

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT ACCOUNTANT'S REVIEW REPORT

March 31, 2020

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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Independent Accountant's Review Report

Board of Directors
Costar Technologies, Inc.
Coppell, Texas

We have reviewed the consolidated financial statements of Costar Technologies Inc. and its subsidiaries (collectively, the Company), which comprise the consolidated balance sheet as of March 31, 2020, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the three-month periods ended March 31, 2020 and 2019.

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, 2019

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, 2019, 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 30, 2020. In our opinion, the accompanying consolidated balance sheet of the Company as of December 31, 2019, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

BKD, LLP

Dallas, Texas
May 14, 2020

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

	March 31, 2020 (Reviewed)	December 31, 2019 (Audited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1	\$ 1
Accounts receivable, less allowance for doubtful accounts of \$274 and \$396 in 2020 and 2019, respectively	10,674	9,056
Inventories, net of reserve for obsolescence of \$1,090 and \$1,264 in 2020 and 2019, respectively	19,639	20,196
Prepaid expenses and other current assets	2,992	2,295
Total current assets	<u>33,306</u>	<u>31,548</u>
Non-current assets		
Property and equipment, net	828	910
Deferred financing costs, net	50	59
Deferred tax asset, net	4,514	4,514
Trade names, net	2,108	2,198
Distribution agreements, net	775	801
Customer relationships, net	4,017	4,187
Covenants not to compete, net	53	60
Patents, net	162	169
Technology, net	251	268
Goodwill	6,513	6,513
Right of use assets	2,899	3,131
Other non-current assets	149	149
Total non-current assets	<u>22,319</u>	<u>22,959</u>
Total assets	<u>\$ 55,625</u>	<u>\$ 54,507</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 7,683	\$ 5,639
Accrued expenses and other	6,591	5,879
Line of credit	15,152	15,953
Current maturities of long-term debt, net of unamortized financing fees	783	781
Contingent purchase price	1,490	1,490
Current maturities of notes payable, unrelated party	333	583
Current maturities of lease liabilities	1,006	990
Total current liabilities	<u>33,038</u>	<u>31,315</u>
Long-Term liabilities		
Long-term debt, net of current maturities and unamortized financing fees	3,396	3,592
Non-current maturities of lease liabilities	2,133	2,389
Total long-term liabilities	<u>5,529</u>	<u>5,981</u>
Total liabilities	<u>38,567</u>	<u>37,296</u>
Stockholders' Equity		
Preferred stock		
Common stock	3	3
Additional paid-in capital	157,518	157,478
Accumulated deficit	(135,942)	(135,749)
Less common stock held in treasury, at cost	(4,521)	(4,521)
Total stockholders' equity	<u>17,058</u>	<u>17,211</u>
Total liabilities and stockholders' equity	<u>\$ 55,625</u>	<u>\$ 54,507</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

	Three Months Ended March 31,	
	2020	2019
	(Reviewed)	(Reviewed)
Net revenues	\$ 17,028	\$ 14,389
Cost of revenues	<u>10,378</u>	<u>9,677</u>
Gross profit	6,650	4,712
Selling, general and administrative expenses	5,185	6,513
Engineering and development expense	<u>1,432</u>	<u>1,409</u>
	<u>6,617</u>	<u>7,922</u>
Income (loss) from operations	<u>33</u>	<u>(3,210)</u>
Other expenses		
Interest expense	<u>(291)</u>	<u>(308)</u>
Total other expenses, net	<u>(291)</u>	<u>(308)</u>
Income (loss) before taxes	(258)	(3,518)
Income tax provision (benefit)	<u>(65)</u>	<u>(886)</u>
Net loss	<u>\$ (193)</u>	<u>\$ (2,632)</u>
<u>Net loss per share:</u>		
Basic	\$ (0.12)	\$ (1.69)
Diluted	\$ (0.12)	\$ (1.69)
<u>Weighted average shares outstanding:</u>		
Basic	1,586	1,558
Diluted	1,586	1,558

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Three Months Ended March 31, 2020 and 2019

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balances at December 31, 2018 (audited)	1,777	\$ 3	\$ 157,029	\$ (133,051)	226	\$ (4,521)	\$ 19,460
Net loss				(2,632)			(2,632)
Exercise of stock options	14		28				28
Stock based compensation			86				86
Balances at March 31, 2019 (reviewed)	1,791	\$ 3	\$ 157,143	\$ (135,683)	226	\$ (4,521)	\$ 16,942
Balances at December 31, 2019 (audited)	1,810	\$ 3	\$ 157,478	\$ (135,749)	226	\$ (4,521)	\$ 17,211
Net loss				(193)			(193)
Exercise of stock options	8		8				8
Stock based compensation			32				32
Balances at March 31, 2020 (reviewed)	1,818	\$ 3	\$ 157,518	\$ (135,942)	226	\$ (4,521)	\$ 17,058

See 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,	2020	2019
	(Reviewed)	(Reviewed)
Cash flows from operating activities		
Net loss	\$ (193)	\$ (2,632)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Loss on asset disposal		2
Stock based compensation	32	86
Depreciation and amortization	435	425
Amortization of deferred financing costs	12	15
Amortization of right of use assets	232	170
Provision for doubtful accounts	(122)	(195)
Provision for obsolete inventory	(174)	13
Changes in operating assets and liabilities		
Accounts receivable, net	(1,496)	(298)
Inventories, net	731	(131)
Prepaid expenses and other current assets	(697)	(779)
Other non-current assets		(40)
Accounts payable	2,044	(287)
Lease liabilities	(240)	(170)
Accrued expenses and other	712	(246)
Net cash provided by (used in) operating activities	1,276	(4,067)
Cash flows from investing activities		
Purchase of property and equipment	(36)	(81)
Net cash used in investing activities	(36)	(81)
Cash flows from financing activities		
Proceeds from (repayment of) line of credit	(801)	4,358
Payment of long-term debt	(197)	(197)
Payment of note payable, unrelated party, net	(250)	
Payment of notes payable, related party		(197)
Exercise of stock options	8	28
Net cash provided by (used in) financing activities	(1,240)	3,992
Net change in cash and cash equivalents		(156)
Cash and cash equivalents, beginning of period	1	189
Cash and cash equivalents, end of period	\$ 1	\$ 33
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 288	\$ 273

See notes to consolidated financial statements.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

1. Nature of Operations

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

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 14, 2020. Subsequent events have been evaluated through this date.

Reclassifications

Certain reclassifications have been made to the 2019 consolidated financial statements to conform to the 2020 consolidated financial statement presentation. These reclassifications had no effect on net earnings.

Commitments and Contingencies

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

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. As of March 31, 2020 and December 31, 2019, the Company had \$1 in cash and cash equivalents.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

Inventories are recorded on the first in first out basis and are stated at the lower of average cost or net realizable value. A provision is made to reduce excess or obsolete inventories to their net realizable value. The reserve for inventory obsolescence was \$1,090 and \$1,264 as of March 31, 2020 and December 31, 2019, respectively. Inventories at March 31, 2020 and December 31, 2019 were comprised of the following:

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Parts, components, and materials	\$ 3,902	\$ 4,411
Work-in-process	4	3
Finished products	<u>15,733</u>	<u>15,782</u>
Total Inventory	<u>\$ 19,639</u>	<u>\$ 20,196</u>

Property and Equipment

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

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

Long-Lived Assets

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

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

Goodwill

Goodwill is tested annually for impairment, or sooner when circumstances indicate an impairment may exist. The Company has elected to first perform a qualitative assessment, based on the entity's events and circumstances, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of this qualitative assessment determine whether it is necessary to perform an impairment test. There were no impairments recognized during the three month periods ended March 31, 2020 and 2019, and the year ended December 31, 2019.

Fair Value Measurements

The Company follows the guidance from FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk (See Note 4).

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.

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 March 31, 2020 and December 31, 2019 liabilities for return allowances of \$1,432 and \$1,405 are included in accrued expenses and other current liabilities and \$864 and \$805 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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

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 payments 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. Provisions for estimated losses on sales or related receivables are recorded when identified.

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 in the current year. As of March 31, 2020 and December 31, 2019, the accrued warranty liability was approximately \$2,373 and \$2,411, respectively.

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 March 31, 2020 and December 31, 2019. 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.

Recent Accounting Pronouncements

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In August 2016, the FASB issued Accounting Standards Update No. 2016-15 (ASU 2016-15): Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, a consensus of the Emerging Issues Task Force. ASU 2016-15 provides guidance on how certain transactions are classified in the statement of cash flows. ASU 2016-15 clarifies the classification of debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments subsequent to a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate and bank-owned life insurance policies, distributions received from equity method investments, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle in the statement of cash flows. ASU 2016-15 requires retrospective application and is effective for financial statements issued for fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. The Company adopted ASU 2016-15 during the three month period ended March 31, 2020, which did not have a material impact 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 month periods ended March 31, 2020 and 2019 the Company recognized \$32 and \$86 in stock based compensation expense in its consolidated financial statements relating to the issuance of stock options and stock awards, respectively (See Note 10).

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

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

The fair value of the stock options granted during the three month period ended March 31, 2019 was estimated on the date of grant using the Black-Scholes valuation model based on the following assumptions:

	Three Months Ended March 31, 2019
Expected dividend yield	0.00%
Expected stock price volatility	64.25%
Risk-free interest rate	2.67%
Expected life	10 years
Weighted-average fair value of options granted	\$6.68

No options were granted during the three month period ended March 31, 2020.

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 month periods ended March 31, 2020 and March 31, 2019, 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 month periods ended March 31, 2020 and 2019:

	Three Months Ended March 31,	
	2020	2019
Net loss	\$ (193)	\$ (2,632)
Shares		
Weighted average shares outstanding - basic	1,586	1,558
Weighted average dilutive share equivalents from stock options		
Weighted average shares outstanding - diluted	1,586	1,558
Net loss per share - basic	\$ (0.12)	\$ (1.69)
Net loss per share - diluted	\$ (0.12)	\$ (1.69)

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

2. Summary of Significant Accounting Policies (continued)

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 2016.

Operating Segments

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

3. Segment Information

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

3. Segment Information (continued)

Revenues and net income (loss) by reportable segment for the three month periods ending March 31, 2020 and 2019 are as follows:

	Three Months Ended March 31,	
	2020	2019
Revenues		
Costar Video Systems	\$ 10,644	\$ 11,376
CohuHD Costar	6,384	3,013
	<u>\$ 17,028</u>	<u>\$ 14,389</u>
Net Income (Loss)		
Costar Video Systems	\$ (283)	\$ (1,697)
CohuHD Costar	1,014	(918)
Other	(924)	(17)
	<u>\$ (193)</u>	<u>\$ (2,632)</u>

Intercompany sales between the CohuHD Costar and Costar Video Systems operating segments totaled \$0 and \$23 for the three month periods ending March 31, 2020 and 2019, respectively, and have been eliminated upon consolidation.

The following table reflects depreciation and amortization expense by business segment for the three month periods ending March 31, 2020 and 2019:

	Three Months Ended March 31,	
	2020	2019
Depreciation		
Costar Video Systems	\$ 71	\$ 39
CohuHD Costar	47	62
	<u>\$ 118</u>	<u>\$ 101</u>
Amortization		
Costar Video Systems	\$ 238	\$ 244
CohuHD Costar	79	80
	<u>\$ 317</u>	<u>\$ 324</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

3. Segment Information (continued)

Total assets and goodwill by business segment at March 31, 2020 and December 31, 2019 are as follows:

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Total Assets		
Costar Video Systems	\$ 36,649	\$ 38,042
CohuHD Costar	13,415	11,403
Other	5,561	5,062
	<u>\$ 55,625</u>	<u>\$ 54,507</u>
Goodwill		
Costar Video Systems	\$ 4,450	\$ 4,450
CohuHD Costar	2,063	2,063
	<u>\$ 6,513</u>	<u>\$ 6,513</u>

4. Fair Value Measurements

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

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

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

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

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

4. Fair Value Measurements (continued)

Contingent Purchase Price

As of March 31, 2020 and December 31, 2019, the Company had obligations to transfer \$1,490 in contingent purchase price to the prior shareholders of Innotech in conjunction with the acquisition if specified future operational objectives are met over the years 2017 through 2019. The Company recorded the acquisition-date fair value of this liability, based on the likelihood of contingent earn-out payments, as part of the consideration transferred. The contingent purchase price is subsequently remeasured to fair value each reporting date. The Company classified the contingent purchase price liability as Level 3, due to the lack of relevant observable inputs and market activity.

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

The following table summarizes financial liabilities measured at fair value on a recurring basis as of March 31, 2020 and December 31, 2019, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

Description	As of March 31, 2020 and December 31, 2019	Fair Value Measurement at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Contingent purchase price	\$ 1,490	\$	\$	\$ 1,490

The following table reflects the activity for liabilities measured at fair value using Level 3 inputs for the three month period ending March 31, 2020:

Balance as of December 31, 2019	\$ 1,490
Issuances	
Payments	
Related change in fair value	
Balance as of March 31, 2020	<u>\$ 1,490</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

5. Property and Equipment

Property and equipment at March 31, 2020 and December 31, 2019, were as follows:

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Furniture, equipment and leasehold improvements	\$ 2,492	\$ 2,458
Less accumulated depreciation	<u>(1,664)</u>	<u>(1,548)</u>
Total property and equipment, net	<u>\$ 828</u>	<u>\$ 910</u>

Depreciation expense for the three month periods ending March 31, 2020 and 2019 was \$118 and \$101, respectively.

6. Intangible Assets

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

	<u>March 31, 2020</u>	
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	1,009
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	1,361
Customer relationships - CohuHD	779	466
Covenant not to compete - CohuHD	20	20
Trade name - Innotech	1,015	329
Customer relations - Innotech	5,762	2,058
Covenant not to compete - Innotech	150	97
Technology - Innotech	469	218
Patents - Innotech	8	4
Trade name - Arecont Vision Costar	243	42
Distribution agreement - Arecont Vision Costar	370	54
Patents - Arecont Vision Costar	208	50
Total amortized intangible assets	<u>13,923</u>	<u>7,482</u>
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Goodwill - Arecont Vision Costar	939	
Total unamortized intangible assets	<u>7,438</u>	
Total intangible assets	<u>\$ 21,361</u>	<u>\$ 7,482</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

6. Intangible Assets (continued)

The following is a summary of amortized and unamortized intangible assets at December 31, 2019:

	December 31, 2019	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	991
Customer relations - IVS	125	125
Covenant not to compete - IVS	50	50
Trade name - CohuHD	1,657	1,302
Customer relationships - CohuHD	779	447
Covenant not to compete - CohuHD	20	20
Trade name - Innotech	1,015	305
Customer relations - Innotech	5,762	1,907
Covenant not to compete - Innotech	150	90
Technology - Innotech	469	201
Patents - Innotech	8	4
Trade name - Arecont Vision Costar	243	35
Distribution agreement - Arecont Vision Costar	370	46
Patents - Arecont Vision Costar	208	43
Total amortized intangible assets	13,923	7,165
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Goodwill - CohuHD	2,063	
Goodwill - Innotech	3,511	
Goodwill - Arecont Vision Costar	939	
Total unamortized intangible assets	7,438	
Total intangible assets	\$ 21,361	\$ 7,165

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

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

Amortization expense for the three month periods ended March 31, 2020 and 2019 was \$317 and \$324, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

6. Intangible Assets (continued)

Future amortization expense is as follows:

Year Ending March 31,	
2021	\$ 1,268
2022	1,066
2023	967
2024	934
2025	815
Thereafter	<u>1,391</u>
Total future amortization expense	<u>\$ 6,441</u>

7. 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 mature on July 6, 2021. The term loan is payable in \$66 monthly payments due on the first of the month with the remaining balance due at maturity. 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 March 31, 2020 the Company was paying interest at 5.33% for the term loan and revolving line of credit.

Future principal payments for the term loan and revolving draw note as of March 31, 2020, are as follows:

Year Ending March 31,	
2021	\$ 789
2022	3,396
Less: deferred financing costs, net	<u>(6)</u>
	<u>\$ 4,179</u>

On June 28, 2019 the Company executed a Promissory Note with UMB Bank for \$1,000 which matures on June 28, 2020. The Promissory Note is payable in \$83 monthly payments due on the first of the month with the remaining balance due at maturity. As of March 31, 2020, the Company owed \$333 on the note and was paying interest at 6.58%

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

As of March 31, 2020 and December 31, 2019, \$15,152 and \$15,953 was owed to UMB Bank on the revolving line of credit, \$4,185 and \$4,382 on the term loan, and \$333 and \$583 on the Promissory Note, respectively.

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

8. Income Taxes (Benefit)

Total income tax expense (benefit) for the three months ended March 31, 2020 and 2019 was (\$65) and (\$886). The Company's effective tax rate differs from the U.S. federal statutory tax rate due primarily to state income and franchise taxes.

9. Stockholders' Equity (shown in whole amounts)

At March 31, 2020 and December 31, 2019, 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, 2020 and December 31, 2019, 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, 2020 and December 31, 2019, there were 1,592,566 and 1,584,566 shares of common stock outstanding and 1,818,332 and 1,810,332 shares of common stock issued.

10. 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, 2020 and December 31, 2019, there were 60,066 and 68,066 share options issued under this plan.

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

At the Company's annual meeting on December 16, 2014, the Company's stockholders approved and adopted the Company's 2014 Omnibus Performance Award Plan (the "Plan"). The Board adopted the Plan on November 17, 2014, subject to and effective upon its approval by stockholders. With the adoption of the Plan, no new awards will be granted under the 2000 Incentive Plan, although it will remain in effect for options that are currently outstanding in accordance with their terms. The Plan authorizes the grant of awards relating to 150,000 shares of the Company's Common Stock. As of March 31, 2020 and December 31, 2019 there were 72,000 share options issued under this plan.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

The following table summarizes information about stock options outstanding at March 31, 2020:

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
\$1.425 - \$15.020	132,066	5.82	\$8.24	132,066	\$8.24

Stock option activity for the three month periods ended March 31, 2020 and 2019 is as follows:

	March 31, 2020		March 31, 2019	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	140,066	\$7.83	123,066	\$6.27
Granted			12,000	\$9.15
Exercised	(8,000)	\$1.05	(14,000)	\$1.98
Outstanding at period end	132,066	\$8.24	121,066	\$7.05
Options exercisable at period end	132,066	\$8.24	121,066	\$7.05
Weighted average fair value of options granted during the period				\$6.68

On March 23, 2018 a grant of 21,000 restricted stock awards ("2018 Awards") was authorized by the Compensation Committee of the Company's Board of Directors. All of the 2018 Awards are subject to a time-vesting schedule and 75% are subject to performance conditions relating to EBITDA growth for the years ending December 31, 2018 and 2019, as stated in the 2018 Awards Agreements. The 25% of the 2018 Awards not subject to performance conditions have a fair market grant date value of approximately \$45,000, with the expense recognized over the two year vesting period. The 2018 Awards subject to the performance conditions have a fair market grant date value of \$135,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$0 and \$6,000 was recognized in the Company's financial statements in relation to the 2018 Awards during the three month periods ending March 31, 2020 and 2019, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

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

On June 20, 2019, an additional grant of 23,000 restricted stock awards and 7,000 on July 26, 2019 (“2019 Awards”) was authorized by the Compensation Committee of the Company’s Board of Directors. All of the 2019 Awards are subject to a time-vesting schedule and 75% are subject to performance conditions relating to EBITDA growth for the years ending December 31, 2019 and 2020, as stated in the 2019 Awards Agreements. The 25% of the 2019 Awards not subject to performance conditions have a fair market grant date value of approximately \$63,000, with the expense recognized over the two year vesting period. The 2019 Awards subject to the performance conditions have a fair market grant date value of \$190,000, with the expense recognized over the two year vesting period based upon the probability of achievement. Stock based compensation expense of approximately \$32,000 was recognized in the Company’s financial statements in relation to the 2019 Awards during the three month period ending March 31, 2020.

During the three month periods ended March 31, 2020 and 2019 the Company recognized approximately \$32,000 and \$86,000 in stock based compensation expense in its consolidated financial statements, respectively.

11. Lease Agreements

The Company has entered into the following lease agreements:

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

11. Lease Agreements (continued)

During the three month periods ended March 31, 2020 and March 31, 2019 lease costs included in operating expenses were \$273 and \$516, respectively.

	<u>Three Months Ended March 31, 2020</u>	<u>Three Months Ended March 31, 2019</u>
Lease cost		
Finance lease cost		
Amortization of right-of-use asset	\$ 1	\$ -
Interest on lease liabilities		
Operating lease cost (a)	<u>273</u>	<u>516</u>
Total lease cost	\$ 274	\$ 516

(a) Operating lease cost for the three months ended March 31, 2019 includes \$318 in rent associated with short-term leases.

	<u>Three Months Ended March 31, 2020</u>	<u>Three Months Ended March 31, 2019</u>
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	
Operating cash flows from operating leases	240	170
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:

	<u>March 31, 2020</u>	<u>March 31, 2019</u>
Lease term and discount rate		
Weighted-average remaining lease term operating leases	3.5 years	4.4 years
Weighted-average discount rate operating leases	5.6%	5.6%
Weighted-average remaining lease term financing lease	2.3 years	
Weighted-average discount rate financing lease	5.6%	

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

11. Lease Agreements (continued)

Future minimum lease payments and reconciliation to the Consolidated Balance Sheet at March 31, 2020 are as follows:

Year Ending March 31,	
2021	\$ 1,143
2022	1,140
2023	667
2024	248
2025	189
Thereafter	<u>130</u>
Total lease payments	3,517
Less imputed interest	<u>(378)</u>
Present values of lease liabilities	<u>\$ 3,139</u>

12. 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 three month period ended March 31, 2019 the Costar Video Systems operating segment's largest customer, Protection 1 Security Solutions, accounted for approximately \$1,826 or 12.7% of the Company's total revenue. Amounts owed by one main customer of the Costar Video Systems' operating segment accounted for \$1,302 or 12.2% and two main customers accounted for \$2,445 or 27.0% of the Company's outstanding receivable balance as of March 31, 2020 and December 31, 2019, respectively.

Concentration of Suppliers

For the three month periods ended March 31, 2020 Company made purchases from two main suppliers of the Costar Video Systems' operating segment of approximately \$2,486 or 22.9% and from one main supplier of the Costar Video Systems' operating segment of approximately \$5,893 or 12.1% for the three month period ended March 31, 2019. Amounts owed to two main suppliers of the Costar Video Systems' operating segment accounted for \$3,168 or 41.2% and \$2,507 or 44.5% of the Company's accounts payable balance as of March 31, 2020 and December 31, 2019 respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

13. Subsequent Events

On April 14, 2020 the Company was granted a loan under the U. S Small Business Administration's ("SBA") Paycheck Protection Program for approximately \$3,000. Payments on the loan are deferred until November 2020 with the loan maturing in April 2022 with a 1% interest rate. The Company will apply for forgiveness of the loan in accordance with the requirements of SBA. As of the filing date the amount of loan forgiveness could not be estimated.

As a result of the spread of COVID-19 coronavirus, economic uncertainties have arisen which may negatively affect the financial position, results of operations and cash flows of the Company. The duration of these uncertainties and the ultimate financial effects cannot be reasonably estimated at this time. We believe our existing cash and cash equivalents, internally generated funds and our credit facilities, described above and in Note 7 Lines of Credit and Long-Term Debt, are adequate to meet our operating needs over the next fiscal year, subject to the length and severity of the COVID-19 pandemic.