COSTAR TECHNOLOGIES, INC.
AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REVIEW REPORT

September 30, 2021

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONTENTS

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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, 2021, and the related consolidated statements of operations for the three-month and nine-month periods ended September 30, 2021 and 2020 and the consolidated statements of changes in stockholders' equity and cash flows for the nine-month periods ended September 30, 2021 and 2020.

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, 2020

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, 2020, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 29, 2021. In our opinion, the accompanying consolidated balance sheet of the Company as of December 31, 2020, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Emphasis of Matter

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in *Note 2,* the Company entered into a Forbearance Agreement with its bank in July 2021, which extended the forbearance period through February 2022. Management's plans in regard to these matters are also described in *Note 2*. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

BKD, LLP

Dallas, Texas
November 15, 2021

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(AMOUNTS SHOWN IN THOUSANDS)

	September 30 2021 (Reviewed)	December 31, 2020 (Audited)
ASSETS		
Current assets		
Cash and cash equivalents	$ 5	$ 480
Accounts receivable, less allowance for doubtful accounts of $217 and $175, respectively	6,581	8,579
Inventories	13,889	14,225
Prepaid expenses and other current assets	3,829	2,170
Total current assets	24,304	25,454
Non-current assets		
Property and equipment, net	238	533
Deferred financing costs, net		20
Intangible assets, net	5,529	6,411
Goodwill	5,574	5,574
Right of use assets, net	1,461	2,185
Other non-current assets	109	149
Total non-current assets	12,911	14,872
Total assets	$ 37,215	$ 40,326
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 6,204	$ 4,591
Accrued expenses and other current liabilities	3,819	5,141
Line of credit	9,502	13,024
Current maturities of long-term debt, net of unamortized financing fees	3,003	3,592
Current maturities of lease liabilities	843	1,049
Total current liabilities	23,371	27,397
Long-Term liabilities		
Payroll Protection Program loan		3,025
Deferred tax liability	116	116
Non-current maturities of lease liabilities	764	1,340
Total long-term liabilities	880	4,481
Total liabilities	24,251	31,878
Stockholders' Equity		
Preferred stock		
Common stock	3	3
Additional paid-in capital	157,775	157,686
Accumulated deficit	(140,293)	(144,720)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	12,964	8,448
Total liabilities and stockholders' equity	$ 37,215	$ 40,326

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
	(Reviewed)	(Reviewed)	(Reviewed)	(Reviewed)
Net revenues	$ 12,646	$ 15,727	$ 38,145	$ 47,395
Cost of revenues	8,789	12,917	25,479	32,449
Gross profit	3,857	2,810	12,666	14,946
Selling, general and administrative expenses	3,413	4,065	10,778	13,448
Engineering and development expense	739	997	2,357	3,552
Restructuring costs				635
Impairment loss		939		939
	4,152	6,001	13,135	18,574
Loss from operations	(295)	(3,191)	(469)	(3,628)
Other income (expenses)				
Interest expense	(240)	(205)	(740)	(703)
Other income, net	883		5,687	1
Total other income (expenses), net	643	(205)	4,947	(702)
Income (loss) before taxes	348	(3,396)	4,478	(4,330)
Income tax provision (benefit)	(16)	4,896	51	4,653
Net income (loss)	$ 364	$ (8,292)	$ 4,427	$ (8,983)
Net income (loss) per share:				
Basic	$ 0.22	$ (5.17)	$ 2.68	$ (5.63)
Diluted	$ 0.22	$ (5.17)	$ 2.68	$ (5.63)
Weighted average shares outstanding:				
Basic	1,652	1,603	1,649	1,596
Diluted	1,655	1,603	1,652	1,596

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Nine Months Ended Sepember 30, 2021 and 2020

	Common Stock		Additional Paid-In	Accumulated	Treasury Stock		Total Stockholders'
	Shares	Amount	Capital	Deficit	Shares	Amount	Equity
Balances at December 31, 2019 (audited)	1,810	$ 3	$ 157,478	$ (135,749)	226	$ (4,521)	$ 17,211
Net loss				(8,983)			(8,983)
Exercise of stock options	15		23				23
Stock based compensation	4		112				112
Balances at September 30, 2020 (reviewed)	1,829	$ 3	$ 157,613	$ (144,732)	226	$ (4,521)	$ 8,363
Balances at December 31, 2020 (audited)	1,855	$ 3	$ 157,686	$ (144,720)	226	$ (4,521)	$ 8,448
Net income				4,427			4,427
Exercise of stock options	23		35				35
Stock based compensation			54				54
Balances at September 30, 2021 (reviewed)	1,878	$ 3	$ 157,775	$ (140,293)	226	$ (4,521)	$ 12,964

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,	2021 (Reviewed)	2020 (Reviewed)
Cash flows from operating activities		
Net income (loss)	$ 4,427	$ (8,983)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Stock based compensation	54	112
Depreciation and amortization	1,177	1,299
Amortization of deferred financing costs	21	36
Amortization of right of use assets	724	705
Provision for doubtful accounts	42	(147)
Provision for obsolete inventory	580	
Goodwill impairment loss		939
Forgiveness of PPP loan	(3,025)	
Deferred tax expense		4,614
Changes in operating assets and liabilities		
Accounts receivable	1,956	(264)
Inventories	(244)	4,222
Prepaid expenses and other current assets	(1,659)	9
Other non-current assets	40	
Accounts payable	1,613	(1,277)
Lease liabilities	(782)	(737)
Accrued expenses and other	(1,322)	594
Net cash provided by operating activities	3,602	1,122
Cash flows from investing activities		
Purchase of property and equipment		(81)
Net cash used in investing activities		(81)
Cash flows from financing activities		
Payment of contingent purchase price		(992)
Repayment of line of credit	(3,522)	(1,923)
Proceeds from PPP loan		3,025
Payment of long-term debt	(590)	(591)
Exercise of stock options	35	23
Proceeds from (repayment of) notes payable, unrelated party		(583)
Net cash used in financing activities	(4,077)	(1,041)
Net change in cash and cash equivalents	(475)	
Cash and cash equivalents, beginning of period	480	1
Cash and cash equivalents, end of period	$ 5	$ 1
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 750	$ 710
Cash paid during the period for taxes	$ 57	$ 94

See notes to consolidated financial statements.

1. Nature of Operations

Costar Technologies, Inc. ("Costar Technologies") was incorporated in the State of Delaware in February 1997 under the name "Fairmarket, Inc.". Costar Technologies, and its wholly owned subsidiaries, Costar Video Systems, LLC ("Costar") and its wholly owned subsidiaries Innotech Security, Inc. ("Innotech") and Arecont Vision Costar, LLC ("Arecont Vision"), LQ Corporation ("LQ") and CostarHD, LLC (formerly CohuHD Costar, LLC "CostarHD") (collectively the "Company"), develops, designs and distributes a range of security solution products such as surveillance cameras, lenses, digital video recorders, high speed domes and industrial vision products CostarHD is a leading provider of video cameras and related products, specializing in IP video solutions for traffic monitoring, security, surveillance and military applications; and accessories, such as cables, camera mounts, lenses and data storage devices.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of Costar Technologies and its wholly owned subsidiaries. All material intercompany transactions have been eliminated in consolidation.

These consolidated financial statements were approved by management and available for issuance on November 15, 2021. Subsequent events have been evaluated through this date.

Going Concern

The Company's financial statements for the quarter ended September 30, 2021 have been prepared on a going concern basis. The Company entered into a Forbearance Agreement with its bank in January 2021 which was subsequently extended in April 2021 and July 2021. See Footnote 6 Lines of Credit and Long-Term Debt for additional information. In addition, economic uncertainties have arisen which have negatively affected the financial position of the Company as a result of COVID-19. The duration of these uncertainties and ultimate financial effects cannot be reasonably estimated at this time. The Company's ability to continue as a going concern is dependent upon its ability to reach a revised agreement with its existing lender or secure other sources of financing and attain profitable operations.

Commitments and Contingencies

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

Use of Estimates

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

(AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents**.** As of September 30, 2021 and December 31, 2020, the Company had $5 and $480 in cash and cash equivalents, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

Inventories are stated at the lower of average cost or net realizable value. A provision is made to reduce excess or obsolete inventories to their net realizable value. Inventories at September 30, 2021 and December 31, 2020 were comprised of the following:

	September 30, 2021	December 31, 2020
Parts, components, and materials	$ 7,137	$ 5,451
Work-in-process	27	
Finished products	6,725	8,774
Total Inventory	$ 13,889	$ 14,225

Property and Equipment

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

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

Long-Lived Assets

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

2. Summary of Significant Accounting Policies (continued)

Long-Lived Assets (continued)

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

Goodwill

Goodwill is tested annually for impairment, or sooner when circumstances indicate an impairment may exist. The Company has elected to first perform a qualitative assessment, based on the entity's events and circumstances, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of this qualitative assessment determine whether it is necessary to perform a quantitative impairment test. During the year ending December 31, 2020 the Company performed step one of the impairment test to estimate fair value for CostarHD and Arecont Vision Costar as a result of multi-year declining revenues and profitability and budgetary shortfalls. The income and market approaches were utilized to determine the fair value of the reporting unit based on the prices of comparable businesses and the present value of free cash flows that the business is projected to produce. The fair value of CostarHD exceeded its carrying value and no impairment was recognized. Arecont Vision Costar goodwill was determined to be impaired and an impairment loss of $939 was recognized in the nine month period ended September 30, 2020. There were no impairments recognized during the nine month period ended September 30, 2021.

Fair Value Measurements

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

Revenue Recognition

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

(AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

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

Some of the Company's sales are sold with a right of return and the Company may provide other credits or incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize. We have elected to apply the portfolio practical expedient. We estimate the variable consideration using the expected value method when calculating the returns reserve because the difference in applying it to the individual contract would not differ materially. Returns are estimated based on historical experience and are required to be established and presented at the gross sales value with an asset established for the estimated value of the merchandise returned separate from the refund liability. At September 30, 2021 and December 31, 2020 liabilities for return allowances of $489 and $1,043 are included in accrued expenses and other current liabilities and $357 and $646 for the estimated value of the merchandise to be returned is included in prepaid expenses and other current assets on the Consolidated Balance Sheets, respectively.

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

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

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

Product Warranties

The Company provides limited warranties on certain products for periods up to three years. The Company records an accrued liability and expense for estimated future warranty claims based upon historical experience and management's estimate of the level of future claims. Changes in the estimated amounts recognized in prior years are recorded as an adjustment to the accrued liability and expense (benefit) in the current year. As of September 30, 2021 and December 31, 2020, the accrued warranty liability was approximately $1,329 and $1,839, respectively, and is included in accrued expense and other in the accompanying balance sheets.

Warranty accrual at December 31, 2020	$	1,839
Warranty expenditures		(29)
Warranty expense (benefit)		(481)
Warranty accrual at September 30, 2021	$	1,329

2. Summary of Significant Accounting Policies (continued)

Leases

At contract inception the Company determines if an arrangement is a lease. Operating leases are included in right of use assets and current maturities of lease liabilities and non-current maturities of lease liabilities in the Consolidated Balance Sheets. Financing leases are included in property and equipment, net and other current and non-current liabilities in the Consolidated Balance Sheets. The gross amount of balances recorded related to finance leases was immaterial as of September 30, 2021 and December 31, 2020. Operating lease expense is recognized on a straight-line basis over the lease term.

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

Employee Retention Credit

In the second quarter of 2021 the Company determined eligibility for the Employee Retention Credit ("ERC"). The ERC was created under the CARES Act and modified and extended by the Taxpayer Certainty and Disaster Relief Act of 2020, which was part of the Consolidated Appropriations Act. The ERC was subsequently extended through the third quarter of 2021 by the American Rescue Plan Act of 2021. The estimated refund due of approximately $1,836 is included in other current assets in the Consolidated Balance Sheets at September 30, 2021 and $884 and $2,684 is included in other income in the Consolidated Statements of Operations for the three and nine month periods ended September 30, 2021, respectively.

Research and Development

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

Restructuring Costs

In the second quarter of 2020 the Company implemented a cost reduction plan and incurred restructuring charges of $635, primarily resulting from severance costs incurred due to a reduction in workforce

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.

(AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

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

During the nine month periods ended September 30, 2021 and 2020 the Company recognized $54 and $112 in stock based compensation expense in its consolidated financial statements relating to the issuance of stock options and stock awards, respectively (See Note 9).

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

Basic income (loss) per share is computed by dividing income (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted income (loss) per share reflects the dilution of common stock equivalents, such as options, to the extent the impact is dilutive. As the Company incurred a net loss for the three and nine month periods ended September 30, 2020, potentially dilutive securities have been excluded from the diluted net loss per share computation as their effect would be anti-dilutive.

The following table reconciles the number of shares utilized in the net loss per share calculations for the three and nine month periods ended September 30, 2021 and 2020:

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Net income (loss)	$ 364	$ (8,292)	$ 4,427	$ (8,983)
Shares				
Weighted average shares outstanding - basic	1,652	1,603	1,649	1,596
Weighted average dilutive share equivalents from stock options	3		3	
Weighted average shares outstanding - diluted	1,655	1,603	1,652	1,596
Net income (loss) per share - basic	$ 0.22	$ (5.17)	$ 2.68	$ (5.63)
Net income (loss) per share - diluted	$ 0.22	$ (5.17)	$ 2.68	$ (5.63)

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.

(AMOUNTS SHOWN IN THOUSANDS)

2. Summary of Significant Accounting Policies (continued)

Income Taxes (continued)

In accordance with GAAP, the Company is required to determine whether a tax position is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The Company files an income tax return in the U.S. federal jurisdiction, and may file income tax returns in various U.S. states and foreign jurisdictions. The tax benefit recognized is measured as the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. De-recognition of a tax benefit previously recognized results in the Company recording a tax liability that increases the accumulated deficit. Generally, the Company is no longer subject to income tax examination by major taxing authorities for the years before 2017.

Operating Segments

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

3. Segment Information

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

Revenues and net income (loss) by reportable segment for the three and nine month periods ending September 30, 2021 and 2020 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Revenues				
Costar Video Systems	$ 10,200	$ 11,838	$ 30,417	$ 33,972
CostarHD	2,446	3,889	7,728	13,423
	$ 12,646	$ 15,727	$ 38,145	$ 47,395
Net Income (Loss)				
Costar Video Systems	$ 1,129	$ (1,960)	$ 3,886	$ (1,745)
CostarHD	(270)	(649)	(412)	87
Other	(495)	(5,683)	953	(7,325)
	$ 364	$ (8,292)	$ 4,427	$ (8,983)

There were no intercompany sales between the CostarHD and Costar Video Systems operating segments for the three and nine month periods ending September 30, 2021. Intercompany sales between the CostarHD and Costar Video Systems operating segments were $335 and $572 for the three and nine month periods ending September 30, 2020, respectively.

(AMOUNTS SHOWN IN THOUSANDS)

3. Segment Information (continued)

The following table reflects depreciation and intangible amortization expense by business segment for the three and nine month periods ending September 30, 2021 and 2020:

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Depreciation				
Costar Video Systems	$ 63	$ 74	$ 208	$ 217
CostarHD	24	41	87	129
	$ 87	$ 115	$ 295	$ 346
Amortization				
Costar Video Systems	$ 235	$ 240	$ 707	$ 718
CostarHD	19	78	175	235
	$ 254	$ 318	$ 882	$ 953

Total assets and goodwill by business segment at September 30, 2021 and December 31, 2020 are as follows:

	September 30, 2021	December 31, 2020
Total Assets		
Costar Video Systems	$ 28,851	$ 29,790
CostarHD	7,877	9,068
Other	487	1,468
	$ 37,215	$ 40,326
Goodwill		
Costar Video Systems	$ 3,511	$ 3,511
CostarHD	2,063	2,063
	$ 5,574	$ 5,574

4. Property and Equipment

Property and equipment at September 30, 2021 and December 31, 2020, were as follows:

	September 30, 2021	December 31, 2020
Furniture, equipment and leasehold improvements	$ 2,519	$ 2,519
Less accumulated depreciation	(2,281)	(1,986)
Total property and equipment, net	$ 238	$ 533

Depreciation expense for the three month periods ending September 30, 2021 and 2020 was $87 and $115, respectively, and for the nine month periods ending September 30, 2021 and 2020 was $295 and $346, respectively.

(AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets

The following is a summary of amortized and unamortized intangible assets at September 30, 2021:

	September 30, 2021	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Distribution agreement - Southern Imaging	$ 1,468	$ 1,120
Customer relationships - CohuHD	779	581
Trade name - Innotech	1,015	482
Customer relations - Innotech	5,762	2,944
Covenant not to compete - Innotech	150	143
Technology - Innotech	469	318
Patents - Innotech	8	5
Trade name - Arecont Vision Costar	243	78
Distribution agreement - Arecont Vision Costar	370	102
Patents - Arecont Vision Costar	208	95
Total amortized intangible assets	10,472	5,868
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	$ 16,971	$ 5,868

(AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets (continued)

The following is a summary of amortized and unamortized intangible assets at December 31, 2020:

	December 31, 2020	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Distribution agreement - Southern Imaging	$ 1,468	$ 1,064
Trade name - CohuHD	1,657	1,539
Customer relationships - CohuHD	779	524
Trade name - Innotech	1,015	406
Customer relations - Innotech	5,762	2,507
Covenant not to compete - Innotech	150	120
Technology - Innotech	469	268
Patents - Innotech	8	5
Trade name - Arecont Vision Costar	243	60
Distribution agreement - Arecont Vision Costar	370	77
Patents - Arecont Vision Costar	208	73
Total amortized intangible assets	12,129	6,643
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	$ 18,628	$ 6,643

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

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

Amortization expense for the three month periods ending September 30, 2021 and 2020 was $254 and $318, respectively, and for the nine month periods ending September 30, 2021 and 2020 was $882 and $953, respectively.

(AMOUNTS SHOWN IN THOUSANDS)

5. Intangible Assets (continued)

Future amortization expense is as follows:

Year Ending September 30,		
2022	$	983
2023		959
2024		874
2025		785
2026		730
Thereafter		273
Total future amortization expense	$	4,604

6. Lines of Credit and Long-Term Debt

In connection with the acquisition of Arecont Vision Costar on July 13, 2018 the Company entered into a Loan Agreement with UMB Bank ("Loan Agreement"). The Loan Agreement allows for up to $18,000 in a revolving line of credit and a $5,500 term loan which originally matured on July 6, 2021. The Loan Agreement, as modified through the second amendment to the Forbearance and Loan Modification agreement on July 12, 2021, extended the maturity to February 18, 2022. The term loan is payable in $66 monthly payments due on the first of the month with the remaining balance due at maturity. The obligations under the Loan Agreement are secured by a lien on substantially all accounts receivable, inventory and equipment.

The Loan Agreement contains customary representations and warranties, events of default and covenants, including, among other things, covenants that restrict the ability of Costar to incur certain additional indebtedness or to issue distributions or dividends. The Company is also restricted in its mergers and acquisitions activity. The Loan Agreement contains financial covenants calculated on a consolidated basis requiring the Company to maintain a certain Debt Service Coverage Ratio and to not exceed a maximum Senior Cash Flow Leverage Ratio. The Company maintains zero balance accounts, which are swept daily to the revolving line of credit. The Company entered into a modification agreement with UMB Bank effective May 1, 2019 which adjusted the borrowing base and covenant compliance requirements and modified interest rates. The Company entered into a second modification agreement with UMB Bank effective March 24, 2020 which adjusted the borrowing base and covenant compliance requirements and modified interest rates. As of December 31, 2020 and September 30, 2021 the Company was not in compliance with its debt covenants with UMB bank. The Company entered into a Forbearance and Loan Modification Agreement with UMB Bank effective January 26, 2021 which further adjusted the borrowing base and covenant compliance and reporting requirements and modified interest rates and is effective through April 15, 2021. The Company entered an amendment of the Forbearance and Loan Modification Agreement on April 15, 2021 which extended the forbearance period through July 14, 2021.

As of September 30, 2021 the Company was paying interest at 7.25% for the term loan and revolving line of credit.

Future principal payments for the term loan as of September 30, 2021, are as follows:

Year Ending September 30,		
2022	$	3,003

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

On June 28, 2019 the Company executed a promissory note with UMB Bank for $1,000 which matured on June 28, 2020. The promissory note was payable in $83 monthly payments due on the first of the month with the remaining balance due at maturity. As of September 30, 2021 and December 31, 2020, the Company owed $0 on the note.

On April 14, 2020 the Company was granted a loan under the U. S Small Business Administration's ("SBA") Paycheck Protection Program ("PPP") for approximately $3,025. Payments on the loan were deferred with the loan maturing in April 2022 with a 1% interest rate. The Company made a policy election to present the entire balance of the PPP loan as long-term on the accompany consolidated balance sheets, as no payments are expected to become due. The Company has elected to account for the funding as a loan in accordance with ASC Topic 470, *Debt*. Interest is accrued in accordance with the loan agreement. The Company received a Notice of Paycheck Protection Program Forgiveness Payment dated June 10, 2021 indicating the full forgiveness of the Company's PPP loan and accrued interest. Approximately $3,060 is included in other income in the Consolidated Statements of Operations for the nine month period ending September 30, 2021 in relation to the PPP loan forgiveness.

As of September 30, 2021 and December 31, 2020, $9,502 and $13,024 was owed to UMB Bank on the revolving line of credit, $3,003 and $3,592 on the term loan, and $0 on the Promissory Note, respectively.

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

7. Income Taxes (Benefit)

Total income tax expense (benefit) for the three months ending September 30, 2021 and 2020 was ($16) and $4,896, respectively, and $51 and $4,653 for the nine months ending September 30, 2021 and 2020, respectively. The Company's effective tax rate differs from the U.S. federal statutory rate due primarily to state income and franchise taxes, recording the valuation allowance for the Company's deferred tax asset during the three month period ending September 30, 2020 and PPP loan forgiveness and recognition of the Employee Retention Credit in the three and nine month periods ending September 30, 2021.

8. Stockholders' Equity (shown in whole amounts)

At September 30, 2021 and December 31, 2020, 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, 2021 and December 31, 2020, 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, 2021 and December 31, 2020, there were 1,652,431 and 1,629,098 shares of common stock outstanding and 1,878,197 and 1,854,864 shares of common stock issued.

9. 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, 2021 and December 31, 2020, there were 17,000 and 46,000 share options outstanding under this plan.

(AMOUNTS SHOWN IN THOUSANDS)

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

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

At the Company's annual meeting on December 16, 2014, the Company's stockholders approved and adopted the Company's 2014 Omnibus Performance Award Plan (the "Plan"). The Board adopted the Plan on November 17, 2014, subject to and effective upon its approval by stockholders. With the adoption of the Plan, no new awards will be granted under the 2000 Incentive Plan, although it will remain in effect for options that are currently outstanding in accordance with their terms. The Plan authorizes the grant of awards relating to 150,000 shares of the Company's common stock. At the Company's annual meeting on October 29, 2020, the Company's stockholders approved an additional 150,000 shares under The Plan. As of September 30, 2021 and December 31, 2020 there were 78,000 and 96,000 share options outstanding under this plan, respectively.

The following table summarizes information about stock options outstanding at September 30, 2021:

	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
$1.875 - $13.550	95,400	6.39	$8.96	95,400	$8.96

Stock option activity for the nine month periods ended September 30, 2021 and 2020 is as follows:

	September 30, 2021		September 30, 2020	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	142,066	$9.16	140,066	$7.83
Granted				
Exercised	(23,333)	$1.52	(15,000)	$1.51
Cancelled	(23,333)	$9.96	(7,000)	$11.46
Outstanding at period end	95,400	$8.96	118,066	$8.41
Options exercisable at period end	95,400	$8.96	118,066	$8.41

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

On June 20, 2019, a 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 grant date fair 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 grant date fair 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 $0 and $37,000 was recognized in the Company's financial statements in relation to the 2019 Awards during the six month periods ending June 30, 2021 and June 30, 2020, respectively. As certain performance conditions were not met, 12,750 of the 2019 Awards were forfeited at December 31, 2020.

On October 29, 2020, an additional grant of 33,000 ("2020 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2020 Awards are subject to a time-vesting schedule and 75% are subject to performance conditions relating to EBITDA growth for the years ending December 31, 2020, December 31, 2021 and December 31, 2022, as stated in the 2020 Awards Agreements. The 25% of the 2020 Awards not subject to performance conditions have a grant date fair value of approximately $45,000, with the expense recognized over the three year vesting period. The 2020 Awards subject to the performance conditions have a grant date fair value of $134,000, with the expense recognized over the three year vesting period based upon the probability of achievement. Stock based compensation expense of approximately $54,000 and $0 was recognized in the Company's financial statements in relation to the 2020 Awards during the nine month periods ending September 30, 2021 and September 30, 2020, respectively. At September 30, 2021, unrecognized stock based compensation related to unvested awards totaled $109,000 and is expected to be recognized over a weighted average period of 0.7 years.

On April 30, 2020 and July 20, 2020, 8,000 and 1,000 shares were issued to Board members in lieu of fees, which resulted in $48,000 and $9,000 in stock based compensation expense, respectively.

During the nine month periods ended September 30, 2021 and 2020 the Company recognized approximately $54,000 and $112,000 in stock based compensation expense in its consolidated financial statements, respectively.

10. Lease Agreements and Related Party Transactions

The Company has entered into the following lease agreements:

Financing Leases

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

Operating Leases

All of the Company's office and warehouse facilities are leased under operating leases. These leases expire between 2022 and 2025 and certain leases contain renewal options for periods ranging from three to five years. Lease payments have an escalating fee schedule with 3% increases each year. Termination of the leases is generally prohibited unless there is a violation under the lease agreement. The Company has a related party lease with a member of management for its facility in Pompano Beach, FL which terminates on December 31, 2022. Rent expense from the related party lease was $28 and $84 for the three and nine month periods ended September 30, 2021 and September 30, 2020, respectively.

(AMOUNTS SHOWN IN THOUSANDS)

10. Lease Agreements and Related Party Transactions (continued)

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

During the three and nine month periods ended September 30, 2021 and September 30, 2020 lease costs included in operating expenses were as follows:

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Lease cost				
Finance lease cost				
Amortization of right-of-use asset	$ -	$ 1	$ 2	$ 3
Interest on lease liabilities				
Operating lease cost (a)	270	272	811	818
Total lease cost	$ 270	$ 273	$ 813	$ 821

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Other information				
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from finance leases	$ -	$ -	$ -	$ -
Financing cash flows from finance leases	1	1	3	3
Operating cash flows from operating leases	289	220	866	735
Right of use assets obtained in exchange for new finance lease liabilities				
Right of use assets obtained in exchange for new operating lease liabilities				

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

Lease term and discount rate	September 30, 2021	September 30, 2020
Weighted-average remaining lease term operating leases	2.5 years	3.1 years
Weighted-average discount rate operating leases	5.6%	5.6%
Weighted-average remaining lease term financing lease	0.8 years	1.8 years
Weighted-average discount rate financing lease	5.6%	5.6%

Upon adoption of ASU 2016-02, the discount rate used for existing leases was established as of January 1, 2019.

(AMOUNTS SHOWN IN THOUSANDS)

10. Lease Agreements (continued)

Future minimum lease payments and reconciliation to the Consolidated Balance Sheet at September 30, 2021 are as follows:

Year Ending September 30,		
2022	$	917
2023		465
2024		186
2025		192
2026		33
Total lease payments		1,793
Less imputed interest		(186)
Present values of lease liabilities	$	1,607

11. Risk Concentrations

Concentration of Cash

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

Concentration of Customers

For the nine month period ended September 30, 2021 two of the Costar Video Systems operating segment's largest customers accounted for approximately $10,704 or 28.1% of the Company's total revenue. For the nine month period ended September 30, 2020 the Costar Video Systems operating segment's largest customer accounted for $5,640 or 11.9% of the Company's total revenue. Amounts owed by one customer of the Costar Video Systems' operating segment accounted for $1,306 or 19.8% of the Company's outstanding receivable balance as of September 30, 2021. Amounts owed by one customer of the Costar Video Systems' operating segment and one customer of the CostarHD operating segment accounted for $2,381 or 27.8% of the Company's outstanding receivable balance as of December 31, 2020.

Concentration of Suppliers

For the nine month periods ended September 30, 2021 and September 30, 2020 the Company made purchases from one main supplier of the Costar Video Systems' operating segment of approximately $5,780 or 22.4% and from two main suppliers of the Costar Video Systems' operating segment of $7,712 or 26.5%, respectively. Amounts owed to one main supplier of the Costar Video Systems' operating segment accounted for $3,224 or 52.0% and two main suppliers of the Costar Video Systems' operating segment accounted for $1,263 or 27.5% of the Company's accounts payable balance as of September 30, 2021 and December 31, 2020, respectively.