

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT ACCOUNTANT'S REVIEW REPORT

September 30, 2019

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 consolidated financial statements of Costar Technologies, Inc. and its subsidiaries (collectively, the Company), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statements of operations for the three-month and nine-month periods ended September 30, 2019 and 2018, and the related changes in stockholders' equity and cash flows for the nine-month periods ended September 30, 2019 and 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, except for the issue noted in the Known Departure from Accounting Principles Generally Accepted in the United States of America paragraph, 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.

Known Departure From Accounting Principles Generally Accepted in the United States of America

The Company is considered a public business entity (PBE), which requires the adoption of ASU 2016-02, Leases (Topic 842) by the Company effective January 1, 2019. This standard requires the Company to record its right-of-use assets on its balance sheet, as well as the ongoing lease liability related to these right-of-use assets. Company management is currently evaluating the effects of this adoption on the Company's consolidated financial statements and anticipates adoption of this standard in its December 31, 2019 audited financials.

Report on Consolidated Balance Sheet as of December 31, 2018

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, 2018, 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 May 31, 2019. In our opinion, the accompanying consolidated balance sheet of the Company as of December 31, 2018, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

BKD, LLP

Dallas, Texas
November 14, 2019

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	September 30, 2019 (Reviewed)	December 31, 2018 (Audited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1	\$ 189
Accounts receivable, less allowance for doubtful accounts of \$570 and \$859 in 2019 and 2018, respectively	9,250	9,333
Inventories, net of reserve for obsolescence of \$1,026 and \$1,101 in 2019 and 2018, respectively	20,525	20,618
Prepaid expenses and other current assets	2,573	1,531
Total current assets	<u>32,349</u>	<u>31,671</u>
Non-current assets		
Property and equipment, net	991	915
Deferred financing costs, net	69	99
Deferred tax asset, net	3,766	3,766
Trade names, net	2,289	2,561
Distribution agreements, net	827	905
Customer relationships, net	4,361	4,884
Covenants not to compete, net	68	92
Patents, net	177	200
Technology, net	285	335
Goodwill	6,513	6,513
Other non-current assets	149	109
Total non-current assets	<u>19,495</u>	<u>20,379</u>
Total assets	<u>\$ 51,844</u>	<u>\$ 52,050</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 4,885	\$ 5,786
Accrued expenses and other	7,026	7,075
Line of credit	14,772	11,738
Current maturities of long-term debt, net of unamortized financing fees	779	773
Current portion of contingent purchase price	992	1,048
Current maturities of notes payable, unrelated party	833	
Current maturities of notes payable, related party	206	805
Total current liabilities	<u>29,493</u>	<u>27,225</u>
Long-Term liabilities		
Long-term debt, net of current maturities and unamortized financing fees	3,788	4,373
Contingent purchase price, net of current portion		992
Total long-term liabilities	<u>3,788</u>	<u>5,365</u>
Total liabilities	<u>33,281</u>	<u>32,590</u>
Stockholders' Equity		
Preferred stock		
Common stock	3	3
Additional paid-in capital	157,363	157,029
Accumulated deficit	(134,282)	(133,051)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	<u>18,563</u>	<u>19,460</u>
Total liabilities and stockholders' equity	<u>\$ 51,844</u>	<u>\$ 52,050</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Reviewed)	(Reviewed)	(Reviewed)	(Reviewed)
Net revenues	\$ 17,774	\$ 18,960	\$ 52,588	\$ 41,864
Cost of revenues	10,054	11,426	31,527	25,400
Gross profit	7,720	7,534	21,061	16,464
Selling, general and administrative expenses	4,821	5,264	17,358	12,327
Engineering and development expense	1,462	1,204	4,411	2,746
Transaction and related expense		243		307
	6,283	6,711	21,769	15,380
Income (loss) from operations	1,437	823	(708)	1,084
Other expenses				
Interest expense	(350)	(329)	(1,006)	(521)
Other income (expense), net	8	(414)	9	(414)
Total other expenses, net	(342)	(743)	(997)	(935)
Income (loss) before taxes	1,095	80	(1,705)	149
Income tax provision (benefit)	255	24	(474)	81
Net income (loss)	\$ 840	\$ 56	\$ (1,231)	\$ 68
<u>Net income (loss) per share:</u>				
Basic	\$ 0.53	\$ 0.04	\$ (0.78)	\$ 0.04
Diluted	\$ 0.51	\$ 0.04	\$ (0.78)	\$ 0.04
<u>Weighted average shares outstanding:</u>				
Basic	1,597	1,546	1,576	1,546
Diluted	1,633	1,600	1,576	1,600

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Nine Months Ended September 30, 2019 and 2018

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Treasury Stock</u>		<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			<u>Shares</u>	<u>Amount</u>	
Balances at December 31, 2017 (audited)	1,758	\$ 3	\$ 156,767	\$ (130,171)	226	\$ (4,521)	\$ 22,078
Net income				68			68
Exercise of stock options	6		35				35
Stock based compensation	21		178				178
Balances at September 30, 2018 (reviewed)	1,785	\$ 3	\$ 156,980	\$ (130,103)	226	\$ (4,521)	\$ 22,359
Balances at December 31, 2018 (audited)	1,777	\$ 3	\$ 157,029	\$ (133,051)	226	\$ (4,521)	\$ 19,460
Net loss				(1,231)			(1,231)
Exercise of stock options	19		37				37
Stock based compensation	30		297				297
Balances at September 30, 2019 (reviewed)	1,826	\$ 3	\$ 157,363	\$ (134,282)	226	\$ (4,521)	\$ 18,563

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (AMOUNTS SHOWN IN THOUSANDS)

For the Nine Months Ended September 30,	2019	2018
	(Reviewed)	(Reviewed)
Cash flows from operating activities		
Net income (loss)	\$ (1,231)	\$ 68
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Loss on asset disposal	2	
Stock based compensation	297	178
Depreciation and amortization	1,306	1,220
Amortization of deferred financing costs	42	75
Provision for doubtful accounts	(289)	544
Provision for obsolete inventory	(75)	302
Changes in operating assets and liabilities, net of effect of acquisition		
Accounts receivable, net	372	(3,075)
Inventories, net	168	(2,501)
Prepaid expenses and other current assets	(1,042)	481
Other non-current assets	(40)	377
Accounts payable	(901)	(805)
Accrued expenses and other	(49)	50
Net cash used in operating activities	<u>(1,440)</u>	<u>(3,086)</u>
Cash flows from investing activities		
Purchase of property and equipment	(413)	(151)
Proceeds from the sale of property and equipment		3
Acquisition of Arecont Vision Costar		(11,647)
Net cash used in investing activities	<u>(413)</u>	<u>(11,795)</u>
Cash flows from financing activities		
Payment of contingent purchase price	(1,048)	(339)
Deferred financing costs		(154)
Proceeds from line of credit, net	3,034	15,589
Proceeds from long-term debt		5,500
Proceeds from note payable, unrelated party, net	833	
Payment of long-term debt	(592)	(5,381)
Payment of notes payable, related party	(599)	(491)
Exercise of stock options	37	35
Net cash provided by financing activities	<u>1,665</u>	<u>14,759</u>
Net change in cash and cash equivalents	(188)	(122)
Cash and cash equivalents, beginning of period	189	196
Cash and cash equivalents, end of period	<u>\$ 1</u>	<u>\$ 74</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 942</u>	<u>\$ 599</u>
Cash paid during the period for taxes	<u>\$ 143</u>	<u>\$ 105</u>

See notes to consolidated financial statements.

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 subsidiaries Innotech Security, Inc. ("Innotech") and Arecont Vision Costar, LLC ("Arecont Vision"), 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, high speed domes and industrial vision products. 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 July 13, 2018, Costar acquired the assets of Arecont Vision, a manufacturer of network cameras and megapixel surveillance cameras, offering a large selection of megapixel IP cameras.

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 November 14, 2019. 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.

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 September 30, 2019 and December 31, 2018, the Company had \$1 and \$189 in cash and cash equivalents, respectively.

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)

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 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 \$1,026 and \$1,101 as of September 30, 2019 and December 31, 2018, respectively. Inventories at September 30, 2019 and December 31, 2018 were comprised of the following:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
Parts, components, and materials	\$ 4,313	\$ 9,165
Work-in-process	3	1,475
Finished products	<u>16,209</u>	<u>9,978</u>
Total Inventory	<u>\$ 20,525</u>	<u>\$ 20,618</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 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.

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.

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)

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 three and nine month periods ended September 30, 2019 and 2018, and the year ended December 31, 2018.

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 (See Note 5).

Revenue Recognition

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.

Revenue includes certain shipping and handling costs and is stated net of third party agency fees. 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 payments terms, but occasionally offers extended terms. Our products are sold with warranty provisions that require us 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. Provisions for estimated losses on sales or related receivables are recorded when identified.

The adoption of Topic 606, see Recent Accounting Pronouncements below, did not have a material effect on the consolidated statements of operations during the three and nine month periods ended September 30, 2019.

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

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. The Company adopted ASU 2016-12 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, 2019, 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 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 adopted this standard using a modified retrospective approach with the cumulative effect of initially applying the new standard recognized in retained earnings at the beginning of the year of adoption. The Company has applied the new standard to all contracts. The Company's adoption of ASC 606 did not result in a change to the timing of revenue recognition.

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 nine months ended September 30, 2019 and 2018, the Company recognized \$297 and \$178 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 nine month period ended September 30, 2019 was estimated on the date of grant using the Black-Scholes valuation model based on the following assumptions:

	Nine Months Ended September 30, 2019
Expected dividend yield	0.00%
Expected stock price volatility	64.25% - 65.72%
Risk-free interest rate	1.49% - 2.67%
Expected life	10 years
Weighted-average fair value of options granted	\$6.68 - \$7.59

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 nine month period ending September 30, 2019, potentially dilutive securities have been excluded from the diluted net loss per share computation as their effect would be anti-dilutive. As the Company incurred net income for the three month periods ended September 30, 2019 and 2018 and the nine month period ended September 30, 2018, potentially dilutive securities have been included in the diluted net income per share computation.

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 nine month periods ended September 30, 2019 and 2018:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income (loss)	\$ 840	\$ 56	\$ (1,231)	\$ 68
Shares				
Weighted average shares outstanding - basic	1,597	1,546	1,576	1,546
Weighted average dilutive share equivalents from stock options	36	54		54
Weighted average shares outstanding - diluted	1,633	1,600	1,576	1,600
Net income (loss) per share - basic	\$ 0.53	\$ 0.04	\$ (0.78)	\$ 0.04
Net income (loss) per share - diluted	\$ 0.51	\$ 0.04	\$ (0.78)	\$ 0.04

The number of potentially dilutive shares from stock options excluded from the diluted net income (loss) per share calculation as of September 30, 2019 and 2018 was 68 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 2015.

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 and Arecont Vision Costar), 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 nine month periods ending September 30, 2019 and 2018, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenues				
Costar Video Systems	\$ 13,766	\$ 14,366	\$ 39,967	\$ 26,637
CohuHD Costar	4,008	4,594	12,621	15,227
	<u>\$ 17,774</u>	<u>\$ 18,960</u>	<u>\$ 52,588</u>	<u>\$ 41,864</u>
Net Income (Loss)				
Costar Video Systems	\$ 2,211	\$ 1,153	\$ 1,941	\$ 2,336
CohuHD Costar	(244)	(26)	(878)	235
Other	(1,127)	(1,071)	(2,294)	(2,503)
	<u>\$ 840</u>	<u>\$ 56</u>	<u>\$ (1,231)</u>	<u>\$ 68</u>

Intercompany sales totaled \$13 and \$12 for the three month periods ending September 30, 2019 and 2018, and \$74 and \$46 for the nine month periods ending September 30, 2019 and 2018, respectively, 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 nine month periods ending September 30, 2019 and 2018:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Depreciation				
Costar Video Systems	\$ 67	\$ 44	\$ 166	\$ 85
CohuHD Costar	51	64	169	196
	<u>\$ 118</u>	<u>\$ 108</u>	<u>\$ 335</u>	<u>\$ 281</u>
Amortization				
Costar Video Systems	\$ 244	\$ 245	\$ 732	\$ 699
CohuHD Costar	79	79	239	240
	<u>\$ 323</u>	<u>\$ 324</u>	<u>\$ 971</u>	<u>\$ 939</u>

Total assets and goodwill by business segment at September 30, 2019 and December 31, 2018, are as follows:

	September 30, 2019		December 31, 2018	
Total Assets				
Costar Video Systems	\$ 33,471	\$ 35,747		
CohuHD Costar	5,198	12,006		
Other	13,175	4,297		
	<u>\$ 51,844</u>	<u>\$ 52,050</u>		
Goodwill				
Costar Video Systems	\$ 4,450	\$ 4,450		
CohuHD Costar	2,063	2,063		
	<u>\$ 6,513</u>	<u>\$ 6,513</u>		

4. Acquisition

Effective July 13, 2018, Costar completed the acquisition of Arecont Vision (the "Arecont Acquisition"), a manufacturer of network cameras and megapixel surveillance cameras pursuant to the terms of the Asset Purchase Agreement dated June 29, 2018 and subsequent amendment dated July 9, 2018. Results from operations for Arecont Vision have been included in the Company's consolidated financial statements beginning July 14, 2018.

Total consideration for the Arecont Acquisition was approximately \$11,647 consisting of an initial cash deposit of \$1,125 and additional cash payments of \$10,522 upon closing. The Company acquired Arecont Vision to expand its footprint in the security and surveillance industry, cross-selling opportunities, expansion of its product portfolio and its additive value to the Company's future profits.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

4. Acquisition (continued)

The Arecont Acquisition meets the definition of a business combination under GAAP. The following table presents a summary of the fair value of the assets acquired and liabilities assumed as of July 13, 2018.

Assets acquired:	
Accounts receivable	\$ 4,260
Inventories	9,826
Prepaid expenses	1,178
Property and equipment	126
Trade name	243
Distribution agreements	370
Patents	208
Goodwill	939
Other assets	390
Total assets acquired	<u>17,540</u>
Liabilities assumed:	
Accounts payable	2,005
Accrued expenses	3,888
Total liabilities assumed	<u>5,893</u>
Total assets acquired and liabilities assumed, net	<u>\$ 11,647</u>

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

The weighted average amortization period for the acquired amortizable intangible assets is 9 years.

Goodwill arising from the Arecont 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.

Included in the consolidated statements of operations are Arecont Vision revenues of \$6,308 and \$18,817 and net income (loss) of \$981 and (\$1,388) for the three and nine month periods ending September 30, 2019, respectively. The following pro forma information gives effect to the acquisition as if it had occurred on the first day of each of the three and nine month periods ending September 30, 2019 and September 30, 2018:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Total revenue	\$ 17,774	\$ 19,480	\$ 52,588	\$ 59,127
Pre-tax income (loss)	\$ 1,095	\$ (2,459)	\$ (1,705)	\$ (11,252)

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 September 30, 2019 and December 31, 2018, the Company had obligations to transfer \$992 and \$2,040, 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 years 2017 through 2019. 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 table summarizes financial liabilities measured at fair value on a recurring basis as of September 30, 2019 and December 31, 2018, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

<u>Description</u>	<u>As of September 30, 2019</u>	<u>Fair Value Measurement at Reporting Date Using</u>		
		<u>Quoted Prices in</u> <u>Active Markets</u> <u>for Identical</u> <u>Assets (Level 1)</u>	<u>Significant Other</u> <u>Observable</u> <u>Inputs (Level 2)</u>	<u>Significant</u> <u>Unobservable</u> <u>Inputs (Level 3)</u>
Liabilities:				
Contingent purchase price	\$ 992	\$	\$	\$ 992

<u>Description</u>	<u>As of December 31, 2018</u>	<u>Fair Value Measurement at Reporting Date Using</u>		
		<u>Quoted Prices in</u> <u>Active Markets</u> <u>for Identical</u> <u>Assets (Level 1)</u>	<u>Significant Other</u> <u>Observable</u> <u>Inputs (Level 2)</u>	<u>Significant</u> <u>Unobservable</u> <u>Inputs (Level 3)</u>
Liabilities:				
Contingent purchase price	\$ 2,040	\$	\$	\$ 2,040

The following table reflects the activity for liabilities measured at fair value using Level 3 inputs for the nine month period ended September 30, 2019:

Balance as of December 31, 2018	\$ 2,040
Issuances	
Payments	(1,048)
Related change in fair value	
Balance as of September 30, 2019	<u>\$ 992</u>

Related Party Notes Payable

As of September 30, 2019 and December 31, 2018, the Company had obligations to transfer \$206 and \$805, respectively, in notes payable to the prior shareholders of Innotech. The notes payable are due in equal monthly installments. 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 September 30,		
2020	\$	206
		<u>206</u>
	\$	<u>206</u>

6. Property and Equipment

Property and equipment at September 30, 2019 and December 31, 2018, are as follows:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
Furniture, equipment and leasehold improvements	\$ 2,512	\$ 2,144
Less accumulated depreciation	<u>(1,521)</u>	<u>(1,229)</u>
Total property and equipment, net	<u>\$ 991</u>	<u>\$ 915</u>

Depreciation expense for the three month periods ending September 30, 2019 and 2018 was \$118 and \$108, and for the nine month periods ending September 30, 2019 and 2018 was \$335 and \$281, 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 September 30, 2019:

	September 30, 2019	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	973
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	1,243
Customer relationships - CohuHD	779	427
Covenant not to compete - CohuHD	20	20
Trade name - Innotech	1,015	279
Customer relations - Innotech	5,762	1,753
Covenant not to compete - Innotech	150	82
Technology - Innotech	469	184
Patents - Innotech	8	3
Trade name - Arecont Vision Costar	243	29
Distribution agreement - Arecont Vision Costar	370	38
Patents - Arecont Vision Costar	208	36
Total amortized intangible assets	13,923	6,841
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Goodwill - Arecont Vision Costar	939	
Total unamortized intangible assets	7,438	
Total intangible assets	\$ 21,361	\$ 6,841

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, 2018:

	December 31, 2018	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	917
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	1,065
Customer relationships - CohuHD	779	367
Covenant not to compete - CohuHD	20	18
Trade name - Innotech	1,015	203
Customer relations - Innotech	5,762	1,290
Covenant not to compete - Innotech	150	60
Technology - Innotech	469	134
Patents - Innotech	8	2
Trade name - Arecont Vision Costar	243	11
Distribution agreement - Arecont Vision Costar	370	16
Patents - Arecont Vision Costar	208	14
Total amortized intangible assets	13,923	5,871
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Goodwill - Arecont Vision Costar	939	
Total unamortized intangible assets	7,438	
Total intangible assets	\$ 21,361	\$ 5,871

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 and patents	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 month periods ended September 30, 2019 and 2018 was \$323 and \$324, and for the nine month periods ended September 30, 2019 and 2018 was \$971 and \$939, 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 September 30,		
2020	\$	1,277
2021		1,200
2022		983
2023		959
2024		874
Thereafter		<u>1,789</u>
Total future amortization expense	\$	<u>7,082</u>

8. Lines of Credit and Long-Term Debt

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.

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 mature on July 6, 2021. The term loan is payable in \$66 monthly payments due on the first of the month with the remaining balance due at maturity. Obligations under the Comerica Agreements were extinguished upon entering into the Loan Agreement. 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. As of September 30, 2019, the Company was in compliance with its debt covenants and paying interest at 5.85% for the term loan and revolving line of credit.

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)

Future principal payments for the term loan as of September 30, 2019, are as follows:

Year Ending September 30,	
2020	\$ 789
2021	789
2022	3,002
Less: deferred financing costs, net	<u>(13)</u>
	<u>\$ 4,567</u>

On June 28, 2019 the Company executed a Promissory Note with UMB Bank for \$1,000 which matures on June 28, 2020. The Promissory Note is payable in \$83 monthly payments due on the first of the month with the remaining balance due at maturity. As of September 30, 2019, the Company owed \$833 on the note and was paying interest at 7.10%

As of September 30, 2019 and December 31, 2018, \$14,772 and \$11,738 was owed to UMB Bank on the revolving line of credit, \$4,580 and \$5,171 on the term loan, and \$833 and \$0 on the Promissory Note, respectively.

The Company paid approximately \$154 in various fees associated with securing the UMB Loan Agreement. The fees are treated as a deferred financing costs asset and will be 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.

9. Income Taxes (Benefit)

Total income tax expense (benefit) for the three months ended September 30, 2019 and 2018 was \$255 and \$24, and (\$474) and \$81 for the nine months ended September 30, 2019 and 2018, 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 September 30, 2019 and December 31, 2018, 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 September 30, 2019 and December 31, 2018, 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 September 30, 2019 and December 31, 2018, there were 1,600,316 and 1,551,316 and shares of common stock outstanding and 1,826,082 and 1,777,082 shares of common stock issued.

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)

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 September 30, 2019 and December 31, 2018, there were 68,066 and 87,066 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. As of September 30, 2019 and December 31, 2018, there were 72,000 and 36,000 share options issued under this plan, respectively.

The following table summarizes information about stock options outstanding at September 30, 2019:

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
\$1.050-\$15.020	140,066	5.99	\$7.83	140,066	\$7.83

Stock option activity for the nine month periods ended September 30, 2019 and 2018, is as follows:

	September 30, 2019		September 30, 2018	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	123,066	\$6.27	119,466	\$5.72
Granted	36,000	\$10.05		
Exercised	(19,000)	\$1.96	(6,400)	\$5.41
Canceled			(2,000)	\$4.75
Outstanding at period end	140,066	\$7.83	111,066	\$5.76
Options exercisable at period end	140,066	\$7.83	111,066	\$5.76
Weighted average fair value of options granted during the period at fair value		\$7.29		

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 \$0 and \$80,700 was recognized in the Company's financial statements in relation to the 2017 Awards during the nine month period ending September 30, 2019 and 2018, respectively.

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 \$16,900 and \$84,700 was recognized in the Company's financial statements in relation to the 2018 Awards during the nine month periods ending September 30, 2019 and 2018, respectively.

On June 20, 2019, an additional grant of 23,000 restricted stock awards and 7,000 on July 26, 2019 ("2019 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2019 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, 2019 and 2020, as stated in the 2019 Awards Agreements. The 25% of the 2019 Awards not subject to performance conditions have a fair market grant date value of approximately \$63,000, with the expense recognized over the two year vesting period. The 2019 Awards subject to the performance conditions have a fair market grant date value of \$190,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$17,800 was recognized in the Company's financial statements in relation to the 2019 Awards during the nine month period ending September 30, 2019.

During the nine month periods ended September 30, 2019 and 2018, the Company recognized approximately \$297,000 and \$178,000 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 originally expired in 2018. On June 11, 2018, the Company entered into a lease amendment to extend the term of this lease through November 2025. Rent expense under the agreement for the three month periods ended September 30, 2019 and 2018 was approximately \$44 and \$26, and \$132 and \$78 for the nine month periods ending September 30, 2019 and 2018, 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)

On May 20, 2016, the Company signed a seventy-eight month lease for the new CohuHD Costar facilities which commenced in December 2016 and expires in 2023. Rent expense under the agreement for the three month periods ending September 30, 2019 and 2018 was \$85, and \$255 and \$254 for the nine month periods ending September 30, 2019 and 2018, respectively.

On December 29, 2016, the Company signed a three-year lease with a related party, a member of Innotech management, for the Innotech facilities which commenced on January 1, 2017. Rent expense under the agreement for the three month periods ending September 30, 2019 and 2018 was \$26, and \$78 for the nine month periods ending September 30, 2019 and 2018, respectively.

In connection with the acquisition of Arecont Vision the Company entered into a license agreement for certain facilities that expires in February 2019. Rent expense under the agreement was \$0 and \$318 for the three and nine month periods ended September 30, 2019, respectively.

On February 19, 2019, the Company signed a lease agreement for the Arecont Vision Costar corporate headquarters which commenced on March 1, 2019. The lease is for two suites with one and three-year terms. Rent expense under the agreement was \$31 and \$98 for the three and nine month periods ended September 30, 2019, respectively.

On February 21, 2019, the Company signed a three-year lease agreement for the Arecont Vision Costar satellite office which commenced on March 1, 2019. Rent expense under the agreement was \$14 and \$33 for the three and nine month periods ended September 30, 2019, respectively.

On February 26, 2019, the Company signed a thirty-eight month lease for the Arecont Vision Costar production facility which commenced on March 1, 2019. Rent expense under the agreement was \$46 and \$107 for the three and nine month periods ended September 30, 2019, respectively.

Future minimum annual rent payments as of September 30, 2019, are approximately as follows:

Year Ending September 30,	3rd Party	Related Party	Total
2020	\$ 941	\$ 27	\$ 968
2021	934		934
2022	750		750
2023	435		435
2024	186		186
Thereafter	225		225
Total future minimum lease commitments	\$ 3,471	\$ 27	\$ 3,498

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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 nine month periods ended September 30, 2019 and 2018, the Costar Video Systems' operating segment's largest customer, ADT, accounted for approximately \$6,939 or 13.2% and \$5,028 or 12.0% of the Company's total revenue, respectively. Amounts owed by Costar Video Systems' operating segment's one main customer accounted for \$933 or 10.1% of the Company's outstanding receivables balances as of September 30, 2019, and two customers accounted for \$2,359 or 25.3% of the Company's outstanding receivable balance as of December 31, 2018.

Concentration of Suppliers

For the nine month periods ended September 30, 2019 and 2018, the Company made purchases from one main supplier of the Costar Video Systems' operating segment of approximately 13.6% and 12.5%, respectively. Amounts owed to one main supplier of the Costar Video Systems' operating segment accounted for 32.3% of the Company's accounts payable balance as of September 30, 2019. Amounts owed to two main suppliers of the Costar Video Systems' operating segment accounted for 42.2% of the Company's accounts payable balance as of December 31, 2018.