SIELOX, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
AND
INDEPENDENT ACCOUNTANTS' COMPILATION REPORT

SEPTEMBER 30, 2010

SIELOX, INC. AND SUBSIDIARIES

Certified
Public
Accountants

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INDEPENDENT ACCOUNTANTS' COMPILATION REPORT

To the Board of Directors and Stockholders of
Sielox, Inc. and Subsidiaries

We have compiled the accompanying consolidated balance sheet of Sielox, Inc. and Subsidiaries (collectively, the "Company") as of September 30, 2010, and the related consolidated statements of operations, changes in stockholders' equity (deficit) and comprehensive income (loss), and cash flows for the nine month period ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying consolidated financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2, the Company has an accumulated deficit, a working capital deficit and a net loss from operations, which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Rothstein, Kass & Company, P.C.

Roseland, New Jersey
November 11, 2010

SIELOX, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
($ In thousands)
SEPTEMBER 30, 2010

ASSETS

Current assets		
Cash	$	169
Accounts receivable, less allowance for doubtful accounts of $121		3,134
Inventories, net of reserve for obsolescence of $325		5,576
Prepaid expenses		216
Total Current Assets		9,095
Fixed assets, net		222
Trade Name - Costar		800
Trade mark - Sielox LLC		170
Distribution agreement, net		1,156
Customer relationships, net		466
Proprietary technology, net		302
Deposits and other assets		65
Total assets	$	12,276

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities		
Accounts payable	$	1,606
Accrued expenses and other		173
Contingent purchase price, current portion		273
Deferred revenue		70
Lines of credit		2,644
Total Current Liabilities		4,766
Long term liability, contingent purchase price		88
Total Liabilities		4,854
Stockholders' equity		
Common stock		42
Additional paid in capital		155,805
Accumulated other comprehensive income		260
Accumulated deficit		(144,161)
Less common stock held in treasury		(4,524)
Total Stockholders' Equity		7,422
Total liabilities and stockholders' equity	$	12,276

See independent accountants' compilation report and notes to consolidated financial statements.

SIELOX, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
($ In thousands)
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2010

Net revenues	$	14,112
Cost of revenues		9,867
Gross profit		4,245
Selling, general and administrative expenses		4,458
Loss from operations		(213)
Interest expense		(223)
Net loss	$	(436)

SIELOX, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN
STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE INCOME (LOSS)
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2010
($ In thousands)

	Common Stock		Additional Paid - In Capital	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount		Shares	Amount			
Balances at December 31, 2009	42,017	$ 42	$ 155,805	6,296	$ (4,524)	$ 260	$ (143,725)	$ 7,858
Net loss							(436)	(436)
Balances at September 30, 2010	42,017	$ 42	$ 155,805	6,296	$ (4,524)	$ 260	$ (144,161)	$ 7,422

SIELOX, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
($ In thousands)
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2010

CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$	(436)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization		394
Provision for doubtful accounts		(133)
Changes in operating assets and liabilities:		
Accounts receivable, net		(436)
Inventory		(51)
Prepaid expenses		19
Accounts payable		264
Accrued expenses and other		11
Deferred revenue, current		13
Net cash used in operating activities		(355)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of fixed assets		(32)
Payment of earnout provision related to Southern Imaging		(193)
Net cash used in investing activities		(225)
CASH PROVIDED BY FINANCING ACTIVITIES		
Proceeds from debt, net		515
NET DECREASE IN CASH		(65)
CASH, BEGINNING OF PERIOD		234
CASH, END OF PERIOD	$	169
SUPPLEMENTAL DISCLOSURE CASH FLOW INFORMATION:		
Cash paid during the period for interest	$	223

SIELOX, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
($ in thousands)

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Sielox, Inc. was incorporated in the State of Delaware in February 1997 under the name “Fairmarket, Inc.” Sielox, Inc. and its wholly owned subsidiaries, Costar Video Systems, LLC (“Costar”) and Sielox LLC (“Sielox”), (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 access control systems. 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.

The Company operates through two wholly-owned subsidiaries: Costar and Sielox. Costar runs the Company’s operations relating to its security surveillance and industrial vision products and Sielox runs the Company’s operations relating to its access control systems.

PRINCIPLES OF CONSOLIDATION

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 Sielox, Inc. and its wholly owned subsidiaries, Costar and Sielox. All material intercompany transactions have been eliminated in consolidation.

These consolidated financial statements were approved by management and available for issuance on November 11, 2010. 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

The Company considers all highly-liquid debt instruments with original maturities of three months or less to be cash equivalents.

ACCOUNTS RECEIVABLE, AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company complies with the accounting and reporting requirements of GAAP that Lend to or Finance the Activities of Others. 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.

SIELOX, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
($ in thousands)

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 September 30, 2010, the Company had $95 in raw materials and $5,481 in finished goods.

PROPERTY AND EQUIPMENT

Property and equipment is 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.

	Estimated Useful Life
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 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 statement 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, we review property and equipment for impairment whenever events or changes in circumstances indicated that the carrying amounts of the assets may not be recoverable. A loss is recognized on the consolidated statement 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.

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Revenue from separately priced extended warranty and product maintenance contracts is deferred and recognized in income on a straight-line basis over the contract period.

DEFERRED REVENUE

Deferred revenue represents the unrecognized portion of the Company's separately priced product maintenance contracts. Revenue from these contracts is recognized in income on a straight line basis over the contract period.

RESEARCH & DEVELOPMENT

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

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 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.

The Company elected to utilize the modified prospective transition method, which requires the application of the accounting standard to all share-based awards issued on or after January 1, 2006 and any outstanding share-based awards that were issued but not vested as of January 1, 2006.

During the nine months ended September 30, 2010, the Company recognized $0 in stock based compensation expense in its consolidated financial statements.

NOTE 1 - NATURE OF OPERATIONS AND 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 financial statement and tax bases 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. 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. state and local jurisdictions. Generally the Company is no longer subject to income tax examinations by major taxing authorities for years before 2006. 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 deficit accumulated during the development stage. The Company's conclusions regarding this may be subject to review and adjustment at a later date based on factors including, but not limited to, on-going analyses of and changes to tax laws, regulations and interpretations thereof. The Company recognizes interest accrued related to unrecognized tax benefits and penalties related to unrecognized tax benefits in income tax fees payable, if assessed. No interest expense or penalties have been recognized as of and for the period ended September 30, 2010.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss), which includes foreign currency translation adjustments, and unrealized gains and losses on marketable securities classified as available for sale. In accordance with GAAP, the Company establishes standards for disclosure and financial statement presentation for reporting total comprehensive income (loss) and its individual components. Comprehensive income (loss), as defined, includes all changes in equity during a period from non-owner resources.

NOTE 2 - LIQUIDITY AND GOING CONCERN CONSIDERATION

The Company has continued to incur losses and negative cash flows from operations. For the nine months ended September 30, 2010, the Company incurred a net loss of approximately $436. As of September 30, 2010, the Company had an accumulated deficit of approximately $144,161 and outstanding debt in the amount of $2,644 from its lines of credit which expire on November 21, 2010 and August 17, 2011. These conditions, among others, including the current credit and economic crisis, raise substantial doubt about the Company's ability to continue as a going concern.

Effective as of August 25, 2009, Sielox, entered into a Loan and Security Agreement (the "Sielox Loan Agreement") with Summit Financial Resources, L.P. ("Summit"). The Sielox Loan Agreement provides Sielox with up to $1,500 in revolving lines of credit. The original agreement was due to expire on August 25, 2010. The provisions of the Sielox Loan Agreement are more fully described in Note 6.

Effective August 17, 2010, Summit modified and extended the Sielox Loan Agreement. In accordance with the Loan Agreement, the Company paid a facility renewal fee of $15. The maturity date is extended to August 17, 2011. All other terms and conditions of the Sielox Loan Agreement remain in full force and effect. As of September 30, 2010, approximately $658 was owed to Summit.

In addition, effective as of August 24, 2009, Costar entered into a Revolving Credit and Security Agreement with BBVA Compass Bank ("Compass") (the "Costar Loan Agreement", and together with the Sielox Loan Agreement the "Loan Agreements"). The Costar Loan Agreement provides Costar with up to $4,000 in revolving lines of credit. The original agreement was due to expire on August 25, 2010. The provisions of the Costar Loan Agreement are more fully described in Note 6.

Effective June 1, 2010, Compass Bank amended and restated the Revolving credit and Security Agreement dated as of August 21, 2009. The restated agreement provides Costar with up to $2,500 in revolving lines of credit due on January 21, 2011, or such future date to which the Maturity Date of the revolving line may be extended at the banks sole discretion. Borrowings under the restated agreement accrue interest at a rate equal to the greater of 7% per annum or the 30-day LIBOR plus 4% per annum. As of September 30, 2010, approximately $1,986 was owed to Compass.

Effective as of June 1, 2010, Compass waived the Company's failure to maintain compliance with the Tangible Net Worth covenant for the quarter ended December 31, 2009 and for the quarter ended March 31, 2010. The Company is in compliance with all of the Compass covenants as of September 30, 2010, with the exception of the Quick Ratio. The Company has informed Compass Bank of its failure to meet this covenant and has requested a waiver.

Effective November 21, 2010, Compass Bank amended and restated the Revolving Credit and Security Agreement dated as of August 21, 2009. The restated agreement provides Costar with up to $2,500 in revolving lines of credit due on January 21, 2011, or such future date to which the Maturity Date of the revolving line may be extended at the banks sole discretion. Borrowings under the restated agreement accrue interest at a rate equal to the greater of 7% per annum or the 30-day LIBOR plus 4% per annum.

Effective November 21, 2010, Compass Bank acknowledged that the Company failed to maintain the Quick Ratio required pursuant to Section 6.8 of the Loan Agreement, for the period ended September 30, 2010. Compass Bank has agreed to forebear from exercising its rights and remedies under the Loan Agreement and the related Loan documents solely in connection with such default, for a period through and including January 21, 2011.

NOTE 2 - LIQUIDITY AND GOING CONCERN CONSIDERATION (continued)

The Company has taken measures to reduce expenses in 2010. One of those measures is the decision to suspend its reporting obligations under the Securities Exchange Act of 1934, as amended. On March 30, 2010, the Company filed Form 15. As a result, the Company has ceased filing current and periodic reports with the Securities and Exchange Committee (“SEC”). There can be no assurances that the Company will successfully reduce expenses.

The Company’s existing and future obligations include expenses associated with developing synergies between the Company’s operating subsidiaries and marketing and growing its customer base and product offerings. The general economic slowdown has negatively impacted demand for the Company’s products, thereby limiting the ability of the Company to improve its liquidity through increased sales. No adjustment has been made in the consolidated financial statements of the Company to the amounts and classification of assets and liabilities which could result, should the Company be unable to continue as a going concern.

There can be no assurance that the Company will be successful in building its customer base and product lines or that available capital will be sufficient to fund current operations and to meet the Company’s financial obligations as they relate to working capital requirements and debt repayment obligations until such time that revenues increase to the extent necessary to cover operating costs. If the Company is unsuccessful in building its customer base or if available capital is insufficient to fund current operations, there could be a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company.

NOTE 3 - CONCENTRATIONS

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; they use the Company’s video systems to monitor activity on the production line. The Company’s access control product line is sold through a national network of authorized business partners. For the nine months ended September 30, 2010, the Company’s largest customer accounted for approximately $2,981 or 21.1% of the Company’s total revenue. For the nine months ended September 30, 2010, that same customer owed $375 or 12.0% of the outstanding receivable balance.

CONCENTRATION OF SUPPLIERS

For the nine months ended September 30, 2010, the Company made purchases from one main supplier of approximately 30.4% of total purchases. For the nine months ended September 30, 2010, amounts owed to this supplier were approximately 49.3% of the total accounts payable balance.

($ in thousands)

NOTE 4 - FIXED ASSETS

Fixed assets are recorded at cost less accumulated depreciation. The Company provides for depreciation using the straight-line method over estimated useful lives of 3-5 years.

Fixed assets at September 30, 2010 were as follows:

Office Furniture and Equipment	$ 565
Demonstration and Technical Equipment	318
Leasehold Improvements	90
	973
Less accumulated depreciation	(751)
Total	$ 222

NOTE 5 – 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 is less than its carrying value.

Intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Assets not subject to amortization are tested for impairment at least annually.

The following is a summary of amortized and unamortized intangibles at September 30, 2010:

	September 30, 2010	
	Gross Carrying Amount	Accumulated Amortization
Amortized Intangible Assets		
Customer Relationships	$1,598	$ 1,132
Distribution Agreement	1,468	312
Proprietary Technology	500	198
	3,566	$ 1,642
Unamortized Intangible Assets		
Trade Name Costar	800	
Trademark Sielox, LLC	170	
	$ 4,536	

The weighted average amortization period is 12 years. The estimated useful life for customer relationships distribution agreements and proprietary technology are 6, 20 and 8 years, respectively.

($ in thousands)

NOTE 5 – INTANGIBLE ASSETS (continued)

Amortization expense was $300 for the nine month period ended September 30, 2010. Estimated amortization expense for each of the ensuing years is:

Period Ending September 30,	
2011	$403
2012	400
2013	135
2014	135
2015	135
	$1,208

NOTE 6 - CREDIT LINES

Effective as of June 1, 2010, Compass waived the Company's failure to maintain compliance with the Tangible Net Worth covenant for the quarter ended December 31, 2009 and for the quarter ended March 31, 2010. The Company is in compliance with all of the Compass covenants as of September 30, 2010, with the exception of the Quick Ratio. The Company has informed Compass Bank of its failure to meet this covenant and has requested a waiver.

In addition, effective June 1, 2010, Compass amended and restated the Revolving Credit and Security Agreement dated as of August 21, 2009, executed by and between Costar Video Systems LLC and Compass, ("the Costar Loan Agreement"). The Costar Loan Agreement provides Costar with up to $2,500 in revolving lines of credit due on January 21, 2011 (the "Maturity Date") (See Note 11), or such future date to which the Maturity Date of the revolving line may be extended at the banks sole discretion. The obligations under the Costar Loan Agreement are evidenced by a Master Revolving Promissory Note made by Costar in favor of Compass.

The obligations under the Costar Loan Agreement 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 Costar Loan Agreement. The Company is a guarantor of Costar's obligations under the Costar Loan Agreement pursuant to the unlimited guaranty made by the Company in favor of Compass.

The Costar 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 equity interests. The Costar Loan Agreement also contains financial covenants restricting Costar's Debt Service Coverage Ratio, Total Debt to Tangible Net worth Ratio, and Quick ratio (as each of such terms is defined in the Loan Agreement), as well as limiting capital expenditures of Costar and requiring each of Costar and the Company to maintain a specific Tangible Net Worth. As of September 30, 2010 approximately $1,986 was owed to Compass.

Effective August 17, 2010, Summit modified and extended the Loan and Security Agreement. In accordance with the Loan Agreement, the Company paid a facility renewal fee of $15. The restated agreement provides Sielox with up to $1,500 in revolving lines of credit due on August 17, 2011.

NOTE 6 - CREDIT LINES (continued)

Effective November 21, 2010, Compass Bank amended and restated the Revolving Credit and Security Agreement dated as of August 21, 2009. The restated agreement provides Costar with up to $2,500 in revolving lines of credit due on January 21, 2011, or such future date to which the Maturity Date of the revolving line may be extended at the banks sole discretion. Borrowings under the restated agreement accrue interest at a rate equal to the greater of 7% per annum or the 30-day LIBOR plus 4% per annum.

Effective November 21, 2010, Compass Bank acknowledged that the Company failed to maintain the Quick Ratio required pursuant to Section 6.8 of the Loan Agreement, for the period ended September 30, 2010. Compass Bank has agreed to forebear from exercising its rights and remedies under the Loan Agreement and the related Loan documents solely in connection with such default, for a period through and including January 21, 2011.

The obligations under the Sielox Loan Agreement are secured by a lien position on all business assets, including accounts receivable, inventory, equipment, cash deposit accounts and general intangibles. Borrowings under the Sielox Loan Agreement accrue interest at a rate equal to the Prime Rate, as published in the Wall Street Journal, plus 2% per annum and incur a monthly administrative fee of 1.1% of the average loan outstanding.

All other terms and conditions of the Loan and Security Agreement, as stated in the original agreement, dated August 25, 2009, remain in full force and effect. As of September 30, 2010 approximately $658 was owed to Summit.

NOTE 7 - STOCKHOLDERS' EQUITY

At September 30, 2010, the authorized capital stock of the Company consisted of (i) 90,000,000 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. The Company's Board has the authority to determine the voting powers, designations, preferences, privileges and restrictions of the preferred shares.

NOTE 8 - EARNOUT, CONTINGENT PURCHASE PRICE

Pursuant to that certain Asset Purchase Agreement, dated as of June 20, 2006, by and between Southern Imaging, Inc., Video Solutions Technology Center, LLC, and certain shareholders of Southern Imaging, Costar and Video Solutions Technology Center, LLC, whereby the Company acquired substantially all of the assets of Southern Imaging and Video Solutions (the "Southern Imaging Agreement," included as Exhibit 2.1 to the Company's 8-K filed on June 26, 2006), the Company was obligated to make an earn out payment of $773 on April 1, 2009 (the "2008 earn out payment"). The Company was unable to pay, in full, the 2008 earn out payment. Since that date, several payments have been made that include principal and interest at 9% per annum. As of September 30, 2010, the unpaid balance was $361.

($ in thousands)

NOTE 8 - EARNOUT, CONTINGENT PURCHASE PRICE (continued)

On January 15, 2010, the Company and the previous owners of Southern Imaging agreed on a payment schedule whereby the Company will make a payment, on or about the 15th of each month, of $25, including principal and interest at 9% per annum. Future payments of principal are approximately as follows:

Period Ending September 30,	
2011	$ 273
2012	88
	$ 361

NOTE 9- LEASE AGREEMENTS

The Company leases certain of its facilities under operating leases which expire in 2010 and 2011. Future minimum annual rent payments are approximately as follows:

Period Ending September 30,	
2011	$121

NOTE 10 - LEGAL PROCEEDINGS

The Company, as well as the Company's subsidiary, L Q Corporation, are defendants in certain purported class action lawsuits entitled "In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS)" filed by individual shareholders in the U.S. District Court for the Southern District of New York against certain of the Company's former officers and directors, and various of the underwriters in the Company's initial public offering ("IPO") and secondary offering. The lawsuits have been filed by individual shareholders who purport to seek class action status on behalf of all other similarly situated persons who purchased the Company's common stock between July 8, 1999 and December 6, 2000. A consolidated amended class action complaint was filed on April 19, 2002. The complaint alleges that certain underwriters of the IPO solicited and received excessive and undisclosed fees and commissions in connection with that offering. The complaint further alleges that the defendants violated the federal securities laws by issuing a registration statement and prospectus in connection with the Company's IPO which failed to accurately disclose the amount and nature of the commissions and fees paid to the underwriter defendants. On or about February 19, 2003, the Court entered an Order dismissing with prejudice the claims asserted against the Company under Section 10(b) of the Exchange Act. As a result, the only claims that remain against the Company are those arising under Section 11 of the Securities Act.

The parties have reached a global settlement of the litigation. The Company, and other defendants will receive complete dismissal from the case.

On October 5, 2009, the court entered an order granting final approval of the settlement. Ten appeals were filed objecting to the definition of the settlement classes and fairness of the settlement, five of which have been dismissed with prejudice. Appeal briefs have been filed by the remaining objector groups, and briefs in opposition to those appeals are currently due December 17, 2010. While there can be no assurance as to the ultimate outcome of these proceedings, we currently believe that the final results of these actions will have no material effect on our consolidated financial condition, results of operations or cash flows.

NOTE 10 - LEGAL PROCEEDINGS (continued)

Thompson, Pritchett & Switzer, LP v. Sielox, Inc. Et al. C.A. No. 09-13228 (Tex. Dist. Dallas County)

A Complaint has been filed in the District Court of Dallas County, Texas, 162nd Judicial District (Cause No. 0913228), on behalf of Thompson, Pritchett & Switzer, L.P., as Plaintiff, against the Company, its predecessor company and Costar, as Defendants, alleging that the Defendants owe the Plaintiff approximately $705 plus 9% interest and attorneys fees in connection with certain "earn-out" payments alleged to be due and owing to the Plaintiff by the Defendants in connection with that certain Asset Purchase Agreement pursuant to which the predecessor of the Company acquired certain companies known as Southern Imaging Inc. and Video Solutions Technologies Center Inc. On October 13, 2009, the parties agreed that the Plaintiff would not serve the Defendants with the Complaint until after January 15, 2010 unless the Defendants default on any of the following agreed upon payments: $125 on October 14, 2009 (payment has been made), $25 on November 2, 2009 (payment has been made) and an additional $25 on December 15, 2009 (payment has been made). On January 15, 2010, the Company and the previous owners of Southern Imaging agreed on a payment schedule where by the Company will make a payment on or about the 15th of each month, of $25, including principal and interest at 9% per annum. Should the Defendants ultimately be served with the Complaint, the Defendants intend to vigorously defend against the allegations in the Complaint.

NOTE 11 - SUBSEQUENT EVENT

Effective November 21, 2010, Compass Bank amended and restated the Revolving Credit and Security Agreement dated as of August 21, 2009. The restated agreement provides Costar with up to $2,500 in revolving lines of credit due on January 21, 2011, or such future date to which the Maturity Date of the revolving line may be extended at the banks sole discretion. Borrowings under the restated agreement accrue interest at a rate equal to the greater of 7% per annum or the 30-day LIBOR plus 4% per annum.

Effective November 21, 2010, Compass Bank acknowledged that the Company failed to maintain the Quick Ratio required pursuant to Section 6.8 of the Loan Agreement, for the period ended September 30, 2010. Compass Bank has agreed to forebear from exercising its rights and remedies under the Loan Agreement and the related Loan documents solely in connection with such default, for a period through and including January 21, 2011.