selling opportunities and its additive value to the Company's profits.

Certain expenses were incurred related to the Acquisition in the amount of \$68 for the six months ended June 30, 2017.

The Acquisition meets the definition of a business combination under GAAP. The following table presents a summary of the fair value of assets acquired and liabilities assumed as of December 29, 2016, including the measurement period adjustment recognized during the second quarter of 2017.

Assets acquired:	
Cash	\$ 713
Accounts receivable	513
Inventories	793
Property and equipment	9
Trade name	1,015
Customer relationships	5,762
Covenant not to compete	150
Patents	8
Technology	469
Goodwill	3,511
Total assets acquired	<u>12,943</u>
Liabilities assumed:	
Accounts payable	55
Accrued expenses	128
Total liabilities assumed	<u>183</u>
Total assets acquired and liabilities assumed, net	<u>\$ 12,760</u>

The gross contractual value of accounts receivable approximates the fair value of accounts receivable at the time of the transaction.

Goodwill arising from the acquisition consists primarily of assembled workforce and other intangible assets that do not qualify for separate recognition. The entire goodwill balance is expected to be deductible for tax purposes.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

5. Fair Value Measurements

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.

The Company applies the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1: Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.

Level 2: Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

Contingent Purchase Price

As of June 30, 2018 and December 31, 2017, the Company had obligations to transfer \$1,108 and \$1,447, respectively, in contingent purchase price to the prior shareholders of Innotech in conjunction with the Acquisition if specified future operational objectives are met over the next three years. The Company recorded the acquisition-date fair value of this liability, based on the likelihood of contingent earn-out payments, as part of the consideration transferred. The contingent purchase price is subsequently remeasured to fair value each reporting date. The Company classified the contingent purchase price liability as Level 3, due to the lack of relevant observable inputs and market activity.

Increases or decreases in the fair value of our contingent purchase price liability can result from changes in discount periods and rates, as well as changes in the timing and amount of revenue and EBITDA estimates. The contingent consideration fair market value was estimated using a Monte Carlo simulation. The recurring Level 3 fair value measurement of our contingent purchase price liability included the following unobservable inputs: management's EBITDA forecasts, risk-free interest rate based on the U.S. Treasury Strip rate and volatility based on the average of historical and implied asset volatilities of selected guideline public companies.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

5. Fair Value Measurements (continued)

Contingent Purchase Price (continued)

The following tables summarize financial liabilities measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

Description	As of June 30, 2018	Fair Value Measurement at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Contingent purchase price	\$ 1,108	\$	\$	\$ 1,108

Description	As of December 31, 2017	Fair Value Measurement at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Contingent purchase price	\$ 1,447	\$	\$	\$ 1,447

The following table reflects the activity for liabilities measured at fair value using Level 3 inputs for the six month period ending June 30, 2018:

Balance as of December 31, 2017	\$ 1,447
Issuances	
Payments	(339)
Related change in fair value	
Balance as of June 30, 2018	<u>\$ 1,108</u>

Related Party Notes Payable

As of June 30, 2018 and December 31, 2017 the Company had obligations to transfer \$1,188 and \$1,558 in notes payable to the prior shareholders of Innotech. The notes payable are due in 36 equal monthly installments commencing in January 2017. The Company recorded the acquisition-date fair value of this liability using a discounted cash flow model. The Company classified the related party notes payable liability as Level 3, due to the lack of relevant observable inputs and market activity. The significant unobservable input included in the Level 3 fair value was the discount rate of 2.8%.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

5. Fair Value Measurements (continued)

Related Party Notes Payable (continued)

Future payments on the related party notes are as follows:

Year Ending June 30,		
2019	\$	779
2020		<u>409</u>
	\$	<u>1,188</u>

6. Property and Equipment

Property and equipment at June 30, 2018 and December 31, 2017, were as follows:

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Furniture, equipment and leasehold improvements	\$ 1,837	\$ 1,704
Less accumulated depreciation	<u>(1,007)</u>	<u>(843)</u>
Total property and equipment, net	<u>\$ 830</u>	<u>\$ 861</u>

Depreciation expense for the three months ended June 30, 2018 and 2017 was \$86 and \$59 and for the six months ended June 30, 2018 and 2017 was \$173 and \$113, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

7. Intangible Assets

The following is a summary of amortized and unamortized intangible assets at June 30, 2018:

	June 30, 2018	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	881
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	947
Customer relationships - CohuHD	779	327
Covenant not to compete - CohuHD	20	16
Trade name - Innotech	1,015	152
Customer relations - Innotech	5,762	972
Covenant not to compete - Innotech	150	45
Technology - Innotech	469	100
Patents - Innotech	8	2
Total amortized intangible assets	<u>13,102</u>	<u>5,216</u>
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Total unamortized intangible assets	<u>6,499</u>	
Total intangible assets	<u>\$ 19,601</u>	<u>\$ 5,216</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

7. Intangible Assets (continued)

The following is a summary of amortized and unamortized intangible assets at December 31, 2017:

	December 31, 2017	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	844
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	828
Customer relationships - CohuHD	779	286
Covenant not to compete - CohuHD	20	14
Trade name - Innotech	1,015	102
Customer relations - Innotech	5,762	655
Covenant not to compete - Innotech	150	30
Technology - Innotech	469	67
Patents - Innotech	8	1
Total amortized intangible assets	13,102	4,601
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Total unamortized intangible assets	6,499	
Total intangible assets	\$ 19,601	\$ 4,601

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

Trade name	7 years
Customer relationships	6 and 10 years
Distribution agreements	20 years
Covenants not to compete	3 and 5 years

Amortization expense for the three months ended June 30, 2018 and 2017 was \$308 and \$317 and for the six months ended June 30, 2018 and 2017 was \$615 and \$635, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

7. Intangible Assets (continued)

Future amortization expense is as follows:

Year Ending June 30,	
2019	\$ 1,220
2020	1,197
2021	1,177
2022	907
2023	874
Thereafter	<u>2,511</u>
Total future amortization expense	<u>\$ 7,886</u>

8. Lines of Credit and Long-Term Debt

In connection with the acquisition of Innotech on December 29, 2016 the Company entered into an Installment Note Agreement, Master Revolving Note Agreement and Revolving Draw Note Agreement with Comerica Bank ("Comerica Agreements"). The Comerica Agreements allow for up to \$3,000 in a revolving line of credit under the Master Revolving Note Agreement, up to \$3,000 in advances under the Revolving Draw Note Agreement, both with maturities of December 30, 2019, and a \$7,000 term loan which matures on December 29, 2023. The term loan is payable in \$250 quarterly payments due the first business day following each quarter end, commencing in April 2017, with any unpaid principal and interest due at maturity. The obligations under the Comerica Agreements are secured by a lien on substantially all accounts receivable, inventory and equipment. As of June 30, 2018 the Company was paying interest at 4.07% for the term loan and revolving line of credit.

Future principal payments for the term loan and revolving draw note as of June 30, 2018, are as follows:

Year Ending June 30,	
2019	\$ 1,000
2020	1,000
2021	1,000
2022	1,000
2023	750
Less: deferred financing costs, net	<u>(28)</u>
	<u>\$ 4,722</u>

The Comerica Agreements contain 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 Comerica Agreements contain 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. As of June 30, 2018 and December 31, 2017, \$2,983 and \$0 was owed to Comerica Bank on the revolving line of credit, \$0 on the revolving draw note and \$4,750 and \$5,250 on the term loan, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

The Company paid approximately \$84 in various fees associated with securing the Comerica Agreements. The fees are treated as a deferred financing costs asset and will be amortized over the life of the accord using the straight-line method for the revolving line of credit portion and the effective-interest method for the term note portion.

9. Income Taxes

Total income tax expense (benefit) for the three months ended June 30, 2018 and 2017 was \$39 and \$79 and for the six months ended June 30, 2018 and 2017 was \$57 and (\$9), respectively. The Company's effective tax rate differs from the U.S. federal statutory tax rate due primarily to state income and franchise taxes.

10. Stockholders' Equity (shown in whole amounts)

At June 30, 2018 and December 31, 2017, 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, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, there were 1,559,191 and 1,531,791 and shares of common stock outstanding and 1,784,957 and 1,757,557 shares of common stock issued.

11. 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, 2018 and December 31, 2017, there were 87,066 and 95,466 share options issued under this plan.

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 June 30, 2018 and December 31, 2017 there were 24,000 share options issued under this plan.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

The following table summarizes information about stock options outstanding at June 30, 2018:

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
\$0.725-\$15.020	111,066	4.78	\$5.76	110,754	\$5.74

Stock option activity for the six months ended June 30, 2018 and 2017 is as follows:

	June 30, 2018		June 30, 2017	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	119,466	\$5.72	135,066	\$5.45
Granted			4,000	\$10.00
Exercised	(6,400)	\$5.41	(9,800)	\$2.50
Canceled	(2,000)	\$4.75		
Outstanding at period end	111,066	\$5.76	129,266	\$5.82
Options exercisable at period end	110,754	\$5.74	125,579	\$5.65

On June 1, 2016 a grant of 13,250 restricted stock awards ("2016 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2016 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, 2016 and 2017, as stated in the 2016 Awards Agreements. The 25% of the 2016 Awards not subject to performance conditions have a fair market grant date value of approximately \$28,000, with the expense recognized over the two year vesting period. The 2016 Awards subject to the performance conditions have a fair market grant date value of \$85,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$0 and \$28,300 was recognized in the Company's financial statements in relation to the 2016 Awards during the six month periods ending June 30, 2018 and 2017.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

On May 16, 2017 an additional grant of 21,000 restricted stock awards ("2017 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2017 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, 2017 and 2018, as stated in the 2017 Awards Agreements. The 25% of the 2017 Awards not subject to performance conditions have a fair market grant date value of approximately \$54,000, with the expense recognized over the two year vesting period. The 2017 Awards subject to the performance conditions have a fair market grant date value of \$161,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$53,800 was recognized in the Company's financial statements in relation to the 2017 Awards during the six month periods ending June 30, 2018 and 2017.

On March 23, 2018 an additional grant of 21,000 restricted stock awards ("2018 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2018 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, 2018 and 2019, as stated in the 2018 Awards Agreements. The 25% of the 2018 Awards not subject to performance conditions have a fair market grant date value of approximately \$45,000, with the expense recognized over the two year vesting period. The 2018 Awards subject to the performance conditions have a fair market grant date value of \$135,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$45,200 was recognized in the Company's financial statements in relation to the 2018 Awards during the six month period ending June 30, 2018.

During the six months ended June 30, 2018 and 2017 the Company recognized approximately \$112,000 and \$134,000 in stock based compensation expense in its consolidated financial statements, respectively.

12. Lease Agreements and Related Party Transactions

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 three months ended June 30, 2018 and 2017 was approximately \$26 and for the six months ended June 30, 2018 and 2017 was approximately \$52, respectively. On June 11, 2018 the Company entered into a lease amendment to extend the term of this lease through November 2025.

On May 20, 2016 the Company signed a seventy-eight month lease for the new CohuHD Costar facilities which commenced in December 2016 and will expire in 2023. Rent expense under the agreement for the three month periods ending June 30, 2018 and 2017 was \$85 and \$81 and \$171 and \$168 for the six month periods ending June 30, 2018 and 2017, respectively.

On December 29, 2016 the Company signed a three-year lease with a related party for the Innotech facilities which commenced on January 1, 2017. Rent expense under the agreement for the three and six month periods ending June 30, 2018 and 2017 was \$26 and \$52, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

12. Lease Agreements and Related Party Transactions (continued)

Future minimum annual rent payments as of June 30, 2018 are approximately as follows:

Year Ending June 30,	3rd Party	Related Party	Total
2019	\$ 470	\$ 107	\$ 577
2020	511	54	565
2021	526		526
2022	542		542
2023	527		527
Thereafter	457		457
Total future minimum lease commitments	<u>\$ 3,033</u>	<u>\$ 161</u>	<u>\$ 3,194</u>

13. 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 six months ended June 30, 2018 and 2017 the Costar Video Systems operating segment's largest customer, ADT, accounted for approximately \$3,068 or 13.4% and \$2,739 or 13.8% of the Company's total revenue. Amounts owed by Costar Video Systems operating segment's largest customer accounted for \$674 or 9.8% of the Company's outstanding receivable balance as of June 30, 2018 and \$1,098 or 15.2% as of December 31, 2017.

Concentration of Suppliers

For the six months ended June 30, 2018 and 2017 the Company made purchases from one main supplier of the Costar Video Systems' operating segment of approximately 15.1% and 28.8%, respectively. Amounts owed to one main supplier of the Costar Video Systems' operating segment accounted for 33.8% and 22.9% of the Company's accounts payable balance as of June 30, 2018 and December 31, 2017, respectively.

13. Subsequent Events

In July 2018 the Company entered into a funding agreement with UMB Bank to provide up to \$23.5M, which extinguished its previous debt facility with Comerica and provided funding to acquire the assets of Arecont Vision. The acquisition closed on July 13, 2018 with a purchase price of approximately \$12M in cash net of a working capital adjustment, subject to certain post-closing adjustments as set forth in the definitive agreement. During the three months ended June 30, 2018 the Company incurred \$64 in expenses relating to the transaction.