

Costar Technologies, Inc.

Letter from the President and Chief Executive Officer



OTC: CSTI.PK

www.costartechnologies.com



Letter from the President and Chief Executive Officer

October 10, 2012

Dear Shareholders,

Three years ago, in the depth of the global economic collapse, Costar Technologies, Inc. began initiating changes to improve the profitability and cost structure of the Company. I am pleased to report that the changes we made are benefitting our shareholders, as in 2011 we reported our first annual profit since we completed the turnaround that began in mid-2009.

The Company generated more than \$751,000 of EBITDA in 2011, a year-on-year improvement of 27.7%. In 2011, video sales increased 16% to \$17.341 million from \$14.947 million in 2010, with operating profits increasing to \$0.044 million from (\$0.683) million in the prior year. The improvement in EBITDA was primarily due to a 16% increase in revenue with only a 2.6% increase in SG&A expenses. Gross profit margins also increased 7.6% in 2011 due to a more favorable product mix of higher margin digital video recorders and network products.

The global economy is changing around the world at different speeds. In Asia, our suppliers continue to struggle. In the first six months of 2011 production problems from the Japanese tsunami significantly affected product availability as electronic components were difficult to obtain. Among other things, hard drives were extremely difficult to find and prices more than doubled. Costar purchased extra hard drives for its digital video recorders to protect the delivery of this key product line. Many overseas factories continue to experience financial difficulties from lost revenue and some have closed operations impacting selected product delivery. Luckily, Costar has not been materially affected by the Asian product supply issues and has actually benefitted from the situation by obtaining discounts for the prepayment of product which has helped support our supply partners.

Banks have continued to tighten their lending standards. In 2011, we spent a significant amount of time seeking a new banking relationship that would give us the flexibility to take advantage of strategic opportunities made available to the Company. The Company has just completed its first year of a three year agreement with Briar Capital and we are pleased with the relationship to date.

In this environment, companies must invest to grow, while staying competitive and responsive. We have significantly upgraded the performance of our existing products and introduced several new product families to increase our market share. The security industry has a seasonality of sales with the fourth and first quarters of the year relatively flat to down slightly. This seasonality increased the financial stress on several of our competitors during a period of “tightening” in the financial markets. Early in the third quarter of 2011, two of our primary competitors went out of business, and our new banking relationship provided the capital to the Company to acquire selected inventory from one competitor at favorable pricing as well as to increase the products we supply to our largest retail customer.

Within our video surveillance peer group, our primary competitors have reported revenues down slightly to up 5% compared to Costar’s **16 % increase** for the year – over –year comparison after adjusting for intercompany sales in the 2010 period. We have taken advantage of the downsizing actions and the closing of some of our competitors to add several new outstanding employees to our team to focus on new business opportunities. Our business strategy has been, and continues to be, to focus on targeted accounts that have a low business acquisition cost utilizing these new employees. Despite the added headcount expenses of these strategic hires, we continued to hold margins within our plan.

We see signs of economic strength every day, but remain cautious as we enter a new economic era with a lot of unrest throughout the world. With an improved balance sheet and a strong team in place, we believe that we are well prepared to capitalize on opportunities as the economy improves.

Sincerely,

James D. Pritchett

President and Chief Executive Officer

DIRECTORS

Rory J. Cowan, *Chairman of the Board*
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James D. Pritchett

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COMPANY FINANCIAL INFORMATION

A Copy of the Annual Report is available upon request and will be mailed to you at no charge.
Please send requests to:

Investor Relations
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It can also be downloaded from our website at www.costartechnologies.com.