

# **COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REVIEW REPORT

March 31, 2016

# **COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES**

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RSM US LLP

## Independent Auditor's Review Report

To the Audit Committee  
Costar Technologies, Inc.  
Coppell, Texas

### Report on the Financial Statements

We have reviewed the accompanying consolidated balance sheet of Costar Technologies, Inc. and subsidiaries as of March 31, 2016, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the three-month periods ending March 31, 2016 and 2015.

### Management's Responsibility

The Company's management is responsible for the preparation and fair presentation of the interim 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 generally accepted accounting principles.

### 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 accompanying interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America.

### Report on the Balance Sheet as of December 31, 2015

We previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 2015, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and we have expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 30, 2016. In our opinion, the accompanying consolidated balance sheet of Costar Technologies, Inc. and subsidiaries as of December 31, 2015, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

*RSM US LLP*

Dallas, Texas  
May 10, 2016

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# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	March 31, 2016 (Reviewed)	December 31, 2015 (Audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$	\$
Accounts receivable, less allowance for doubtful accounts of \$44 and \$78 in 2016 and 2015, respectively	6,767	5,509
Inventories, net of reserve for obsolescence of \$992 and \$1,000 in 2016 and 2015, respectively	8,029	7,991
Prepaid expenses	554	644
Total current assets	15,350	14,144
<b>Non-current assets</b>		
Property and equipment, net	375	398
Deferred financing costs, net	11	22
Deferred tax asset, non-current	7,312	7,312
Trade names, net	2,168	2,227
Distribution agreement, net	752	771
Customer relationships, net	669	695
Covenant not to compete, net	13	14
Goodwill	2,063	2,063
Total assets	\$ 28,713	\$ 27,646
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 2,735	\$ 2,995
Accrued expenses and other	1,606	1,017
Line of credit	1,755	1,189
Short-term debt	592	591
Total current liabilities	6,688	5,792
<b>Long-Term liabilities</b>		
Long-term debt	442	590
Total long-term liabilities	442	590
Total liabilities	7,130	6,382
<b>Commitments and Contingencies</b>		
<b>Stockholders' Equity</b>		
Preferred stock		
Common stock	3	3
Additional paid in capital	156,231	156,216
Accumulated deficit	(130,130)	(130,434)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	21,583	21,264
Total liabilities and stockholders' equity	\$ 28,713	\$ 27,646

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

	Three Months Ended March 31,	
	2016	2015
	(Reviewed)	(Reviewed)
Net revenues	\$ 10,130	\$ 8,099
Cost of revenues	<u>6,266</u>	<u>4,880</u>
Gross profit	3,864	3,219
Selling, general and administrative expenses	2,697	2,368
Engineering and development expense	<u>629</u>	<u>761</u>
	3,326	3,129
Income from operations	<u>538</u>	<u>90</u>
Other income (expenses)		
Interest expense	(40)	(44)
Other income and expense, net	2	1
Total other expenses, net	<u>(38)</u>	<u>(43)</u>
Income before taxes	500	47
Income tax provision	<u>196</u>	<u>18</u>
Net income	<u>\$ 304</u>	<u>\$ 29</u>
Net income per share:		
Basic	\$ 0.20	\$ 0.02
Diluted	\$ 0.20	\$ 0.02
Weighted average shares outstanding		
Basic	1,485	1,466
Diluted	1,534	1,550

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Three Months Ended March 31, 2016 and 2015

	Common Stock		Additional Paid - In Capital	Treasury Stock		Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount		Shares	Amount		
Balances at December 31, 2014 (audited)	1,692	\$ 3	\$ 156,073	226	\$ (4,521)	\$ (130,908)	\$ 20,647
Net income						29	29
Stock based compensation			16				16
Balances at March 31, 2015 (reviewed)	1,692	\$ 3	\$ 156,089	226	\$ (4,521)	\$ (130,879)	\$ 20,692
Balances at December 31, 2015 (audited)	1,711	\$ 3	\$ 156,216	226	\$ (4,521)	\$ (130,434)	\$ 21,264
Net income						304	304
Stock based compensation			15				15
Balances at March 31, 2016 (reviewed)	1,711	\$ 3	\$ 156,231	226	\$ (4,521)	\$ (130,130)	\$ 21,583

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

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (AMOUNTS SHOWN IN THOUSANDS)

For the Three Months Ended March 31,	2016 (Reviewed)	2015 (Reviewed)
<b>Cash flows from operating activities</b>		
Net income	\$ 304	\$ 29
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Stock based compensation	15	16
Depreciation and amortization	138	109
Amortization of deferred financing costs	14	15
Provision for doubtful accounts	(34)	(5)
Provision for obsolete inventory	(8)	
Deferred tax asset		16
Changes in operating assets and liabilities		
Accounts receivable, net	(1,224)	2,021
Inventories, net	(30)	(85)
Prepaid expenses	90	(38)
Accounts payable	(260)	(1,114)
Accrued expenses and other	589	(665)
Net cash provided by (used in) operating activities	<u>(406)</u>	<u>299</u>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	<u>(10)</u>	<u>(16)</u>
Net cash used in investing activities	<u>(10)</u>	<u>(16)</u>
<b>Cash flows from financing activities</b>		
Contingent purchase price		(128)
Proceeds from line of credit, net	566	615
Repayment of term debt	(150)	(150)
Net cash provided by financing activities	<u>416</u>	<u>337</u>
<b>Net increase in cash</b>		620
<b>Cash, beginning of period</b>	<u>          </u>	<u>          </u>
<b>Cash, end of period</b>	<u>\$          </u>	<u>\$ 620</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for interest	<u>\$ 26</u>	<u>\$ 29</u>
Cash paid during the period for taxes	<u>\$          </u>	<u>\$ 146</u>

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 1. Nature of operations

Costar Technologies, Inc. ("Costar Technologies") was incorporated in the State of Delaware in February 1997 under the name "Fairmarket, Inc.". Costar Technologies, and its wholly owned subsidiaries, Costar Video Systems, LLC ("Costar"), LQ Corporation ("LQ"), and CohuHD Costar, LLC ("CohuHD Costar") (collectively the "Company"), develops, designs and distributes a range of security solution products such as surveillance cameras, lenses, digital video recorders and high speed domes as well as industrial vision products to observe repetitive production and assembly lines, thereby increasing efficiency by detecting faults in the production process. CohuHD Costar is a leading provider of video cameras and related products, specializing in IP video solutions for traffic monitoring, security, surveillance and military applications; and accessories such as cables, camera mounts, lenses and data storage devices.

### 2. Summary of significant accounting policies

#### *Basis of Presentation*

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

These consolidated financial statements were approved by management and available for issuance on May 10, 2016. 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 (See Note 12).

#### *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 Equivalents*

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. As of March 31, 2016 and December 31, 2015, the Company had no cash equivalents.



# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 2. Summary of significant accounting policies (continued)

#### *Accounts Receivable and Allowance for Doubtful Accounts*

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

#### *Inventories*

Inventories are recorded on the first in first out basis and are stated at the lower of average cost, standard cost, or market. A provision is made to reduce excess or obsolete inventories to their net realizable value. The reserve for inventory obsolescence was \$992 and \$1,000 as of March 31, 2016 and December 31, 2015, respectively. Inventories at March 31, 2016 and December 31, 2015 were comprised of the following:

	<u>March 31, 2016</u>	<u>December 31, 2015</u>
Parts, components, and materials	\$ 2,275	\$ 1,982
Work-in-process	532	1,064
Finished products	5,222	4,945
Total Inventory	<u>\$ 8,029</u>	<u>\$ 7,991</u>

#### *Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over estimated useful lives of 3-5 years as follows:

Computer hardware and software	3 years
Furniture and fixtures	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 income 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 AUDITOR'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 the two-step impairment test. For the year ending December 31, 2015 the Company performed step one of the impairment test and estimated the fair value of CohuHD Costar at December 31, 2015, noting it exceeded its carrying value. Accordingly, step two of the test was not required to be performed and no goodwill impairment was recognized at December 31, 2015. No indicators warranting reevaluation arose during the three months ended March 31, 2016.

#### *Fair Value Measurements*

The Company follows the guidance from FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. This accounting standard does not require any new fair value measurements. The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

#### *Revenue Recognition*

The Company ships and invoices its sales in accordance with signed purchase orders. The Company only recognizes revenue when it is realized and earned when the following criteria are met: there is evidence of an agreement; delivery has occurred; the selling price is fixed or determinable; and collectability is reasonably assured. The Company considers criteria to have been met when goods are shipped in accordance with signed purchase orders. Any software imbedded in the products sold is considered incidental to the product being sold.

#### *Recent Accounting Pronouncements*

In April 2016 the Financial Accounting Standards Board (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 2016-10 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.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 2. Summary of significant accounting policies (continued)

#### *Recent Accounting Pronouncements (continued)*

In March 2016 the FASB issued Accounting Standards Update No. 2016-09 (ASU 2016-09): Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting, effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. ASU 2016-09 simplifies several aspects of the stock compensation guidance including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows, expected term of awards and the intrinsic value election for liability-classified awards. The amendments in ASU 2016-09 are to be applied differently upon adoption with certain amendments being applied prospectively, retrospectively and under a modified retrospective transition method. The Company is currently evaluating the effects the adoption of ASU 2016-09 will have on the consolidated financial statements.

In February 2016 the FASB issued Accounting Standards Update No. 2016-02 (ASU 2016-02): Leases, effective the first quarter of 2020. ASU 2016-02 was issued in three parts: Section A, "Leases: Amendments to the FASB Accounting Standards Codification," Section B, "Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification," and Section C, "Background Information and Basis for Considerations." The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases. Other changes in the new guidance include: (a) defining initial direct costs to only include those incremental costs that would not have been incurred if the lease had not been entered into, (b) requiring related party leases to be accounted for based on their legally enforceable terms and conditions, (c) eliminating the additional requirements that must be applied today to leases involving real estate and (d) revising the circumstances under which the transfer contract in a sale-leaseback transaction should be accounted for as the sale of an asset by the seller-lessee and the purchase of an asset by the buyer-lessor. In addition, leases are subject to new disclosure requirements. The Company is currently evaluating the impact of the pending adoption of ASU 2016-02 on the consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11 (ASU 2015-11): Simplifying the Measurement of Inventory, effective for annual and interim periods beginning after December 15, 2016. ASU 2015-11 changes the inventory measurement principle for entities using the first-in, first out (FIFO) or average cost methods. For entities utilizing one of these methods, the inventory measurement principle will change from lower of cost or market to the lower of cost and net realizable value. The Company is currently evaluating the provisions of ASU 2015-11 and assessing the impact, if any, it may have on the financial position and results of operations.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03 (ASU 2015-03): Simplifying the Presentation of Debt Issuance Costs, effective for annual and interim periods beginning after December 15, 2015. ASU 2015-03 requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt. It is effective retrospectively for all prior periods presented in the financial statements beginning in the first quarter 2016 and is only expected to impact the presentation of the Company's consolidated balance sheet. In August 2015, the FASB issued Accounting Standards Update No. 2015-15 (ASU 2015-15): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, effective for annual and interim periods beginning after December 15, 2015. ASU 2015-15 discusses the presentation and subsequent measurement of debt issuance costs related to line-of-credit arrangements which was not specifically addressed in ASU 2015-03. ASU 2015-15 allows for a Company to record debt issuance costs related to line-of-credit arrangements as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit agreement, regardless of whether there are any outstanding borrowings on the arrangement. The Company adopted and applied ASU 2015-03 retrospectively during the three months ending March 31, 2016.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 2. Summary of significant accounting policies (continued)

#### *Recent Accounting Pronouncements (continued)*

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 2018, with early adoption permitted, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. The Company has not yet selected a transition method and is currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

#### *Research and Development*

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

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

The Company complies with the accounting and reporting requirements of the Accounting for Stock Based Compensation guidelines which require companies to record compensation expense for share-based awards issued to employees in exchange for services provided. The amount of the compensation expense is based on the estimated fair value of the awards on their grant dates and is generally recognized over the applicable vesting period.

The fair value of stock options is determined using an option-pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, expected dividends, and the risk free interest rate over the expected life of the option.

During the three months ended March 31, 2016 and 2015 the Company recognized \$15 and \$16 in stock based compensation expense in its consolidated financial statements relating to the issuance of stock options, respectively.

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

Basic income per share is computed by dividing income attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted income per share reflects the dilution of common stock equivalents such as options to the extent the impact is dilutive. As the Company incurred net income for the three months ended March 31, 2016 and 2015, potentially dilutive securities have been included in the diluted net income per share computations and any potentially anti-dilutive shares have been excluded and are shown below.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 2. Summary of significant accounting policies (continued)

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

The following table reconciles the number of shares utilized in the net income per share calculations for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
	2016	2015
Net income	\$ 304	\$ 29
Shares		
Weighted average shares outstanding - basic	1,485	1,466
Weighted average dilutive share equivalents from stock options	49	84
Weighted average shares outstanding - diluted	1,534	1,550
Net income per share - basic	\$ 0.20	\$ 0.02
Net income per share - diluted	\$ 0.20	\$ 0.02

The number of potentially dilutive shares from stock options excluded from the diluted net income per share calculation as of March 31, 2016 and 2015 was 56 and 3, 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 2012.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 2. Summary of significant accounting policies (continued)

#### *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 System, CohuHD Costar and Other. The Other segment encompasses the Company's costs associated with federal income taxes, company-wide financing (including interest expense), executive compensation and other corporate expenses. Financial information by reportable segment for the three month period ending March 31, 2016 and 2015 is presented below:

	<u>2016</u>	<u>2015</u>
<b>Revenues</b>		
Costar Video Systems	\$ 5,586	\$ 4,746
CohuHD Costar	4,544	3,353
	<u>10,130</u>	<u>8,099</u>
<b>Net income (loss)</b>		
Costar Video Systems	\$ 597	\$ 545
CohuHD Costar	354	(66)
Other	(647)	(450)
	<u>304</u>	<u>29</u>

Total assets by business segment at March 31, 2016 and December 31, 2015 are as follows:

	<u>March 31, 2016</u>	<u>December 31, 2015</u>
Costar Video Systems	\$ 10,028	\$ 9,427
CohuHD Costar	11,336	10,846
Other	7,349	7,373
	<u>28,713</u>	<u>27,646</u>

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 4. Property and equipment

Property and equipment at March 31, 2016 and December 31, 2015, were as follows:

	<u>2016</u>	<u>2015</u>
Office furniture and equipment	\$ 923	\$ 915
Less accumulated depreciation	<u>(548)</u>	<u>(517)</u>
Total property and equipment, net	<u>\$ 375</u>	<u>\$ 398</u>

Depreciation expense for the three months ended March 31, 2016 and 2015 was \$33 and \$6, respectively.

### 5. Intangible assets

The following is a summary of amortized and unamortized intangible assets at March 31, 2016 and December 31, 2015:

	<u>March 31, 2016</u>	
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>
<b>Amortized intangible assets</b>		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	716
Customer relations - IVS	125	92
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	414
Customer relationships - CohuHD	779	143
Covenant not to compete - CohuHD	20	7
Total amortized intangible assets	<u>5,698</u>	<u>3,021</u>
<b>Unamortized intangible assets</b>		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Total unamortized intangible assets	<u>2,988</u>	
Total intangible assets	<u>\$ 8,686</u>	<u>\$ 3,021</u>

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

## 5. Intangible assets (continued)

	December 31, 2015	
	Gross Amount	Accumulated Amortization
<b>Amortized intangible assets</b>		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	697
Customer relations - IVS	125	87
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	355
Customer relationships - CohuHD	779	122
Covenant not to compete - CohuHD	20	6
Total amortized intangible assets	5,698	2,916
<b>Unamortized intangible assets</b>		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Total unamortized intangible assets	2,988	
Total intangible assets	\$ 8,686	\$ 2,916

The weighted average amortization period for the Company's intangible assets is 8 years. Amortizable intangible assets estimated useful lives are as follows:

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

Amortization expense for the three months ended March 31, 2016 and 2015 was \$105 and \$103, respectively. Future amortization expense is as follows:

Year Ending March 31,	
2017	\$ 419
2018	410
2019	398
2020	395
2021	394
Thereafter	661
Total future amortization expense	\$ 2,677



# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 6. Lines of credit and long-term debt

Effective June 3, 2014, the Company entered into an Amended Loan and Security Agreement ("Accord") with Bank of Texas. The Accord allows for up to \$7,000 in a revolving line of credit and a \$3,000 term loan with maturities of June 3, 2016 and June 3, 2019, respectively. The obligation under the Accord with Bank of Texas is secured by a lien on substantially all accounts receivable, inventory, and equipment. As of March 31, 2016, the Company was paying interest at LIBOR plus 2.9% (3.33%) for the revolving line of credit and the term loan.

Future principal payments for the term loan are as follows:

Year Ending March 31,	
2017	\$ 600
2018	450
Less: deferred financing costs, net	<u>(16)</u>
	<u>\$ 1,034</u>

The Accord with Bank of Texas 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 Accord with Bank of Texas contains financial covenants calculated on a consolidated basis requiring the Company to maintain a certain Debt Service Coverage Ratio, Minimum Profitability, and a Minimum Tangible Net Worth. The Company maintains zero balance accounts, which are swept daily to the revolving line of credit. As of March 31, 2016 and December 31, 2015, \$1,755 and \$1,189 was owed to Bank of Texas on the revolving line of credit and \$1,050 and \$1,200 was owed to Bank of Texas on the term loan, respectively.

The Company paid approximately \$125 in various fees associated with securing the Accord. The fees associated with the term loan are presented in the consolidated balance sheet as a direct deduction to the carrying value of the debt and are amortized over the life of the loan using the effective-interest method. Deferred financing costs relating to the term loan were \$16 and \$19 at March 31, 2016 and December 31, 2015, respectively. The fees associated with the line of credit are presented in the consolidated balance sheet as deferred financing costs and are amortized using the straight-line method over the life of the loan. Deferred financing costs relating to the line of credit were \$11 and \$22 at March 31, 2016 and December 31, 2015, respectively.

### 7. Income taxes

Total income tax expense for the three months ended March 31, 2016 and 2015 was \$196 and \$18, respectively. The Company's effective tax rate of approximately 39% differed from the U.S federal statutory tax rate to pre-tax income due primarily to state taxes.

### 8. Stockholders' equity (shown in whole amounts)

At March 31, 2016 and December 31, 2015, the authorized capital stock of the Company consisted of (i) 10,000,000 shares of voting common stock with a par value of \$0.001 per share and (ii) 10,000,000 shares of preferred stock with a par value of \$0.001 per share. As of March 31, 2016 and December 31, 2015, there was no preferred stock issued and outstanding. The Company's Board has the authority to determine the voting powers, designations, preferences, privileges and restrictions of the preferred shares. As of March 31, 2016 and December 31, 2015, there were 1,484,709 shares of common stock outstanding and 1,710,475 shares of common stock issued.

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 9. Stock option plan (shown in whole amounts)

The Company's 2000 Stock Option and Incentive Plan (the "2000 Incentive Plan") provides for awards in the form of incentive stock options, non-qualified stock options, restricted stock awards and other forms of awards to officers, directors, employees and consultants of the Company. At March 31, 2016 and December 31, 2015, there were 120,546 and 123,282 share options issued under this plan, respectively.

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, 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 March 31, 2016 and December 31, 2015, there were 8,000 share options issued under this plan.

The following table summarizes information about stock options outstanding at March 31, 2016:

Options Outstanding				Options Fully Vested and Exercisable	
Range of Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
\$0.725-\$15.020	128,546	5.50	\$5.36	114,500	\$5.04

Stock option activity for the three months ended March 31, 2016 and 2015 is as follows:

	2016		2015	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	131,282	\$5.46	135,982	\$5.24
Granted				
Exercised				
Canceled	(2,736)	\$9.87		
Outstanding at period end	128,546	\$5.36	135,982	\$5.24
Options exercisable at period end	114,500	\$5.04	106,544	\$4.54

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 9. Stock option plan (shown in whole amounts) (continued)

On October 7, 2015 the Compensation Committee of the Company's Board of Directors authorized the grant of 13,250 restricted stock awards (the "Awards") to certain employees pursuant to the provisions of the Plan. The Awards were granted on October 16, 2015. All of the 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, 2015 and 2016, as stated in the Awards Agreements. The 25% of the Awards not subject to performance conditions have a fair market grant date value of approximately \$30,000, with the expense recognized over the two year vesting period. Stock based compensation expense of \$3,600 was recognized in the Company's financial statements in relation to the Awards during the three month period ending March 31, 2016.

During the three months ended March 31, 2016 and 2015 the Company recognized approximately \$15,000 and \$16,000 in stock based compensation expense in its consolidated financial statements, respectively.

### 10. Lease agreements

On January 31, 2011 the Company entered into a new lease agreement for certain facilities that will expire in 2018. Rent expense under the agreement for the three months ended March 31, 2016 and 2015 were approximately \$111 and \$27, respectively.

On June 6, 2014 the Company signed a three year lease with Cohu, Inc. in Poway, CA for the CohuHD Costar business. On December 4, 2015 the Company received a notice of lease termination from Cohu, Inc. terminating the lease effective December 31, 2016. Rent expense under the agreement for the three month periods ended March 31, 2016 and 2015 was approximately \$154 and \$123, respectively.

During the three month period ending March 31, 2016 the Company made a one-time catchup adjustment to properly reflect straight line rent on the leases described above. This adjustment resulted in an additional \$84 of rent expense for the three month period ending March 31, 2016.

Future minimum annual rent payments as of March 31, 2016 are approximately as follows:

Year Ending March 31,	
2017	\$ 538
2018	133
2019	<u>70</u>
Total future minimum lease commitments	<u>\$ 741</u>

### 11. Risk concentrations

#### *Concentration of Cash*

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

# COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

### 11. Risk concentrations (continued)

#### *Concentration of Customers*

For the three months ended March 31, 2016 Costar Video Systems' two largest customers, Wal-Mart and Protection 1, accounted for approximately \$2,968 or 29.3% of the Company's total revenue. For the three months ended March 31, 2015 Costar Video Systems' three largest customers accounted for approximately \$2,759 or 34.1% of the Company's total revenue. Amounts owed by two main customers from the Costar Video Systems operating segment and one main customer from the CohuHD Costar operating segment accounted for \$2,797 or 41.5% and two main customers from the Costar Video Systems operating segment accounted for \$1,424 or 28.1%, of the Company's outstanding accounts receivable balance as of March 31, 2016 and 2015, respectively.

#### *Concentration of Suppliers*

For the three months ended March 31, 2016 and 2015, the Company made purchases from one main supplier of the Costar Video Systems operating segment of approximately 29.6% and two main suppliers of the Costar Video Systems operating segment of approximately 26.3%, respectively. Amounts owed to one main supplier of the Costar Video Systems operating segment accounted for 47.6% and 20.9% of the Company's accounts payable balance, as of March 31, 2016 and 2015, respectively.

### 12. Contingent liabilities

#### *Sales Tax Liabilities*

Subsequent to December 31, 2015 it was determined that Costar had nexus in California and should have been assessing and collecting sales tax on sales into California dating back to 2013. The Company will attempt to; (1) obtain resale or tax exemption certificates from its customers, (2) prove that a customer directly remitted sales tax to the state on the sales in question or (3) attempt to assess and collect sales tax from its customers to minimize its liability to the state. The Company's liability is dependent upon the outcome from the procedures described above but can reasonably be estimated at \$110 on sales into California. The Company is still assessing its actual sales tax liability to the state of California.