

**COSTAR TECHNOLOGIES, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS
AND
INDEPENDENT ACCOUNTANTS' REVIEW REPORT

DECEMBER 31, 2013 AND 2012

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To Costar Technologies, Inc.

We have reviewed the accompanying consolidated balance sheets of Costar Technologies, Inc. and Subsidiaries (collectively, the "Company"), as of December 31, 2013 and 2012, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the consolidated financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the consolidated financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.



Dallas, Texas
March 31, 2014

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AMOUNTS SHOWN IN THOUSANDS)

December 31,	2013	2012
ASSETS		
Current assets		
Cash	\$ 1,637	\$ 114
Accounts receivable, less allowance for doubtful accounts of \$75 and \$67 in 2013 and 2012, respectively	2,136	2,029
Inventories, net of reserve for obsolescence of \$379 and \$675 in 2013 and 2012, respectively	7,180	4,132
Current portion, promissory note	86	151
Prepaid expenses	207	381
Total current assets	<u>11,246</u>	<u>6,807</u>
Non-current assets		
Property and equipment, net	69	105
Trade names	925	925
Distribution agreement, net	918	991
Customer relationships, net	80	101
Covenant not to compete	14	30
Promissory note, less current portion		258
Total assets	<u>\$ 13,252</u>	<u>\$ 9,217</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 2,448	\$ 895
Accrued expenses and other	832	109
Lines of credit		170
Total current liabilities	<u>3,280</u>	<u>1,174</u>
Stockholders' Equity		
Common stock	3	2
Additional paid in capital	155,912	155,893
Accumulated deficit	(141,422)	(143,329)
Less common stock held in treasury	<u>(4,521)</u>	<u>(4,523)</u>
Total stockholders' equity	<u>9,972</u>	<u>8,043</u>
Total liabilities and stockholders' equity	<u>\$ 13,252</u>	<u>\$ 9,217</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (AMOUNTS SHOWN IN THOUSANDS)

For the Years Ended December 31,	2013	2012
Net revenues	\$ 26,476	\$ 19,581
Cost of revenues	<u>19,009</u>	<u>13,908</u>
Gross profit	7,467	5,673
Selling, general and administrative expenses	<u>5,598</u>	<u>4,987</u>
Income from operations	<u>1,869</u>	<u>686</u>
Other income (expenses)		
Interest expense	(52)	(139)
Other income and expense, net	105	45
Current income tax provision	<u>(15)</u>	
Total other income (expense), net	<u>38</u>	<u>(94)</u>
Net income	<u>\$ 1,907</u>	<u>\$ 592</u>
Per share of common stock		
Net income	<u>\$ 1.31</u>	<u>\$ 0.41</u>
Weighted average shares outstanding	<u>1,453</u>	<u>1,447</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

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

For the Years Ended December 31, 2013 and 2012

	<u>Common Stock</u>		<u>Additional Paid - In Capital</u>	<u>Treasury Stock</u>		<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>		<u>Shares</u>	<u>Amount</u>		
Balances at December 31, 2011	1,680	\$ 2	\$ 155,879	233	\$ (4,524)	\$ (143,921)	\$ 7,436
Net income						592	592
Stock issued for professional services					1		1
Stock based compensation			14				14
Balances at December 31, 2012	1,680	\$ 2	\$ 155,893	233	\$ (4,523)	\$ (143,329)	\$ 8,043
Net income						1,907	1,907
Liquidation treasury stock				(7)	2		2
Common stock issuance	4	1	4				5
Stock based compensation			15				15
Balances at December 31, 2013	1,684	\$ 3	\$ 155,912	226	\$ (4,521)	\$ (141,422)	\$ 9,972

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (AMOUNTS SHOWN IN THOUSANDS)

For the Years Ended December 31,	2013	2012
Cash flows from operating activities		
Net income	\$ 1,907	\$ 592
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	15	14
Depreciation and amortization	148	286
Provision for doubtful accounts	8	(40)
Provision for obsolete inventory	(296)	
Changes in operating assets and liabilities:		
Accounts receivable, net	(115)	918
Inventory	(2,752)	2,727
Prepaid expenses	174	102
Accounts payable	1,553	(1,827)
Accrued expenses and other	723	(20)
Net cash provided by operating activities	<u>1,365</u>	<u>2,752</u>
Cash flows from investing activities		
Purchase of property and equipment	(2)	(18)
Business purchase related to IVS		(100)
Note related to the sale of Sielox LLC assets	323	91
Net cash provided by (used in) investing activities	<u>321</u>	<u>(27)</u>
Cash flows from by financing activity		
Repayment on lines of credit	(170)	(2,804)
Common stock	1	
Additional paid in capital - common stock	4	
Liquidation of treasury stock	2	
Net cash used in financing activities	<u>(163)</u>	<u>(2,804)</u>
Net increase (decrease) in cash	1,523	(79)
Cash, beginning of year	<u>114</u>	<u>193</u>
Cash, end of year	<u>\$ 1,637</u>	<u>\$ 114</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	<u>\$ 52</u>	<u>\$ 139</u>
Cash paid during the year for taxes	<u>\$ 43</u>	<u>\$ 68</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (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 LQ Corporation (“LQ”) (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. The Company also develops, designs and distributes industrial vision products to observe repetitive production and assembly lines, thereby increasing efficiency by detecting faults in the production process.

Effective March 2, 2012, the Company’s shares started trading on the OTC Markets Group under the ticker symbol “CSTI” to reflect the Company’s new name, Costar Technologies, Inc. The shares formerly traded on the OTC Markets Group under the stock ticker symbol “SLXN”. The Company has also changed the address of its website from www.sieloxinc.com to www.costartechnologies.com.

Effective April 27, 2012, the Company executed a 1:25 reverse stock split of the Company’s common stock. All of the share and per share amounts discussed and shown in the consolidated financial statements and the notes to the consolidated financial statements have been adjusted to reflect the effect of this reverse stock split.

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 for the year ended December 31, 2013. All material intercompany transactions have been eliminated in consolidation.

These consolidated financial statements were approved by management and available for issuance on March 31, 2014. Subsequent events have been evaluated through this date.

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 December 31, 2013 and 2012, the Company had no such cash equivalents.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of significant accounting policies (continued)

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are 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 market. A provision is made to reduce excess or obsolete inventories to their net realizable value. As of December 31, 2013 and 2012, the Company had \$7,180 and \$4,132 in finished goods, respectively.

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

Intangible 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 business combinations 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.

Intangible assets with finite lives are amortized over their estimated useful lives. These intangible assets are reviewed for impairment 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.

Long-Lived Assets

In accordance with GAAP, the Company reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. A loss is recognized on 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 (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of significant accounting policies (continued)

Comprehensive Income

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05, which defers only those changes in ASU 2011-05 related to the presentation of reclassification adjustments in order to allow the FASB time to re-deliberate whether to present on the face of the financial statements the effects of the reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. ASU 2011-12 was effective at the same time as ASU 2011-05 and until determined, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. The adoption of ASU 2011-12 did not have a material impact on the Company's consolidated financial statements.

In June 2011, FASB issued ASU 2011-05, Comprehensive Income (ASC Topic 220)—Presentation of Comprehensive Income A. SU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity and requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments were effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on the Company's consolidated financial statements.

Comprehensive income consists of net income and other comprehensive income. In accordance with GAAP, the Company establishes standards for disclosure and financial statement presentation for reporting total comprehensive income and its individual components. Comprehensive income, as defined, includes all changes in equity during a period from non-owner resources.

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. The Company considers its revenue to have been earned 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.

Research and Development

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

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of significant accounting policies (continued)

Stock Based Compensation

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 year ended December 31, 2013 the Company recognized \$15 in stock based compensation expense in its consolidated financial statements relating to the issuance of 19 stock options. The Company recorded \$14 in stock based compensation expense during the year ended December 31, 2012 relating to the issuance of 31 stock options.

The fair value of the 2013 and 2012 stock options were estimated on the date of grant using the Black-Scholes valuation model based on the following assumptions:

	Year Ended December 31,	
	2013	2012
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	63.00%	15.60%
Risk-free interest rate	2.00%	2.00%
Expected life in years	10 years	10 years
Weighted-average fair value of options granted	\$1.72	\$0.46

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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

2. Summary of significant accounting policies (continued)

Income Taxes (Continued)

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. Accrued interest and penalties related to income tax matters are classified as a component of income tax expense.

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 2010.

3. Property and equipment

Property and equipment at December 31, 2013 and 2012 were as follows:

	<u>2013</u>	<u>2012</u>
Office furniture and equipment	\$ 395	\$ 408
Demonstration and technical equipment		20
	<u>395</u>	<u>428</u>
Less accumulated depreciation	<u>(326)</u>	<u>(323)</u>
Total property and equipment, net	<u>\$ 69</u>	<u>\$ 105</u>

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

4. Intangible assets

The following is a summary of amortized and unamortized intangible assets December 31, 2013 and 2012.

	December 31, 2013	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	550
Customer relations – IVS	125	45
Covenant not to compete – IVS	50	36
Total amortized intangible assets	<u>3,242</u>	<u>2,230</u>
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Total unamortized intangible assets	<u>925</u>	
Total intangible assets	<u>\$ 4,167</u>	<u>\$ 2,230</u>
	December 31, 2012	
	Gross Amount	Accumulated Amortization
Amortized intangible assets		
Customer relations - Southern Imaging	\$ 1,599	\$ 1,599
Distribution agreement - Southern Imaging	1,468	477
Customer relations – IVS	125	24
Covenant not to compete – IVS	50	20
Total amortized intangible assets	<u>3,242</u>	<u>2,120</u>
Unamortized intangible assets		
Trade name - Costar	800	
Trade name - IVS	125	
Total unamortized intangible assets	<u>925</u>	
Total intangible assets	<u>\$ 4,167</u>	<u>\$ 2,120</u>

The weighted average amortization period for the Company's intangible assets is 12 years. The estimated useful lives for customer relationships, distribution agreements and covenant not to compete are 6, 20 and 3 years, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

4. Intangible assets (continued)

Amortization expense for the years ended December 31, 2013 and 2012 was \$110 and \$244, respectively. Future amortization expense, as of December 31, 2013, is as follows:

Year Ending December 31,	
2014	\$ 108
2015	94
2016	94
2017	91
Thereafter	<u>624</u>
Total future amortization expense	<u>\$ 1,012</u>

5. Lines of credit

Effective as of September 23, 2011, Costar entered into a Loan and Security Agreement with Briar Capital L.P. ("Briar"). The Loan and Security Agreement allows for up to \$3,500 in revolving lines of credit, with a three year maturity. The obligations under the Costar Loan and Security Agreement with Briar are secured by a lien on substantially all accounts receivable, inventory, equipment, general intangibles, including intellectual property, chattel paper, instruments and documents of Costar, as set forth in the Loan and Security Agreement with Briar. The Company is a guarantor of Costar's obligations under the Costar Loan and Security Agreement with Briar pursuant to the guaranty made by the Company in favor of Briar. Borrowings under the Loan and Security Agreement accrue interest at a rate equal to the 30-day LIBOR rate plus 8.25% per annum.

The Costar Loan and Security Agreement with Briar 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 equity interests. The Costar Loan and Security Agreement with Briar also contain financial covenants restricting capital expenditures of Costar and requiring Costar and the Company to maintain a specific Tangible Net Worth. As of December 31, 2013 and 2012, approximately \$0 and \$170, respectively, was owed to Briar.

Effective April 1, 2013, Costar entered into a Loan and Security Agreement ("Facility") with BOKF, NA dba Bank of Texas ("Bank of Texas"). The Facility allows for up to \$1,000 in a revolving line of credit, with a one year maturity. The obligation under the Facility with Bank of Texas is secured by a lien on substantially all accounts receivable, inventory, and equipment. The Company is a guarantor of Costar's obligation under the Facility with Bank of Texas pursuant to the guaranty made by the Company in favor of Bank of Texas. Borrowings under the Facility accrue interest at a rate equal to Bank of Texas Prime, currently 4.0% per annum. With the execution of the new Bank of Texas Facility, the Briar loan was paid in full.

The Facility 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 equity interests. The Facility with Bank of Texas also 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. As of December 31, 2013, \$0 was owed to the Bank of Texas.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

6. Deferred income taxes

Deferred tax assets are determined based on the difference between financial statement and tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. The components of the deferred taxes at December 31, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Net operating loss carryforward	\$ 50,605	\$ 51,361
Valuation allowance	<u>(50,605)</u>	<u>(51,361)</u>
Total net deferred tax asset	<u>\$</u>	<u>\$</u>

In connection with ownership changes, it was determined that certain of the Company's net operating loss carry forwards ("NOL") have been limited. As of December 31, 2013 and 2012, the Company has approximately \$148,900 and \$151,000 of NOLs that can be utilized in future years. These NOLs, if not used, will expire between 2019 and 2030.

A valuation allowance has been established for the full amount of the tax asset since it is more likely than not that the deferred tax asset will not be realized.

7. Stockholders' equity (shown in whole amounts)

At December 31, 2013 and 2012, 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 December 31, 2013 and 2012 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.

8. 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 December 31, 2013 there were 111,749 share options issued under this plan. At December 31, 2013, there were 148,586 shares available for issuance under the 2000 Incentive 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.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

8. Stock option plan (shown in whole amounts) (continued)

The following table summarizes information about stock options outstanding at December 31, 2013:

Options Outstanding				Options Fully Vested and Exercisable	
Range of Exercise Price Per Share	Number Outstanding	Remaining Contractual Life (In Years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
\$0.725-\$13.69	111,749	6.41	\$3.38	85,374	\$3.86

Stock option activity for the years ended December 31, 2013 and 2012 is as follows:

	2013		2012	
	Number of Shares	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	120,612	\$4.31	123,267	\$6.66
Granted	19,333	\$2.53	31,400	\$1.67
Exercised	4,000	\$1.34		
Canceled	24,196	\$7.64	34,055	\$10.38
Outstanding at year end	111,749	\$3.38	120,612	\$4.31
Options exercisable at year end	85,374	\$3.86	96,487	\$5.01
Weighted average fair value of options granted during the period at fair value		\$1.72		\$0.46

During the year ended December 31, 2013 the Company recognized approximately \$15,000 in stock based compensation expense in its consolidated financial statements relating to the issuance of 19,333 stock options. The Company recorded \$14,000 in stock based compensation expense relating to the issuance of 31,400 stock options in the year ended December 31, 2012.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

9. 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 years ended December 31, 2013 and 2012 were approximately \$99 and \$85, respectively.

Future minimum annual rent payments are approximately as follows:

Year Ending December 31,	
2014	\$ 109
2015	117
2016	125
2017	133
2018	<u>105</u>
Total future minimum lease commitments	<u>\$ 589</u>

10. 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

The Company's security surveillance product line customers include traditional "large box" national retailers and distributors. The Company's industrial vision product line customers include manufacturers that assemble products using automated production lines; these customers use the Company's video systems to monitor activity on the production line. For the year ended December 31, 2013 and 2012, the Company's largest two customers, Wal-Mart Stores, Inc. and Diebold, Incorporated, accounted for approximately \$16,180 and \$9,162, or 61.1% and 46.8% of the Company's total revenue, respectively. Amounts owed by three main customers accounted for \$1,219, or 57.0% and two main customers accounted for \$930, or 46.3% of the outstanding accounts receivable balance, as of December 31, 2013 and 2012, respectively.

COSTAR TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (AMOUNTS SHOWN IN THOUSANDS)

10. Risk concentrations (continued)

Concentration of Suppliers

For the year ended December 31, 2013 and 2012, the Company made purchases from two main suppliers of approximately 50.6% and three main suppliers of approximately 54.9% of total purchases, respectively. Amounts owed to two main suppliers accounted for 79.2% and one main supplier accounted for 69.1% of the total accounts payable balance, as of December 31, 2013 and 2012, respectively.

11. Sale of Assets (Promissory Note)

During December 2010, the Company entered into an agreement to sell certain assets and liabilities of Sielox, LLC ("Sielox"), an indirect wholly owned subsidiary. One of the agreed conditions of the sale was that Costar would continue to sell its range of security solution products through the Sielox network of approved business partners. The terms and conditions that govern the sale of Costar products are stated in the Master Distribution Agreement (the "Agreement") entered into between Costar and HGW Acquisition Company ("HGW"). The term of the Agreement commences on January 1, 2011, and ends on December 31, 2013. During the term of the Agreement, HGW has agreed to purchase Costar products in the minimum amount of \$5,000. Actual purchases will be measured against a schedule of semi-annual purchase commitments (the "Purchase Commitment"). In furtherance of the Purchase Commitment, HGW delivered to Costar a secured promissory note with an original principal balance in the amount of \$500 and bearing interest on the unpaid balance at a rate equal to 7% per annum. The promissory note is secured by a first priority security interest in HGW's accounts receivable. In the event that HGW fails to purchase Costar products in an amount equal to the Purchase Commitment as of the end of an applicable semi-annual period, HGW will have a period of 30 days to remedy the purchase default. That remedy will be in the form of a payment to Costar, of an amount equal to 25% of the shortfall, plus interest. The balance of the note at December 31, 2013 and 2012 was approximately \$86 and \$409, respectively.

12. Subsequent Events

As of this filing, HGW paid the Company \$148 to remedy the last semi-annual period purchase default, which is an amount equal to 25% of the shortfall plus interest. The current amount owed by HGW to the Company on the Promissory Note is \$0.

Also as of this filing, Costar entered into a new, two year Master Distribution Agreement with Sielox. Sielox will continue to sell Costar's range of security solution products through the Sielox network of approved business partners.